

EL PASO ELECTRIC CO /TX/  
Form DEF 14A  
March 26, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**SCHEDULE 14A**

**Proxy Statement Pursuant to Section 14(a)**  
**of the Securities Exchange Act of 1934**  
**(Amendment No. )**

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

**Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

**El Paso Electric Company**

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which the transaction applies:

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(2) Aggregate number of securities to which the transaction applies:

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(3) Per unit price or other underlying value of the transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Date Filed:

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**EL PASO ELECTRIC COMPANY**

100 N. Stanton

El Paso, Texas 79901

(915) 543-5711

March 26, 2007

Dear Shareholder:

The Annual Meeting of Shareholders of El Paso Electric Company will be held at the Stanton Tower Building, located at 100 N. Stanton, El Paso, Texas 79901, on Wednesday, May 2, 2007, at 10:00 a.m., Mountain Daylight Time.

The purpose of the Annual Meeting is to give shareholders an opportunity (i) to vote on the election of Class I Directors; (ii) to consider and act upon the recommendation of the Board of Directors to approve the El Paso Electric Company 2007 Long-Term Incentive Plan; and (iii) to consider and act upon the recommendation of the Board of Directors to ratify the selection of KPMG LLP as the El Paso Electric Company's independent registered public accounting firm for the fiscal year ending December 31, 2007.

Information concerning these matters is set forth in the accompanying Notice of the meeting and Proxy Statement. Your Board of Directors recommends that you vote FOR the proposals as explained in the attached Proxy Statement.

Your vote is important. To ensure your representation, even if you cannot attend the Annual Meeting, please mark, sign, date and return promptly the enclosed proxy.

Sincerely,

Gary R. Hedrick

President and Chief Executive Officer

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**EL PASO ELECTRIC COMPANY**

100 N. Stanton

El Paso, Texas 79901

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

To the Shareholders of

El Paso Electric Company:

The Annual Meeting of Shareholders of El Paso Electric Company will be held at the Stanton Tower Building, located at 100 N. Stanton, El Paso, Texas 79901, on Wednesday, May 2, 2007, at 10:00 a.m., Mountain Daylight Time, for the following purposes:

- (1) To give shareholders an opportunity to vote on the election of Class I Directors;
- (2) To consider and act upon the recommendation of the Board of Directors to approve the El Paso Electric Company 2007 Long-Term Incentive Plan. Under the 2007 Long-Term Incentive Plan, employees and directors will be eligible to receive non-qualified stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units, cash-based awards, and other stock-based awards covering up to 1,000,000 shares of the Company's Common Stock;
- (3) To consider and act upon the recommendation of the Board of Directors to ratify the selection of KPMG LLP as El Paso Electric Company's independent registered public accounting firm for the fiscal year ending December 31, 2007; and
- (4) To transact such other business as may properly come before the meeting and any adjournment thereof.

The Board of Directors knows of no matter, other than those set forth in the paragraphs above (which are discussed at greater length in the accompanying Proxy Statement), that will be presented for consideration at the Annual Meeting.

The Board of Directors has fixed the close of business on March 5, 2007, as the record date for the determination of shareholders entitled to vote at the Annual Meeting.

Please mark, date and sign the enclosed proxy and return it promptly in the envelope provided for your convenience. If you attend the meeting and decide to vote in person, you may revoke your proxy. **Shareholders attending the meeting whose shares are registered in the name of a broker and who intend to vote in person should bring an affidavit of ownership from the broker so that beneficial ownership can be verified without delay on the meeting date.** The prompt return of your proxy will save the postage expense of additional mailings.

By Order of the Board of Directors,

Guillermo Silva, Jr.

Corporate Secretary

March 26, 2007

**YOUR VOTE IS IMPORTANT**  
**PLEASE MARK, DATE, SIGN AND**  
**PROMPTLY RETURN YOUR PROXY. THANK YOU.**

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**EL PASO ELECTRIC COMPANY**

100 N. Stanton

El Paso, Texas 79901

**PROXY STATEMENT**

**for**

**ANNUAL MEETING OF SHAREHOLDERS**

**To Be Held on May 2, 2007**

**GENERAL**

The accompanying proxy is solicited on behalf of the Board of Directors of El Paso Electric Company (the Company) for use at its 2007 Annual Meeting of Shareholders (the Annual Meeting) to be held on Wednesday, May 2, 2007, at 10:00 a.m., Mountain Daylight Time, at the Company's principal offices, and at any adjournment thereof. The Company's principal offices are located at the Stanton Tower Building, 100 N. Stanton, El Paso, Texas 79901.

The cost of soliciting proxies will be borne by the Company. In addition to the use of the mails, proxies may be solicited by personal interview, telephone, fax, or other electronic means by the directors, officers, employees and agents of the Company. The Company will reimburse brokers, banks and other persons for reasonable expenses in sending proxy materials to beneficial owners. To assist in the distribution of proxy material and solicitation, the Company has engaged Georgeson Shareholder Communications, Inc. for a fee of \$6,000 plus out-of-pocket expenses.

This Proxy Statement and the accompanying form of proxy are first being mailed to shareholders of the Company on or about March 26, 2007.

**SHARES OUTSTANDING, VOTING RIGHTS AND REVOCABILITY OF PROXIES**

At the close of business on March 5, 2007, the record date for determination of the shareholders entitled to notice of and to vote at the Annual Meeting, the Company had outstanding 46,033,388 shares of its common stock (the Common Stock).

Each outstanding share of Common Stock is entitled to one vote. The holders of at least a majority of the issued and outstanding shares of Common Stock must be represented in person or by proxy at the Annual Meeting for a quorum to be present and business to be conducted. The vote of a plurality of the votes cast at the meeting is required for the election of each Class I Director. The affirmative vote of the holders of a majority of the shares of Common Stock entitled to vote and represented in person



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or by proxy at the meeting is required to approve both the El Paso Electric Company 2007 Long-Term Incentive Plan and the selection of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007.

A shareholder having the right to vote may vote either in person or by proxy executed in writing by the shareholder. A telegram, telex, cablegram or similar transmission by a shareholder or photographic, photostatic, facsimile or similar reproduction of a writing executed by the shareholder, shall be treated as an execution in writing.

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A shareholder who signs and returns a proxy may revoke that proxy at any time before the Annual Meeting by filing with the Secretary of the Company an instrument in writing revoking the proxy, delivering a duly executed proxy bearing a later date, or attending the meeting and voting in person. The shares represented by a proxy given and not so revoked will be voted and, where the shareholder specifies a choice with respect to any matter to be acted upon and for which a ballot is provided in the proxy form, the shares will be voted in accordance with the specification so made. If a proxy is returned, but no choice is specified, the shares will be voted (i) FOR the election of the four nominees described below as Class I Directors; (ii) FOR the approval of the El Paso Electric Company 2007 Long-Term Incentive Plan as described in the Proxy Statement; and (iii) FOR the ratification of the selection of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007. With respect to any other matters that will come before the Annual Meeting, the proxy will be voted in the discretion of the proxy holder. If no proxy is returned, the shares represented by such proxy will not be voted.

The Board of Directors is not aware of any matter that will be presented at the Annual Meeting other than as set forth in the accompanying Notice. If, however, any other matters are properly presented at the Annual Meeting, the proxy holder will have discretionary authority to vote the shares represented by properly executed proxies in accordance with the proxy holder's discretion and judgment as to the best interests of the Company.

Abstentions are included in the determination of the number of shares represented at the Annual Meeting for purposes of determining whether a quorum is present and are counted as a vote AGAINST when determining whether a proposal has been approved. Broker non-votes are not included in the determination of the number of shares represented at the Annual Meeting for purposes of determining whether a quorum is present and are not counted for purposes of determining whether a proposal has been approved.

**PROPOSAL 1 ELECTION OF CLASS I DIRECTORS**

Article III, Section 2, of the Company's Bylaws divides the Board of Directors into three classes, as nearly equal in number as possible, each of which is elected for a three-year term. The Board currently has twelve members with Classes I, II and III containing four members each.

The shares represented by the accompanying proxy will be voted to elect the four nominees for Class I Director recommended by the Board of Directors, unless authority to do so is withheld. Each nominee has agreed to the nomination and has agreed to serve if elected. Should any nominee become unavailable for election, the proxies will be voted for the election of such other person as the Board of Directors may recommend in place of such nominee.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ELECTION OF MESSRS. EDWARDS, BROWN, CICCONI AND MS. HOLLAND-BRANCH AS CLASS I DIRECTORS.**

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<u>Name</u>	<u>Director</u>		<u>Principal Occupation and Employment</u>
	<u>Age</u>	<u>Since</u>	<u>During the Past Five Years<sup>(1)</sup></u>
<b>NOMINEES FOR CLASS I DIRECTORS (New Term will expire in 2010)</b>			
George W. Edwards, Jr. <sup>(2)</sup>	67	1992	Chairman of the Board since 1996.
John Robert Brown <sup>(3)</sup>	62	2003	Chairman of the Board, President and Chief Executive Officer of Desert Eagle Distributing, Inc.
James W. Cicconi	54	1997	Senior Executive Vice President for External and Legislative Affairs of AT&T, Inc., November 2005 to present; General Counsel and Executive Vice President - Law and Government Affairs of AT&T from December 1998 to November 2005.
Patricia Z. Holland-Branch	62	1997	Chief Executive Officer and Owner of HB/PZH Commercial Environments Inc., doing business as Facilities Connection, an HB/PZH Company; Fifty percent partner of MAPRODISA, S.A. de C.V. since 2001.
<b>CLASS II DIRECTORS (Term will expire in 2008)</b>			
Gary R. Hedrick <sup>(4)</sup>	52	2001	President and Chief Executive Officer since November 2001.
Kenneth R. Heitz	59	1996	Partner of Irell & Manella, LLP, a law firm.
Michael K. Parks <sup>(5)</sup>	47	1996	Vice Chairman of the Board since November 2005; Managing Director of TCW Group since 2000.
Eric B. Siegel <sup>(6)</sup>	49	1996	Retired Limited Partner of Apollo Advisors, LP; business consultant since 1995.
<b>CLASS III DIRECTORS (Term will expire in 2009)</b>			
Ramiro Guzmán	60	1996	Director of Business Development, James Edward & Companies since January 1, 2006; Director of Corporate Development, James Edward & Companies from October 2005 to January 2006; President, Viva Distributing from March 2001 to October 2005; owner Ramiro Guzmán & Associates.
James W. Harris	60	1996	Founder and President of Seneca Financial Group, Inc.

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<u>Name</u>	<u>Director</u>		<u>Principal Occupation and Employment</u>
	<u>Age</u>	<u>Since</u>	<u>During the Past Five Years<sup>(1)</sup></u>
Stephen N. Wertheimer <sup>(7)</sup>	56	1996	Managing Director of W Capital Partners.
Charles A. Yamarone <sup>(8)</sup>	48	1996	Executive Vice President of Libra Securities LLC, an institutional broker-dealer, since January 2002.

(1) Where no date is specified, the director has held the position for more than the past five years.

(2) Mr. Edwards is also a director of Hubbell, Inc.

(3) Mr. Brown is also a director of Bank of the West El Paso, Texas.

(4) Mr. Hedrick is chairman of the board of trustees of Las Palmas Medical Center and an advisory director of J.P. Morgan Chase Bank of Texas-El Paso.

(5) Mr. Parks is also a director of Aurora National Life Assurance Company and E\*TRADE Financial Corp. He is chairman of the audit committee and a member of the compensation committee of E\*TRADE Financial Corp.

(6) Mr. Siegel is currently a consultant to and a member of the Advisory Board of the Milwaukee Brewers Baseball Club, and a director and member of the audit committee of Ares Capital Corp.

(7) Mr. Wertheimer is also a board member of Adam Aircraft Industries, Inc.

(8) Mr. Yamarone is also a director of Continental Airlines, Inc. and a director and member of the audit committee of New Millennium Homes, LLC.

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**CORPORATE GOVERNANCE**

**Corporate Governance Guidelines**

The Board has adopted Corporate Governance Guidelines (the Guidelines) that, along with the charters of the Board committees, provide the framework for the governance of the Company. The Board's Nominating and Corporate Governance Committee is responsible for overseeing and reviewing the Guidelines at least annually and recommending any proposed changes to the Board for approval. The Guidelines are available on the Company website at [www.epelectric.com](http://www.epelectric.com). The website is not part of this Proxy Statement.

**Standards of Board Independence**

The Guidelines, among other things, set forth categorical standards to assist the Board of Directors in making determinations of director independence in accordance with the rules of the NYSE. The Board of Directors makes a determination regarding the independence of each director annually based on all relevant facts and circumstances. Although any director who meets the following criteria and the independence criteria of the NYSE is presumed to be independent (except for purposes of serving as a member of the Audit Committee which requires that the director meet additional requirements under SEC Rule 10A-3(b)(1)(ii)), the Board may make an affirmative determination to the contrary based on its review of other factors. Under the Guidelines, the following persons will not be considered to be independent:

- (i) A director who serves as an executive officer or employee of, or beneficially owns more than a 10% equity interest in, any corporation, partnership or other business entity that during the most recently completed fiscal year made payments to the Company or received payments from the Company for goods and services if such payments were more than the greater of 2% of such other entity's gross consolidated revenues for such fiscal year and \$1 million.
- (ii) A director who serves as an executive officer or employee of, or beneficially owns more than a 10% equity interest in, any bank, corporation, partnership or other business entity to which the Company was indebted at the end of its most recently completed fiscal year in an amount more than the greater of 2% of such other entity's total consolidated assets at the end of such fiscal year and \$1 million.
- (iii) A director who is a member or employee of a law firm that has provided services to the Company during the most recently completed fiscal year if the total billings for such services were more than the greater of 2% of the law firm's gross revenues for such fiscal year and \$1 million.
- (iv) A director who is a partner, executive officer or employee of any investment banking firm that has performed services for the Company (other than as a participating underwriter in a syndicate) during the most recently completed fiscal year if the total compensation received for such services was more than the greater of 2% of the investment banking firm's consolidated gross revenues for such fiscal year and \$1 million.

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In determining the independence of each non-employee director, the Board considered any transactions, relationships and arrangements in which a director may be deemed to have an interest. For 2006, the Board considered the provision of services by Irell & Manella, of which Mr. Heitz is a partner, and purchase of goods from Facilities Connection, which is owned by Ms. Holland-Branch. Neither of these involved over \$120,000 or, in the determination of the Board, impacted the independence of the Board member.

Applying these categorical standards and the independence criteria of the NYSE, the Board of Directors has determined that all of its directors meet the independence requirements of the NYSE except for Gary R. Hedrick who serves as President and Chief Executive Officer of the Company.

In addition, the Board of Directors has determined that all members of the Audit Committee meet the independence requirements set forth in Rule 10A-3(b)(1)(ii) under the Securities Exchange Act of 1934, as amended (the Act).

The Company has not made any charitable contributions in excess of the greater of \$1 million or 2% of the charitable organization's consolidated gross revenues within the preceding three years to any charitable organization in which a director of the Company serves as an executive officer.

## **Business Conduct Policies**

The Board of Directors has adopted a Code of Ethics that applies to all directors, officers and employees of the Company, including the Chief Executive Officer, the Executive Vice President, Chief Financial Officer and Chief Administrative Officer and the Controller. A current copy of the Code of Ethics may be found on the Company's internet website at [www.epelectric.com](http://www.epelectric.com). Any amendments to, or waivers from, any provision of the Code of Ethics applicable to the Company's Chief Executive Officer, Executive Vice President, Chief Financial Officer and Chief Administrative Officer, Controller or persons performing similar functions will be disclosed by posting such information on the Company's internet website at [www.epelectric.com](http://www.epelectric.com) within five business days.

Current copies of the charters of the Audit, Compensation, and Nominating and Corporate Governance Committees (the Committee Charters) may also be found on the Company's internet website at [www.epelectric.com](http://www.epelectric.com).

Printed copies of the Guidelines, the Committee Charters and the Code of Ethics are available to any shareholder upon request. Requests for printed copies should be addressed to El Paso Electric Company, 100 N. Stanton, El Paso, Texas 79901, Attention: Office of the Secretary.

Shareholders may correspond directly with non-management directors by writing to James W. Harris, Chairman, Nominating and Corporate Governance Committee, P.O. Box 982, El Paso, Texas 79960.



**Table of Contents****NYSE Corporate Governance Listing Standards**

The Company's Chief Executive Officer must certify to the New York Stock Exchange ( NYSE ) each year that he is not aware of any violation by the Company of NYSE corporate governance listing standards, qualifying the certification to the extent necessary. Such certification must be made within thirty days of the date of the Company's annual shareholders' meeting. The certification following the 2006 annual meeting was submitted to the NYSE timely, without qualification.

**DIRECTORS MEETINGS, COMPENSATION, AND COMMITTEES****Meetings**

The Board of Directors held eleven meetings during 2006. All directors attended at least 75% of the total number of meetings of the Board of Directors and the committees on which they served. The Board of Directors held three executive sessions during 2006. The Chairman of the Board of Directors presides at the executive sessions.

The Company does not have a formal policy regarding director attendance at annual meetings. All members of the Board of Directors attended last year's annual meeting. All members are expected to attend this year's Annual Meeting.

**2006 Director Compensation**

The table set forth below provides information regarding compensation paid to the non-employee directors of the Company.

Name	Fees Earned or Paid in Cash (\$)	Stock	Total (\$)
		Awards (\$)	
	(a)	(b)(c)	
Brown, J. Robert	\$ 89,500	\$ 68,625	\$ 158,125
Cicconi, James W.	87,000	68,625	155,625
Edwards Jr., George W.	90,500	247,048	337,548
Guzmán, Ramiro	59,000	68,625	127,625
Harris, James W.	64,000	68,625	132,625
Heitz, Kenneth R.		120,839	120,839
Holland-Branch, Patricia Z.		116,045	116,045
Parks, Michael K.	84,000	135,281	219,281
Siegel, Eric B.	91,500	68,625	160,125
Wertheimer, Stephen N.	64,000	68,625	132,625



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Yamarone, Charles A.	93,500	68,625	162,125
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(a) This column reports the amount of cash compensation earned in 2006 for Board and committee service, based on the compensation policy described below. Annually, directors can elect to receive retainers and meeting fees in cash, restricted stock or non-qualified stock options. Mr. Heitz and Ms. Holland-Branch elected to receive this compensation in restricted stock in 2006.

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(b) This column represents the dollar amount recognized for financial statement reporting purposes with respect to the 2006 fiscal year for the fair value of restricted stock awards granted in 2006 as well as prior fiscal years, in accordance with SFAS No. 123 (revised) Accounting for Stock-Based Compensation (hereinafter SFAS 123R ). Fair value for restricted stock is calculated using the closing price of our stock on the date of grant.

(c) Each non-employee director had the following number of stock awards and options outstanding at fiscal year end:

Name	Fair Value at		Fair Value at	
	Grant Date	Stock	Grant Date	Option
	Stock Awards	Awards	Option Awards	Awards
	(per share)	(#)	(per share)	(#)
Brown, J. Robert	\$ 19.40	3,500		
Cicconi, James W.	19.40	3,500	\$ 4.3282	5,000
Edwards Jr., George W.	19.40	10,846	3.2380	5,000
Edwards Jr., George W.			4.3282	5,000
Guzmán, Ramiro	19.40	3,500	4.3282	5,000
Harris, James W.	19.40	3,500	3.2380	5,000
Harris, James W.			4.3282	5,000
Heitz, Kenneth R.	21.04	606	3.2380	5,000
Heitz, Kenneth R.	19.04	932	4.3282	5,000
Heitz, Kenneth R.	19.40	3,500	7.0352	711
Heitz, Kenneth R.	20.16	633	5.6696	793
Heitz, Kenneth R.	22.34	660	5.3895	742
Heitz, Kenneth R.			4.3205	702
Holland-Branch, Patricia Z.	21.04	606	4.3282	5,000
Holland-Branch, Patricia Z.	19.04	774		
Holland-Branch, Patricia Z.	19.40	3,500		
Holland-Branch, Patricia Z.	20.16	633		
Holland-Branch, Patricia Z.	22.34	660		
Parks, Michael K.	19.40	8,654	3.2380	5,000
Parks, Michael K.			4.3282	5,000
Siegel, Eric B.	19.40	3,500	3.2380	5,000
Siegel, Eric B.			4.3282	5,000
Wertheimer, Stephen N.	19.40	3,500	4.3282	5,000
Yamarone, Charles A.	19.40	3,500	3.2380	5,000
Yamarone, Charles A.			4.3282	5,000

During 2006, compensation for non-employee directors consisted of the following:

- (1) Each non-employee director received an annual retainer of \$35,000.
- (2) The chair of the Audit Committee received an additional annual retainer of \$10,000, and the chair of each of the other committees of the Board received an additional annual retainer of \$5,000.



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- (3) Each non-employee director received a meeting fee of \$1,000 per meeting for each Board and committee meeting attended (other than Audit Committee meetings).
- (4) Each Audit Committee member received a meeting fee of \$1,500 per meeting for each Audit Committee meeting attended.
- (5) Each non-employee director received an award of 3,500 shares of restricted stock, and the Chairman of the Board received an additional award of 7,346 shares of restricted stock. The Vice Chairman of the Board received an additional award of 5,154 shares of restricted stock with a fair market value of \$100,000 based on the closing market price of the stock on the date of grant. Restricted stock awarded to directors cannot be sold for one year after grant.

Directors are also reimbursed for travel expenses incurred in connection with their duties as directors. Non-employee directors are not eligible to participate in the executive incentive program, savings programs or any of the retirement programs for the Company's employees. Other than as described in this section, there are no separate benefit plans for directors.

The Company's Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws provide for indemnification of the Company's directors and officers and the Company maintains director and officer liability insurance.

## **Committees**

The Board of Directors has the following standing committees: Audit, Compensation, Executive, Palo Verde and Environmental Oversight, External Affairs, and Nominating and Corporate Governance.

During 2006, the Audit Committee was composed of directors Yamarone (Chairman), Brown, Cicconi, Parks and Siegel. The Audit Committee, which held nineteen meetings in 2006, is responsible for appointing the independent auditors of the Company, reviewing all recommendations of the Company's independent auditors and the Company's internal auditors, reviewing and approving non-audit services performed by accountants and other consultants retained by the Company, reviewing the Company's periodic reports filed with the Securities and Exchange Commission (SEC) and otherwise overseeing the Company's financial reporting. The Audit Committee also determines whether management has established a system to promote the accuracy and completeness of the Company's financial statements and other publicly disclosed information. The roles and responsibilities of the Audit Committee are described in detail in a written charter adopted by the Board of Directors. The Board of Directors has determined that each member of the Audit Committee meets the experience and independence requirements of the NYSE rules and Rule 10A-3(b)(1)(ii) under the Act. No member of the Audit Committee serves on the audit committee of more than three public companies. The Board of Directors has determined that Messrs. Yamarone and Parks meet the criteria of audit committee financial experts under the SEC's rules and are independent of management. Certain additional information concerning the composition and role of the Audit Committee is set forth under the caption "Audit Committee Report" below.

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During 2006, the Compensation Committee was composed of directors Cicconi (Chairman), Heitz, Wertheimer and Yamarone. The Board of Directors has determined that each member of this committee is independent under the rules of the NYSE. The Compensation Committee, which held six meetings in 2006, is responsible for evaluating and approving the compensation of executive officers. It also reviews and approves recommended Company-wide compensation increases for employees, as well as approving the adoption of contracts with union employees. The Compensation Committee is also responsible for evaluating, adopting and administering benefit plan programs. The roles and responsibilities of the Compensation Committee are described in detail in a written charter adopted by the Board of Directors. Additional information concerning the process and procedures for the consideration and determination of executive compensation (including its engagement of compensation consultant Hewitt Associates ( Hewitt )) by the Compensation Committee appears under the caption Compensation Discussion and Analysis below.

During 2006, the Executive Committee was composed of directors Siegel (Chairman), Harris, Hedrick, Parks and Wertheimer. The Executive Committee, which held eleven meetings in 2006, consults with senior management on administrative matters and directs the strategic planning effort on behalf of the Board. The Executive Committee may exercise all powers of the Board of Directors (except as prohibited by the Texas Business Corporation Act) between meetings. In addition, the Executive Committee's responsibilities include analyzing and making recommendations to the Board of Directors regarding the maximization of shareholder value. The roles and responsibilities of the Executive Committee are described in detail in a written charter adopted by the Board of Directors.

During 2006, the External Affairs Committee was composed of directors Brown (Chairman), Guzmán, Harris, Heitz and Holland-Branch. The External Affairs Committee, which held six meetings in 2006, is responsible for setting policy and reviewing an annual budget for civic and charitable contributions by the Company in the communities it serves. It is also responsible for assisting management in formulating a business development strategy for Mexico and evaluating business opportunities in Mexico. The Committee created a civic and charitable affairs subcommittee, consisting of Messrs. Brown, Guzmán, Hedrick and Ms. Holland-Branch. This subcommittee, which held three meetings in 2006, is responsible for overseeing the Company's charitable giving and civic activities. The roles and responsibilities of the External Affairs Committee are described in detail in a written charter adopted by the Board of Directors.

During 2006, the Nominating and Corporate Governance Committee was composed of directors Harris (Chairman), Parks, Siegel and Wertheimer. The Board of Directors has determined that each member of this committee is independent under the rules of the NYSE. The Nominating and Corporate Governance Committee, which held one meeting in 2006, is responsible for identifying qualified individuals to serve as members of the Board of Directors, recommending directors for appointment to committees, evaluating Board performance, and overseeing and setting compensation for the members of the Board of Directors. The roles and responsibilities of the Nominating and Corporate Governance Committee are described in detail in a written charter adopted by the Board of Directors. In 2006, the Nominating and Corporate Governance Committee assisted the Board of Directors and each of the Board committees in conducting a self-evaluation to assess their effectiveness.

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During 2006, the Palo Verde and Environmental Oversight Committee was composed of directors Edwards (Chairman), Guzmán, Hedrick, Heitz and Holland-Branch. The Palo Verde and Environmental Oversight Committee, which held six meetings in 2006, is responsible for (i) reviewing and assessing the activities and operations of the Palo Verde Nuclear Generating Station in which the Company is a participant and (ii) overseeing the affairs and operations of the Company to determine whether the Company has operated Company facilities in compliance with applicable environmental laws and regulations, and identifying existing and potential environmental issues facing the Company under federal, state and local law. The roles and responsibilities of the Palo Verde and Environmental Oversight Committee are described in detail in a written charter adopted by the Board of Directors.

## **Consideration of Director Nominees**

The Nominating and Corporate Governance Committee will consider nominees for the Board of Directors submitted in writing by a shareholder. A shareholder wishing to nominate one or more individuals to stand for election as a director at an annual or special meeting of the shareholders must provide written notice thereof not less than eighty days in advance of such meeting; provided, however, that in the event that the date of the meeting was not publicly announced by the Corporation more than ninety days prior to the meeting, such notice, to be timely, must be delivered not later than the close of business on the tenth day following the day on which the date of the meeting was publicly announced. A shareholder's notice must set forth (a) the name and address of the shareholder making the nomination; (b) such information regarding the nominee(s) proposed by such shareholder as would be required to be included in a proxy statement filed pursuant to the proxy rules of the SEC had the nominee(s) been nominated by the Board of Directors; (c) a representation of the shareholder as to the number of shares of stock of the Company that are beneficially owned by the shareholder and the shareholder's intent to appear in person or by proxy at the meeting to propose such nomination; and (d) the written consent of the nominee(s) to serve as a member of the Board of Directors if so elected. Any such shareholder notice should be submitted in writing to: Guillermo Silva, Jr., Corporate Secretary, El Paso Electric Company, 100 N. Stanton, El Paso, Texas 79901.

In making its recommendations regarding nominees to serve on the Board of Directors, the Nominating and Corporate Governance Committee reviews an individual's qualifications including a determination as to the independence of the candidate based on the independence criteria described above. If the nominee is being evaluated for re-nomination to the Board of Directors, the committee will assess the prior performance of such director. The committee will also periodically review the composition of the Board of Directors in light of its current challenges and needs and determine whether it may be appropriate to add or remove individuals after considering issues of judgment, diversity, age, skills, background and experience. No director may serve on the boards of more than three other public companies while serving on the Company's Board of Directors.

The Board of Directors believes that directors should hold meaningful equity ownership positions in the Company. Each non-employee director is expected (but not required) to be a beneficial owner of shares of the Company's Common Stock or common stock equivalents with a market value equivalent to at least three years' annual cash retainer fees by the end of his or her second year of service on the Board of Directors. Each non-employee director on the Board of Directors met this stock ownership guideline as of December 31, 2006.

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**PROPOSAL 2 APPROVAL OF EL PASO ELECTRIC COMPANY**

**2007 LONG-TERM INCENTIVE PLAN**

**General**

The Board of Directors is seeking shareholder approval of the El Paso Electric Company 2007 Long-Term Incentive Plan (the Plan ). The purpose of the Plan is to provide a means whereby employees and directors of the Company develop a sense of proprietorship and personal involvement in the development and financial success of the Company, and to encourage them to devote their best efforts to the business of the Company, thereby advancing the interests of the Company and its shareholders. A further purpose of the Plan is to provide a means through which the Company may attract able individuals to become employees or serve as directors of the Company and to provide a means whereby those individuals upon whom the responsibilities of the successful administration and management of the Company are of importance, can acquire and maintain stock ownership, thereby strengthening their concern for the welfare of the Company. Under the Plan, the Company may grant non-qualified stock options, incentive stock options (within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the Code )), stock appreciation rights ( SARs ), restricted stock, restricted stock units, performance shares, performance units, cash-based awards, and other stock-based awards. Reference is made to Exhibit A to this Proxy Statement for the complete text of the Plan which is summarized below.

As described in more detail below, the Plan is more restrictive than the 1999 Plan as it relates to (i) the definition of a change in control, (ii) the payouts upon the occurrence of a change in control, (iii) the performance measures that may be utilized for performance-based awards and (iv) the maximum annual awards to employees.

**Description of Plan**

*Administration.* The Plan will be administered by the Compensation Committee of the Board of Directors (the Committee ).

Subject to the express provisions of the Plan, the Committee will have the authority to select eligible persons to receive awards and determine all of the terms and conditions of each award. All awards will be evidenced by a written agreement containing such provisions not inconsistent with the Plan as the Committee shall approve. The Committee will also have authority to establish rules and regulations for administering the Plan and to decide questions of interpretation or application of any provision of the Plan.

*Available Shares.* In 1999, the Company s shareholders approved the El Paso Electric Company 1999 Long-Term Incentive Plan (the 1999 Plan ). At March 15, 2007, there remained 44,577 shares available for awards under the 1999 Plan. The Company estimates that substantially all shares available under the 1999 Plan will have been awarded on or prior to the Annual Meeting on May 2, 2007.

Under the Plan, 1,000,000 shares of Common Stock will be available for awards, subject to adjustment in the event of any corporate event or transaction (including, but not limited to, a change in the shares of the Company or the capitalization of the Company) such as a merger, consolidation, reorganization, recapitalization, separation, partial or complete liquidation, stock

dividend, stock split, reverse stock split, split up, spin-off, or other distribution of stock or property of the Company, combination of shares, exchange of shares, dividend in kind, or other like change in capital structure, number of outstanding shares or distribution (other than normal cash dividends) to shareholders of the



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Company, or any similar corporate event or transaction. Shares covered by an award shall be counted as used as of the date of grant. Under the Plan, any shares related to awards under the Plan or the Company's prior plans which terminate by expiration, forfeiture, cancellation, or otherwise without the issuance of such shares, are settled in cash in lieu of shares, or are exchanged with the Committee's permission, prior to the issuance of shares, for awards not involving shares, and shall be available again for grant under the Plan.

*Change in Control.* In the event of certain acquisitions of 30% or more of the Common Stock, certain changes in a majority of the Board of Directors, or the consummation of a reorganization, merger or consolidation or sale or disposition of all or substantially all of the assets of the Company (unless, among other conditions, the Company's shareholders receive 60% or more of the stock of the surviving company) or the liquidation or dissolution of the Company, all outstanding options and SARs will be exercisable in full, and the restricted stock and restricted stock units will become immediately vested and payable. The performance period applicable to performance shares and performance units shall end upon the occurrence of a change in control in the manner and on the date determined by the Committee in its sole discretion. The performance goals associated with such awards shall be measured based on performance achieved through the end of such shortened performance period and such awards shall become vested and payable on a prorated basis to reflect the shortened performance period, with the remaining portion of the awards terminating. The Plan is more restrictive than the 1999 Plan under which all awards vested at maximum levels without proration upon the occurrence of a change in control event. Also, the definition of change in control has been modified under the Plan to require consummation of a transaction rather than shareholder approval.

*Effective Date, Termination and Amendment.* If approved by shareholders, the Plan will become effective as of the date of such approval. The Plan will terminate ten years thereafter unless terminated earlier by the Board of Directors. The Committee may, at any time and from time to time, alter, amend, modify, suspend, or terminate the Plan and any award agreement in whole or in part; provided, however, that, without the prior approval of the Company's shareholders and except as provided in the Plan, options or SARs issued under the Plan will not be repriced, replaced, or regranted through cancellation, or by lowering the option price of a previously granted option or the grant price of a previously granted SAR, and no amendment of the Plan shall be made without shareholder approval if shareholder approval is required by law, regulation, or stock exchange rule.

*Stock Options - General.* The Committee will determine the conditions to the exercisability of each option. Upon exercise of an option, the purchase price may be paid in cash or by delivery of previously owned shares of Common Stock.

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*Non-Qualified Stock Options and Incentive Stock Options.* The period for the exercise of a non-qualified stock option or incentive stock option will be determined by the Committee. The exercise price of a non-qualified stock option or incentive stock option will not be less than the fair market value of the Common Stock on its date of grant. The Committee may impose restrictions on any shares acquired pursuant to the exercise of a non-qualified stock option or incentive stock option granted under the Plan.

The award agreement shall set forth the extent to which the participant shall have the right to exercise the non-qualified stock option or incentive stock option in the event of participant's termination of employment or service. Such provisions will be determined by the Committee.

*Stock Appreciation Rights.* The period for the exercise of a SAR will be determined by the Committee. The base price of a SAR will not be less than 100% of the fair market value of the Common Stock on the date of grant. A SAR entitles the holder to receive upon exercise (subject to withholding taxes) shares of Common Stock (which may be restricted stock), cash or combination thereof with a value equal to the difference between the fair market value of the Common Stock on the exercise date and the base price of the SAR. The Committee may impose restrictions upon exercise of a SAR granted under the Plan.

The award agreement shall set forth the extent to which the participant shall have the right to exercise the SAR in the event of participant's termination of employment or service. Such provisions will be determined by the Committee.

*Restricted Stock and Restricted Stock Units.* The Plan provides for the grant of (i) restricted stock awards which may be subject to a restriction period ( restricted stock ), and (ii) restricted stock units which are similar to restricted stock except no shares are actually awarded. An award of restricted stock or restricted stock units may be subject to specified performance measures during the applicable restriction period. Shares of restricted stock will be freely transferable after all conditions and restrictions have been satisfied or have lapsed. The award agreement shall set forth the extent to which the participant shall have the right to retain restricted stock and/or restricted stock units in the event of participant's termination of employment or service. Such provisions will be determined by the Committee. Unless otherwise set forth in a restricted stock award agreement, the holder of a restricted stock award will have rights as a shareholder of the Company, including the right to vote and receive dividends with respect to the shares of restricted stock. A participant shall have no voting rights with respect to any restricted stock units granted under the Plan.

*Performance Units and Performance Shares.* The Plan also provides for the grant of performance units and performance share awards. Each performance unit and each performance share is a right, contingent upon the attainment of performance measures within a specified performance period. The Committee will determine the form of payout of cash or in shares (or in a combination thereof) equal to the value of earned performance units/performance shares at the close of the applicable performance period. The award agreement shall set forth the extent to which the participant shall have the right to retain the performance units and/or performance shares in the event of participant's termination of employment or service, as determined by the Committee. If the Committee desires to qualify performance-based awards under Section 162(m) of the Code, the performance goals will consist of any of the following:

- (a) Net earnings or net income (before or after taxes);

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- (b) Earnings per share;
- (c) Net sales or revenue growth;
- (d) Net operating profit;
- (e) Return measures (including, but not limited to, return on assets, capital, invested capital, equity, sales, or revenue);
- (f) Cash flow (including, but not limited to, operating cash flow, free cash flow, cash flow return on equity, and cash flow return on investment);
- (g) Earnings before or after taxes, interest, depreciation, and/or amortization;
- (h) Gross or operating margins;
- (i) Productivity ratios;
- (j) Share price (including, but not limited to, growth measures and total shareholder return);
- (k) Expense targets;
- (l) Margins;
- (m) Operating efficiency;
- (n) Market share;
- (o) Customer satisfaction;
- (p) Working capital targets; and
- (q) Economic value added or EVA<sup>®</sup> (net operating profit after tax minus the sum of capital multiplied by the cost of capital).

*Cash-Based Awards and Other Stock-Based Awards.* The Plan also provides for the grant of cash-based awards and other types of equity-based or equity-related awards not otherwise described by the Plan as determined by the Committee. The Committee will determine the value of the cash-based awards and other stock-based awards and may establish performance goals. In the event the Committee establishes performance goals, the number and/or value of cash-based awards or other stock-based awards that will be paid out will depend on the extent to which performance goals are met. The Committee shall determine the extent to which the participant shall have the right to receive cash-based awards or other stock-based awards in the event of participant s termination of employment or service.

*Non-Employee Director Awards.* Unless the Board determines otherwise, on the date of each annual meeting of shareholders of the Company, the following restricted stock awards shall be made to each person who is a non-employee director immediately after such meeting of shareholders:

- (a) Each non-employee director, other than the Chairman of the Board and the Vice Chairman of the Board, shall receive a restricted stock award of three thousand five hundred (3,500) shares;

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- (b) The Vice Chairman of the Board shall receive a restricted stock award equal to the sum of (i) three thousand five hundred (3,500) shares and (ii) an amount of shares equal to one hundred thousand dollars (\$100,000) divided by the closing price of the stock on the date of grant; and
- (c) The Chairman of the Board shall receive a restricted stock award of sixteen thousand (16,000) shares less the number of shares awarded the Vice Chairman under subparagraph (b)(ii) above.

The Board will have full discretion to change grant practices for non-employee directors.

*Maximum Awards for Employees.* Generally, the Plan limits the annual awards to any individual employee as follows:

- (a) 300,000 options;
- (b) 300,000 SARs;
- (c) 150,000 shares of restricted stock or restricted stock units;
- (d) 150,000 performance shares or performance units; and
- (e) \$3,000,000 or 150,000 shares of cash-based or other stock-based awards.

## **Federal Income Tax Consequences**

The following is a brief summary of certain U.S. federal income tax consequences generally arising with respect to awards under the Plan.

A participant generally will not recognize taxable income at the time an option is granted, and the Company will not be entitled to a tax deduction at such time. A participant will recognize compensation taxable as ordinary income (and subject to income tax withholding in respect of an employee) upon exercise of a non-qualified stock option equal to the excess of the fair market value of the shares purchased over their exercise price, and the Company generally will be entitled to a corresponding deduction. A participant will not recognize income (except for purposes of the alternative minimum tax) upon exercise of an incentive stock option. If the shares acquired by exercise of an incentive stock option are held for the longer of two years from the date the option was granted and one year from the date it was exercised, any gain or loss arising from a subsequent disposition of such shares will be taxed as long-term capital gain or loss, and the Company will not be entitled to any deduction. If, however, such shares are disposed of within the above-described period, then in the year of disposition, the participant will recognize compensation taxable as ordinary income equal to the excess of the lesser of (i) the amount realized upon disposition and (ii) the fair market value of the shares on the date of exercise over the exercise price, and the Company generally will be entitled to a corresponding deduction.

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A participant generally will not recognize taxable income at the time SARs are granted and the Company will not be entitled to a tax deduction at such time. Upon exercise, the participant will recognize compensation taxable as ordinary income (and subject to income tax withholding in respect of an employee) in an amount equal to the fair market value of any shares delivered and the amount of any cash paid by the Company. This amount generally is deductible by the Company as compensation expense.

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A participant will not recognize taxable income at the time restricted stock is granted and the Company will not be entitled to a tax deduction at such time, unless the participant makes an election to be taxed at such time. If such election is not made, the participant will recognize compensation taxable as ordinary income (and subject to income tax withholding in respect of an employee) at the time the restrictions lapse in an amount equal to the excess of the fair market value of the shares at such time over the amount, if any, paid for such shares. The amount of ordinary income recognized generally is deductible by the Company as compensation expense, except to the extent the deduction limits of Section 162(m) of the Code apply. Restricted stock units generally will also be taxed as ordinary income upon vesting unless structured in compliance with applicable tax rules to defer taxation until settlement.

Most of the awards under the Plan are discretionary, so it is not possible to determine the benefits received in the future by participants, except with respect to directors under the current Board compensation policy. The following table sets forth the aggregate number of shares of Common Stock that would be granted annually to non-employee directors based on current Board compensation policy. Such awards are granted on the date of each annual meeting of shareholders beginning with the 2007 Annual Meeting.

**New Plan Benefits Table****El Paso Electric Company****2007 Long-Term Incentive Plan**

<b>Position</b>	<b>Restricted Shares</b>	
	<b>Number</b>	<b>Value</b>
Non-employee directors (11 persons)	51,000	\$ 1,199,520

The indicated value is based on a fair market value of \$23.52 per share which is the closing price of Common Stock on the New York Stock Exchange on February 28, 2007.

In 2006, executive officers of the Company received an aggregate award of 20,550 shares of restricted stock which have a three-year vesting schedule, and 70,700 performance shares at target which have a three-year performance cycle. However, awards under the Plan are discretionary, and therefore, officers may receive different amounts of awards in the future.

Table of Contents**Equity Compensation Plan Information**

as of December 31, 2006

<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights  (a)</u>	<u>Weighted-average exercise price of outstanding options, warrants and rights  (b)</u>	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))  (c)</u>
Equity compensation plans approved by security holders	957,888	\$ 12.45	173,065
Equity compensation plans not approved by security holders			
<b>Total</b>	<b>957,888</b>	<b>\$ 12.45</b>	<b>173,065</b>

**Vote Required and Board Recommendation**

The affirmative vote of the holders of a majority of the shares of Common Stock entitled to vote and represented in person or by proxy at the Annual Meeting is required to approve the El Paso Electric Company 2007 Long-Term Incentive Plan. Unless otherwise instructed, the proxy holders will vote the proxies received by them FOR approval of the Plan. **The Board of Directors recommends a vote FOR approval of the Plan.**



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**PROPOSAL 3**

**INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors has selected KPMG LLP to serve as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007. At the Annual Meeting, the Company will ask shareholders to ratify the Board's selection. KPMG LLP, which served in the same capacity in 2003, 2004, 2005 and 2006, is expected to be represented at the Annual Meeting. Representatives of KPMG LLP will have an opportunity to make a statement if they desire to do so and will respond to appropriate questions. If the shareholders do not ratify the Board's proposal, the Board of Directors will reconsider its action with respect to the appointment of KPMG LLP. Approval of the resolution, however, will in no way limit the Board's authority to terminate or otherwise change the engagement of KPMG LLP during the fiscal year ending December 31, 2007.

**Audit Fees**

KPMG LLP billed the Company an aggregate of \$921,000 for professional services rendered in connection with the audit of the Company's financial statements (including \$411,000 for Sarbanes-Oxley Section 404 certification) and review of the Company's financial statements included in the Company's quarterly reports on Form 10-Q during the fiscal year ended December 31, 2006. The Sarbanes-Oxley Section 404 certification fees include \$141,000 of fees associated with the December 31, 2005 attestation, which were billed in 2006, and \$270,000 associated with the December 31, 2006 attestation.

KPMG LLP billed the Company an aggregate of \$1,017,000 for professional services rendered in connection with the audit of the Company's financial statements (including \$522,000 for Sarbanes-Oxley Section 404 Certification) for the fiscal year ended December 31, 2005 and review of the Company's financial statements included in the Company's quarterly reports on Form 10-Q during the fiscal year ended December 31, 2005.

**Financial Information Systems Design and Implementation**

The Company did not pay KPMG LLP nor did KPMG LLP perform professional services in connection with financial information systems design and implementation for the fiscal years ended December 31, 2006 and 2005.

**Audit-Related Fees**

KPMG LLP billed the Company \$216,000 and \$247,000 for audit-related services, including audits of benefit plans and federal and state regulatory filings, during the fiscal years ended December 31, 2006 and 2005, respectively.

**Tax Fees**

KPMG LLP billed the Company \$39,000 and \$44,000 for professional services rendered in connection with tax compliance, tax advice and tax planning during the fiscal years ended December 31, 2006 and 2005, respectively.

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**All Other Fees**

The Company paid no other fees to KPMG LLP during the fiscal years ended December 31, 2006 and 2005.

KPMG LLP determined that these services did not affect its independence under applicable auditing standards. The Audit Committee pre-approved the engagement of KPMG LLP to provide the audit and permissible non-audit services described above in accordance with the requirements of the Sarbanes-Oxley Act of 2002 and determined that KPMG LLP's provision of the services described above under Audit-Related Fees, Tax Fees, and All Other Fees is compatible with KPMG LLP's independence.

**Audit Committee Pre-Approval Policies and Procedures**

The Audit Committee charter provides that the Audit Committee will pre-approve audit services and non-audit services to be provided by the Company's independent auditors pursuant to pre-approval policies and procedures established by the Audit Committee. The Audit Committee may consult with management in the decision-making process, but may not delegate this authority to management. The Audit Committee may delegate its authority to pre-approve services to one or more committee members, provided that such designees present any such pre-approvals to the full committee at the next committee meeting.

**The Board of Directors recommends a vote FOR the ratification of the selection of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007.**

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**COMPENSATION DISCUSSION AND ANALYSIS**

**Executive Compensation Philosophy and Overview**

Our executive compensation program is designed to:

Attract and retain qualified executives by providing comprehensive and market-competitive compensation;

Encourage a high level of performance by linking a significant amount of executive pay to the financial results and operating performance of the Company; and

Motivate our executive team to achieve the Company's business strategy and maximize long-term shareholder return.

In order to meet these goals, our executive compensation currently consists of base salary, an annual performance bonus payable in cash and stock-based long-term incentive awards, along with retirement and other benefits. The levels of compensation are determined through a combination of market data, company performance and individual responsibility and performance.

**Executive Compensation Process**

Our Compensation Committee (the Committee) reviews and approves compensation for all executive officers. The Committee reviews the performance of our President and Chief Executive Officer at least annually. Our CEO reviews other executive officers performance and reports his evaluations to the Committee. Our CEO also recommends to and discusses with the Committee the non-equity compensation elements for executive officers, although the Committee approves actual compensation awarded.

The Committee has engaged Hewitt, an outside global human resource consulting firm, to conduct an annual review of its total compensation program for the executive officers. Hewitt provides the Committee with relevant market data and alternatives to consider when making compensation decisions. Hewitt provides other services directly to the Company related to review, administration and adoption of employee benefit plans, for relatively small fees. The Committee believes that this engagement does not hinder Hewitt's ability to give objective advice to the Committee.

The Committee generally makes decisions regarding base salary, annual bonus targets and equity incentive awards at one or more regularly scheduled meetings during March of each year. The Committee continues to review compensation matters throughout the year and changes or approves compensation at other times in response to hiring needs, market changes and other occurrences. The Committee's decisions about equity awards are not timed or otherwise affected by the planned announcement of material information. Recently, the Company, with review by Hewitt, has begun to provide the Committee with a summary of compensation (also called a tally sheet) for each executive officer showing all compensation, equity holdings and accrued retirement benefits. We intend to provide this information to the Committee at least annually or otherwise when material decisions are being considered by the Committee.



**Table of Contents****Compensation Benchmarking**

In consultation with Hewitt, the Committee has approved a group of companies (referred to in this discussion as the Compensation Comparator Group) from the Edison Electric Institute Index to be used for annual benchmarking of our compensation program. These companies represent regional electric utilities with business issues and compensation programs similar to our own. Although the Compensation Comparator Group consists of companies that vary in size and region served, we feel this group represents companies with which we compete for executive talent. The Committee reviews compensation information of the Compensation Comparator Group compiled from surveys based on companies that participate in these surveys and publicly available data. For companies in the group with annual revenues higher or lower than ours, Hewitt adjusts the compensation market values using regression analysis to mitigate differences in size for comparison purposes, which is a commonly used approach to ensure the market values reflect our Company's size. The companies in the Compensation Comparator Group currently consist of the following 15 companies:

ALLETE, Inc.

Alliant Energy Corporation

Ameren Corporation

Black Hills Corporation

Cleco Corporation

DPL, Inc.

Duquesne Light Holdings, Inc.

Great Plains Energy, Inc.

IDACORP, Inc.

Otter Tail Corporation

Pinnacle West Capital Corporation

PNM Resources, Inc.

SCANA Corporation

Unisource Energy Corporation

Westar Energy, Inc.

**Primary Components of Compensation**

The primary components of our compensation program for the Named Executive Officers (as hereinafter defined) are:

Base salary;

Short-term incentive compensation, currently awarded through an annual cash performance-based bonus plan; and

Long-term incentive equity compensation, currently awarded in shares with a combination of time-based and performance-based vesting as opposed to stock options.

We do not target any element of compensation to be a particular percentage of total compensation.

**Base Salary.** Base salary levels for our executive officers generally are reviewed and set annually. The Committee targets the 50th percentile level of the Compensation Comparator Group, although the Committee also considers executives' responsibility level, experience and individual performance. The Committee most recently approved base salary increases for executive officers in December 2006 after reviewing these factors. Base salaries for the Named Executive Officers at the end of fiscal 2006 averaged approximately the 50th percentile as compared to the Compensation Comparator Group.

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**Annual Cash Bonus Plan.** The purpose of our annual cash performance-based bonus plan is to provide market-based compensation opportunities based on achievement of specific business goals and objectives that are established in advance on an annual basis. For our executive officers, the goals are based solely on corporate financial and operational performance. For 2006, these goals were comprised of the following:

Financial performance, representing 70% of the bonus, was measured by earnings per share (EPS); and

Operational performance was measured by a combination of customer satisfaction (25% of the bonus) and safety goals (5% of the bonus).

Each executive officer is assigned a target award opportunity expressed as a percentage of base salary. These targets range from 25% to 45% of base salary for most executives, and up to 60% for the CEO. The target award represents the level of bonus payment the executive may earn in the event that plan performance is achieved at targeted levels. Payments at the targeted levels are intended to approximate the 50th percentile of the Compensation Comparator Group. In addition, threshold and maximum award levels are established that adjust payouts for performance levels that exceed or fall below our plan.

The EPS bonus goals for 2006 were established based on a range between a threshold of \$1.21 and a maximum of \$1.41. Executives would receive no bonus if the threshold EPS goal (which is less than the target level) is not achieved and a proportionally higher bonus if earnings surpass the pre-established goal. Our target safety goals for 2006 were based on the highest performance level during the previous five years. Our customer satisfaction goals are established and measured based on annual surveys designed and performed by a third-party marketing organization and are within the top quartile of all U.S. electric utilities. Bonuses are paid in late February or early March after the Committee reviews the audited financial results and operational performance for the previous year.

**Long-Term Equity Incentives.** We grant stock awards annually with a three-year payout cycle. These awards are designed to focus executives on the relative performance of our stock and, secondarily, are designed as a retention tool. Since 2004, the Committee has granted annual long-term incentives consisting of two elements:

Performance shares, which are earned based on our total shareholder return over a three-year period; and

Time-vested restricted stock, which vests at the end of a three-year period.

The initial target value of each annual award is based on a weighting of approximately 75% for performance shares and 25% for time-based restricted stock. We have chosen to place more weight on the performance shares so that the most value is realized based on return for our shareholders over a period of three years. We feel the time-based restricted stock awards are also effective retention and incentive tools because their actual value is tied to the value of the Company's stock no earlier than the vesting date. The initial target values (*i.e.*, the initial value of the time-based restricted stock plus 100% target of the performance shares) are intended to approximate the 50th percentile of the Compensation Comparator Group.



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The actual number of performance shares earned at the end of the three-year cycle depends on the Company's percentile ranking within a specific group of companies identified by the Committee in consultation with Hewitt (called the Performance Comparator Group). The Performance Comparator Group is structured to be a group of companies defined by a third-party index and is somewhat different from our Compensation Comparator Group. The Performance Comparator Group represents 15 publicly-traded electric utilities with market capitalizations similar to our own. We believe that these companies have investor bases that are similar to ours. The following companies, chosen from the Standard & Poor's SmallCap 600 and MidCap 400 that are included in the Global Industry Classification Standard's (GICS) sub-industry of Electric Utilities for their similarities to us in type of industry and size of operations, currently are in our Performance Comparator Group:

ALLETE, Inc.	Green Mountain Power Corporation
Central Vermont Public Service Corporation	Northeast Utilities
Cleco Corporation	Pepco Holdings, Inc.
DPL, Inc.	Sierra Pacific Resources
Duquesne Light Holdings, Inc.	UIL Holdings Corporation
Great Plains Energy, Inc.	Unisource Energy Corporation
Hawaiian Electric Industries, Inc.	Westar Energy, Inc.
IDACORP, Inc.	

The actual number of performance shares earned at the end of the three-year cycle can range from 0% to 200% of target, depending on our ranking within the Performance Comparator Group for total shareholder return. Shareholder return is defined as the change in stock value plus dividends over the three-year performance period within the Performance Comparator Group, and pay-outs for each three-year cycle are as follows:

if we rank first, 200% of target

if we rank second, 175% of target

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if we rank third, 150% of target

if we rank below third but above the 50th percentile, we interpolate between 150% and 100% of target

if we are at the 50th percentile, 100% of target

if we rank below 50th percentile but above the 30th percentile, we interpolate between 100% and 30% of target

if we are below the 30th percentile, 0% of target

For the 2004-2006 performance cycle, which ended on December 31, 2006, our total shareholder return ranked third among the Performance Comparator Group, which resulted in performance shares earned at the 150% level.

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We have chosen to make recent long-term awards to executive officers in the form of full-value stock awards rather than stock options because these stock awards have significant retention value due to their value being directly linked to the stock price in the future. In addition, this type of award limits the negative retention impact of short-term volatility in our stock price. The Compensation Committee regularly reviews our equity incentive program and reserves the right to grant different types of equity awards in the future.

## **Other Executive Benefits**

**Retirement Benefits.** We provide our employees, including our executive officers, with a tax-qualified defined benefit pension plan, which provides employees the opportunity to earn service toward income replacement at retirement. The benefit is based on years of service, retirement age and salary over a period of time prior to retirement. However, tax regulations impose a limit on the amount of compensation that can be taken into account for purposes of determining these retirement benefits. As a result, the qualified plan does not achieve a market-competitive structure for senior executives whose total compensation can include a significant amount of variable short-term incentive compensation. We established an excess benefit plan to provide supplemental retirement benefits to senior executives based on actual annual earnings applied to the basic retirement plan formula without regard to the tax limitations.

**Perquisites and Other Benefits.** Generally our Named Executive Officers do not receive material perquisites or other benefits different from other employees. For example, our executives participate in the same medical, dental, life insurance, accidental death & dismemberment, and long-term disability plans as do other employees, and the Company contributions to the 401(k) plan are on the same basis as other employees. However, executives are paid a small monthly car allowance and receive at a minimum five weeks and three days of paid time off annually.

**Change in Control/Termination Agreements.** The Committee has approved change in control severance agreements for each of our Named Executive Officers. As further described in this Proxy Statement, these agreements provide executives with benefits in the event of involuntary termination or adverse job changes in connection with or after a change in control. The Committee periodically reviews the costs of these agreements and market practice. The Committee believes these agreements offer important protection in the event of a change of control, while also ensuring that in the event of an actual proposed change of control, key executives will be willing to remain through the closing because of this protection. This is especially important in the utility industry when the need for regulatory approvals can result in significant delays in consummating transactions following the execution of definitive agreements. In March 2007, after reviewing potential costs and market practice, the Committee approved revisions to these agreements which eliminate the tax reimbursement payments previously provided if an executive is subject to the excise tax under Section 4999 of the Code and instead provide that either (i) the executive will be responsible for paying the excise tax or (ii) payments will be reduced to the extent necessary so that no portion is subject to the excise tax, whichever would result in the executive retaining the higher after-tax amount.

**Table of Contents****Stock Ownership Guidelines**

We believe that stock ownership by executive officers can directly correlate to improved performance and enhancement of shareholder value. Therefore, the Committee has established recommended stock ownership guidelines for executive officers. The guidelines are as follows:

<b><u>Position</u></b>	<b><u>Guideline</u></b>
CEO	Three times base salary
Other Executive Officers	Two times base salary

Our executive officers are expected (but not required) to meet these guidelines within five years after becoming an executive officer. As of the end of 2006, all of our Named Executive Officers met these guidelines or are progressing towards meeting the guidelines within their initial 5-year term. As announced in November 2006, Mr. Hedrick told the Board of his intention to retire no later than 2009, and the Board commenced a search for his successor. As a result, Mr. Hedrick was permitted to begin a program of selling his shares in an orderly manner under stock trading plans pursuant to the requirements of Rule 10b5-1 under the Act. Following the completion of these sales, Mr. Hedrick will no longer meet the stock ownership guidelines.

**Impact of Accounting and Tax Treatment of Compensation**

Historically, the accounting and tax treatment of compensation has not been a driving factor in determining the design or amounts of pay at the Company. For example, the Company granted full value awards prior to its adoption of Financial Accounting Standards Board Statement No. 123R and continues to do so, although the Committee does review the expected accounting treatment of its equity grants.

Section 162(m) of the Code, generally limits the tax deductibility to public companies for compensation in excess of \$1 million per person per year, unless the compensation is performance-based within the meaning of the tax regulations. The Compensation Committee considers it important to retain flexibility to design compensation programs, even where compensation payable under our programs may not be fully deductible, if the programs effectively recognize a full range of criteria important to the Company's success. For example, the Company has not structured its annual cash bonus plan to be performance-based for purposes of Section 162(m), although for 2006, total cash compensation for each Named Executive Officer was below the \$1 million limit. The Company grants some equity awards (such as restricted stock) that are not eligible for the Section 162(m) exception. Our proposed Plan is intended to allow the Committee to approve performance shares and stock options that qualify as performance-based compensation for purposes of Section 162(m) to the extent the Committee deems appropriate.

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**COMPENSATION COMMITTEE REPORT**

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management and, based on such review and discussions, the Compensation Committee recommended to the Board of Directors that the Compensation and Discussion and Analysis be included in the Proxy Statement.

THE COMPENSATION COMMITTEE

James W. Cicconi, Chairman

Kenneth R. Heitz

Stephen N. Wertheimer

Charles A. Yamarone

Table of Contents**SUMMARY OF COMPENSATION**

The Summary Compensation Table sets forth the compensation paid or accrued by the Company for Gary R. Hedrick, the Principal Executive Officer, Scott D. Wilson, the Principal Financial Officer, and each of the Company's other three most highly compensated executive officers. The persons named in the Summary Compensation Table are referred to collectively as the Named Executives or the Named Executive Officers.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$) (b)	Option Awards (\$) (c)	Non-Equity Incentive Plan Compensation (\$) (d)	Change in Pension Value and Non-qualified Deferred Compensation Earnings (\$) (e)	All Other Compensation (\$) (f)	Total (\$) (g)
Gary R. Hedrick President and Chief Executive Officer(a)	2006	\$ 484,135		\$ 796,274	\$ 337,050	\$ 363,101	\$ 282,705	\$ 35,661	\$ 2,298,926
Scott D. Wilson Executive Vice President and Chief Financial Officer and Chief Administrative Officer	2006	269,308		155,001	72,300	152,664	22,038	18,403	689,714
Julius F. Bates Executive Vice President and Chief Operating Officer	2006	283,856		171,396	138,520	141,928	71,054	26,849	833,603
John A. Whitacre Vice President, System Operations and Planning	2006	184,277		84,541	127,920	67,491	55,298	17,230	536,757
Steven P. Busser Vice President, Treasurer and Chief Risk Officer	2006	173,575		56,281	72,300	63,572	7,044	17,343	390,115

(a) Mr. Hedrick is also a director of the Company, but receives no additional compensation for his service as a director.

(b) This column represents the dollar amount recognized as compensation expense for financial statement purposes with respect to 2006 for the fair value of restricted stock and performance shares granted in 2006 as well as prior fiscal years, in accordance with SFAS 123R. Restricted stock awards are valued at the closing market price on the date of grant. Performance shares are valued at target performance goals at grant date fair value which is based upon a Monte Carlo simulation, which is a methodology for determining average payout using different simulations. Amounts disclosed have not been reduced by estimated service-based forfeitures of approximately 15%. For additional information

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on the valuation assumptions with respect to restricted stock and performance shares see Note E - Common Stock of Notes to the Consolidated Financial Statements in the Company's 2006 Form 10-K.

- (c) This column represents the dollar amount recognized as compensation expense for financial statement reporting purposes with respect to the 2006 fiscal year for the fair value of stock options granted in 2006 as well as prior fiscal years, in accordance with SFAS 123R. Pursuant to SEC rules, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. For additional information on the valuation assumptions with respect to the 2006 grants, refer to Note E - Common Stock of Notes to the Consolidated Financial Statements in the Company's 2006 Form 10-K.
- (d) This column represents performance-based bonuses earned under the annual cash bonus plan for performance during 2006. Bonuses were paid based on the Company's achievement of earnings per share, safety and customer satisfaction goals.
- (e) This column represents the change in pension value between the accumulated pension benefit for each Named Executive Officer as of December 31, 2006 as compared to December 31, 2005.

**Table of Contents****2006 ALL OTHER COMPENSATION TABLE**

The following table describes each component of amounts included in All Other Compensation in the Summary Compensation Table above.

Name	Year	Accrued PTO	Group Term	Company	Personal	Other	Total
		Sellback	Life	Contributions	Use of		
		(\$)	Insurance	To Retirement And	Company		
		(a)	(\$)	401(k) Plans	Car/Parking	(\$)	(\$)
Gary R. Hedrick	2006	\$ 27,404	\$ 1,140	\$ 3,617	\$ 3,000	\$ 500	\$ 35,661
Scott D. Wilson	2006	8,215	588	6,600	3,000		18,403
Julius F. Bates	2006	16,067	1,182	6,600	3,000		26,849
John A. Whitacre	2006	6,954	676	6,600	3,000		17,230
Steven P. Busser	2006	6,550	131	6,367	3,000	1,295	17,343

(a) This column represents payments for accrued and unused vacation and personal holiday time pursuant to Company policy.



Table of Contents**GRANTS OF PLAN-BASED AWARDS**

The following table sets forth information concerning equity and cash awards to the Named Executive Officers during the fiscal year ended December 31, 2006:

Name	Grant Date	Estimated Possible Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Awards: Number of Shares of Stock or Units	All Other Awards: Number of Securities Underlying Options	Grant Date Fair Value of Stock and Option Awards
		Grant	Threshold	Target	Maximum	Threshold	Target			
		(\$)	(\$)	(\$)	(#)	(#)	(#)	(#)	(#)	(\$)
Gary R. Hedrick	03/09/06	\$ 72,620	\$ 290,481	\$ 508,342						
Gary R. Hedrick	02/23/06				7,770	25,900	51,800	7,500		\$ 631,633
Scott D. Wilson	03/09/06	\$ 26,931	\$ 121,189	\$ 215,446						
Scott D. Wilson	02/23/06				2,910	9,700	19,400	2,800		\$ 236,373
Julius F. Bates	03/09/06	\$ 28,386	\$ 113,542	\$ 198,699						
Julius F. Bates	02/23/06				1,590	5,300	10,600	1,500		\$ 128,531
John A. Whitacre	03/09/06	\$ 18,428	\$ 55,283	\$ 92,138						
John A. Whitacre	02/23/06				780	2,600	5,200	800		\$ 64,386
Steven P. Busser	03/09/06	\$ 17,358	\$ 52,073	\$ 86,788						
Steven P. Busser	02/23/06				660	2,200	4,400	650		\$ 53,921

(a) Each executive officer has a target incentive opportunity, payable in cash, if the Company achieves specific annual goals that are established in advance by the Compensation Committee and the Board of Directors. It is anticipated that the annual performance goals will be stretch goals based on the achievement of corporate objectives that will lead to enhanced shareholder value. In 2006, the performance goals were related to safety, customer satisfaction and earnings per share. If a certain level of earnings per share is not attained, no bonuses will be paid for any of the measures. Actual amounts paid for 2006 are in the Summary Compensation Table above.

(b) Amounts shown represent the performance shares available under the incentive plan which provides market-based, long-term incentive award opportunities to Named Executive Officers. Performance shares are based on the total shareholder return compared to industry peer companies over a three-year period. Payout values for the performance shares are calculated by determining the Company's percentile ranking within the Company peer group at the end of the three-year cycle and can range from 0% to 200% of target as described above in Compensation Discussion and Analysis Primary Components of Compensation Long Term Equity Incentives.

(c) Restricted shares vest at the end of three years.

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- (d) This column reflects the grant date fair value of restricted stock awards and performance shares under SFAS 123R. With respect to stock awards, the value was calculated as the number of restricted shares multiplied by the closing price on grant date. With respect to performance shares, the value was determined using a Monte Carlo simulation which is a methodology using the average payout of one million simulation paths discounted to the grant date using a risk-free interest rate.

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## OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

The following table sets forth information concerning outstanding equity awards held by the Named Executive Officers at December 31, 2006:

Name	Option Awards					Stock Awards			
	Number of Securities Underlying Unexercised Options (#)	Number of Securities Underlying Unexercised Options (#)	Number of Securities Underlying Unexercised Options (#)	Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
Gary R. Hedrick <sup>(1)</sup>	150,000	50,000		\$ 13.59	11/05/2011				
Gary R. Hedrick <sup>(3)(7)</sup>						10,000	\$ 243,700	36,600	\$ 891,942
Gary R. Hedrick <sup>(4)(8)</sup>						8,700	212,019	9,000	219,330
Gary R. Hedrick <sup>(5)(9)</sup>						7,500	182,775	7,770	189,355
Scott D. Wilson <sup>(1)</sup>	13,500	10,000		12.78	12/04/2013				
Scott D. Wilson <sup>(2)</sup>		10,000		12.78	12/04/2013				
Scott D. Wilson <sup>(4)(7)</sup>						900	21,933	3,200	77,984
Scott D. Wilson <sup>(6)(8)</sup>						5,000	121,850	900	21,933
Scott D. Wilson <sup>(5)(9)</sup>						2,800	68,236	2,910	70,917
Julius F. Bates	100,000			7.50	01/02/2008				
Julius F. Bates <sup>(1)</sup>	80,000	20,000		13.94	11/26/2011				
Julius F. Bates <sup>(4)(7)</sup>						2,500	60,925	10,400	253,448
Julius F. Bates <sup>(5)(8)</sup>						1,500	36,555	2,580	62,875
Julius F. Bates <sup>(9)</sup>								1,590	38,748
John A. Whitacre <sup>(1)</sup>	80,000	20,000		12.85	07/15/2012				
John A. Whitacre <sup>(4)(7)</sup>						1,200	29,244	5,200	126,724
John A. Whitacre <sup>(5)(8)</sup>						800	19,496	1,260	30,706

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John A. Whitacre <sup>(9)</sup>						780	19,009
Steven P. Busser <sup>(1)</sup>	30,000	10,000	12.78	12/04/2013			
Steven P. Busser <sup>(2)</sup>		10,000	12.78	12/04/2013			
Steven P. Busser <sup>(4)(7)</sup>					800	19,496	3,000 73,110
Steven P. Busser <sup>(5)(8)</sup>					650	15,841	780 19,009
Steven P. Busser <sup>(9)</sup>						660	16,084

(1) Unvested options vest on January 2, 2007

(2) Unvested options vest on January 2, 2008

(3) Unvested restricted stock vests on January 1, 2007

(4) Unvested restricted stock vests on December 31, 2007

(5) Unvested restricted stock vests on December 31, 2008

(6) Unvested restricted stock vests on May 4, 2008

(7) Unearned and unvested performance stock vests on January 1, 2007 if performance goals are met

(8) Unearned and unvested performance stock vests on January 1, 2008 if performance goals are met

(9) Unearned and unvested performance stock vests on January 1, 2009 if performance goals are met

Table of Contents**OPTION EXERCISES AND STOCK VESTED**

The table set forth below provides additional information regarding exercise of options, the acquisition of shares on vesting and the value realized during 2006.

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise	Value Realized on Exercised	Number of Shares Acquired on Vesting	Value Realized on Vesting
	(#)	(\$)	(#)	(\$)
Gary R. Hedrick	150,000	\$ 2,270,885	53,151	\$ 1,157,908
Scott D. Wilson	10,000	119,484	3,700	81,153
Julius F. Bates	100,000	1,548,259	12,458	272,896
John A. Whitacre			6,130	134,424
Steven P. Busser			3,475	76,234

**PENSION PLAN**

The Company has a defined benefit plan with a cliff vesting schedule that provides definitely determinable benefits over a period of years, usually an employee's lifetime (the Pension Plan). The purpose of the Pension Plan is to reward eligible employees for long and loyal service by providing them with retirement benefits and is for the exclusive benefit of eligible employees and their beneficiaries. Employees are eligible to participate in the Pension Plan on the first day of the month coincident with or immediately following completion of one year of service during which the employee completes not less than 1,000 hours of service. In order to vest or build ownership in the benefit payable from the Pension Plan, an employee must complete five years of service during which he or she has worked at least 1,000 hours each year. Each of the Named Executive Officers is a participant in the Pension Plan, and the estimated credited years of service for each of them at December 31, 2006 is set forth in the Pension Benefits Table below.

Retirement benefits under the Pension Plan are calculated as the product of 1.25% of the employee's average monthly earnings (Average Monthly Earnings) and the credited years of service (Benefit Accrual Service). An employee's Average Monthly Earnings is the employee's annualized rate of compensation (excluding bonuses, overtime pay, expense allowances, profit sharing and any other compensation in any form) as of any day converted to a monthly amount and then averaged over a five consecutive year period. The maximum benefit payable under the Pension Plan may not consider compensation in excess of that allowed by the Code. For the year 2006, the maximum amount of compensation on which benefits from the Pension Plan may be based is \$220,000. An employee is credited with one year of Benefit Accrual Service in any plan year (January through December) during which 1,000 hours of service is completed for the Company. The formula below provides an illustration as to how a monthly retirement benefit is calculated for an employee at the later of the date the employee attains the normal retirement age of 65 or the date the employee completes five years of vested service during which he or she has worked 1,000 hours each year:

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Pension Plan

Average Monthly Earnings	X	Benefit Accrual Service	X	1.25%
(Subject to Code limitations)				

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A monthly benefit from the Pension Plan is computed as a straight life only annuity that provides a monthly benefit for the employee's lifetime and ends upon the employee's death. Optional benefit forms of payment are also available under the Pension Plan to include:

A joint and survivor annuity option is a joint life annuity payable to the employee for the employee's lifetime with a survivor annuity for the life of any person the employee designates. The amount payable to the survivor will be a certain percentage of the amount that the employee elects of the amount of the annuity payable during the joint lives of the employee and the person the employee designates.

A life annuity with term certain option is payable for the employee's life, with 120 payments guaranteed, regardless of whether the employee dies before all 120 payments have been made. If the employee dies before all 120 payments have been made, the same amount of annuity is payable for the remainder of the 120 months to the employee's beneficiary.

Under the terms of the Pension Plan, an employee of the Company may retire and begin to receive a monthly benefit from the Pension Plan upon attaining age 55 and completing the required vesting period of five years during which the employee has worked 1,000 hours each year. If an employee retires from the Company between the ages of 55 and 64, the amount of benefits payable from the Pension Plan is reduced such that if the employee retires at age 55, he or she will be entitled to 50% of the accrued benefits otherwise payable without a reduction at age 65. The reduction schedule below displays the reduction percentage to which an employee's accrued benefit is subject when retirement from the Company takes effect between ages 55 and 64:

<u>Retirement Age</u>	<u>Percent of Accrued Benefit</u>
65	100.00%
64	93.33
63	86.67
62	80.00
61	73.33
60	66.67
59	63.33
58	60.00
57	56.67
56	53.33
55	50.00

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A monthly benefit payable from the Pension Plan any time before normal retirement age is not subject to the reduction schedule above when the employee's age and years of service are 62 and 20, respectively, or the sum of the employee's age and years of service exceeds 85 with a minimum age of 55. All benefit payments are subject to federal income tax and are payable on the first day of each month of retirement.

For the valuation method and all material assumptions, please see the Retirement Plan's section under Note K Employee Benefits of the Company's Form 10-K.

**EXCESS BENEFIT PLAN**

The Company has a non-qualified deferred compensation plan that provides supplemental retirement benefits to certain employees of the Company (the Excess Benefit Plan). The Company selects those employees who are eligible to receive a benefit from the Pension Plan, the amount of which is reduced by limitations of the Code. Additionally, the Excess Benefit Plan adds bonuses paid pursuant to the Company's short-term bonus plan to the Pension Plan definition of Average Monthly Earnings and without giving effect to any compensation limitations imposed by the Code. Benefits payable from the Excess Benefit Plan are subject to the same vesting schedule, age requirements and benefit payment options as under the Pension Plan. Except as noted under the heading Change in Control Agreement and Other Termination Benefits, it is not possible for an employee's credited years of service under the Pension Plan to exceed the employee's actual years of service with the Company.

Supplemental retirement benefits under the Excess Benefit Plan are calculated as a monthly amount equal to the difference between (a) and (b) below:

- (a) the monthly amount of the Pension Plan benefit to which the employee would have been entitled under the Pension Plan if the benefit were computed without giving effect to any limitation on benefits imposed by the Code and by using Average Monthly Earnings plus bonus amounts paid pursuant to the Company's Short-Term Bonus Plan

LESS

- (b) the monthly amount of the Pension Plan benefit actually payable to the employee under the Pension Plan.



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The formula below provides an illustration as to how a retirement benefit from the Excess Benefit Plan is calculated for an employee at the later of the date the employee attains the normal retirement age of 65 or the date the employee completes five years of vested service during which he or she has worked 1,000 hours each year:

Excess Benefit Plan				
Average Monthly Earnings	X	Benefit Accrual Service	X	1.25%
(Not subject to Code limitations)				
LESS				
Pension Plan				
Average Monthly Earnings	X	Benefit Accrual Service	X	1.25%
(Subject to Code limitations)				

The Excess Benefit Plan is subject to the rules of Section 409A of the Code. Generally, under Section 409A of the Code, distributions cannot be made to certain employees (as defined in Section 416(i) of the Code) of a publicly traded corporation before the earlier of (i) six months following the employee's separation date, or (ii) the death of the employee.

Pursuant to Section 409A, Excess Benefit Plan payments will begin six months after an affected employee's retirement from the Company. The first payment will be paid in a sum equal to six monthly payments from the employee's retirement date plus the employee's seventh month payment. Thereafter, the employee's benefit from the Excess Benefit Plan is payable on the first day of each month. The benefit payable from the Excess Benefit Plan is paid in the same form under which the benefit from the Pension Plan is payable to the employee. All payments are subject to federal income tax and are payable on the first day of each month of retirement.

The Excess Benefit Plan is entirely unfunded. Employees who participate in the Excess Benefit Plan have only the rights of a general unsecured creditor of the Company with respect to any rights under the Excess Benefit Plan.

**PENSION BENEFITS TABLE**

The table set forth below describes pension benefits to the Named Executive Officers under the Company's Pension Plan and the Excess Benefit Plan.

Name	Plan Name	Number of Years of Credited Service (#)	Present Value of Accumulated	Payments During Last Fiscal Year (\$)
------	-----------	--	---------------------------------	--

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		<u>Benefit (\$)</u>		
Gary R. Hedrick	Pension Plan	30	\$ 846,513	\$ 0
	Excess Benefit Plan	30	1,547,558	0
Julius F. Bates	Pension Plan	34.5	1,113,729	0
	Excess Benefit Plan	34.5	573,063	0
Scott D. Wilson	Pension Plan	3	39,506	0
	Excess Benefit Plan	3	10,450	0
John A. Whitacre	Pension Plan	34	896,747	0
	Excess Benefit Plan	34	138,101	0
Steven P. Busser	Pension Plan	5	33,561	0
	Excess Benefit Plan	5	2,948	0

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Assumptions used to compute the present value of accumulated benefit for each Named Executive Officer are as follows:

Discount rate of 5.9%

1994 Group Annuity Mortality Static Table for post-retirement mortality

## **Change in Control Agreements and Other Termination Benefits**

The Company has entered into change of control agreements (the Change of Control Agreements ) with each Named Executive Officer and certain other officers of the Company. In the event the covered officer is terminated without cause or resigns for good reason (including a material reduction in duties and responsibilities, a reduction in pay or a relocation of more than 100 miles) during the two-year period following a change of control, he or she will receive the following benefits under the Change of Control Agreements:

A pro rata payment of the officer s target bonus for the year of termination;

A lump sum payment equal to the officer s annual base salary plus target bonus for the year of termination, multiplied by either three (for Messrs. Hedrick, Bates, Wilson and Gutierrez) or two (for all other officers covered by a Change of Control Agreement);

The actuarial equivalent of vested benefits under the Company s retirement plan calculated with additional years of service equal to either three years (for Messrs. Hedrick, Bates, Wilson and Gutierrez) or two years (for all other officers covered by a Change of Control Agreement);

Continuation of health and other welfare benefits for two years, including service credit for those two years for purposes of eligibility (but not time of commencement of benefits) for retiree benefits under any of these plans; and

Outplacement services for one year.

In March 2007, the Change of Control Agreements were amended to eliminate a tax gross-up payment in the event the payments become subject to the federal change in control excise tax and instead provide that either (i) the executive will be responsible for paying the excise tax or (ii) payments under the agreements will be reduced to an amount that would result in no such excise tax, whichever would result in the executive retaining the higher after-tax amount.

A change of control is defined in the Change of Control Agreements and generally includes the acquisition by any person of 30% or more of the Common Stock or voting power of the Company, or the consummation of a reorganization, merger or consolidation or other disposition of all or substantially all of the assets of the Company which results in at least a 40% change in ownership.



**Table of Contents****POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE IN CONTROL TABLE**

The following table quantifies potential payments or benefits to our Named Executive Officers under our equity incentive plans upon a change in control or under the Change of Control Agreements upon a termination without cause or resignation for good reason following a change in control as described above, in any case based on assumptions as if the change in control or termination had occurred on December 31, 2006. These amounts do not include benefits under our Pension Plan and Excess Benefit Plan that would be paid in connection with any retirement event, as described under Pension Benefits Table above.

Name	Benefit	Change in Control without Termination	Qualifying Termination following a Change in Control <sup>(1)</sup>
<b>Gary R. Hedrick</b>	Severance		\$ 2,376,000
	Settlement of Unvested Equity Awards <sup>(2)</sup>	\$ 4,794,002	n/a
	Lump Sum Equivalent for Pension Service		916,213
	Welfare Benefit Continuation		27,494
	Outplacement		25,000
<b>Scott D. Wilson</b>	Severance		1,378,950
	Settlement of Unvested Equity Awards <sup>(2)</sup>	1,140,801	n/a
	Lump Sum Equivalent for Pension Service		
	Welfare Benefit Continuation		16,960
	Outplacement		25,000
<b>Julius F. Bates</b>	Severance		1,190,700
	Settlement of Unvested Equity Awards <sup>(2)</sup>	1,237,014	n/a
	Lump Sum Equivalent for Pension Service		566,419
	Welfare Benefit Continuation		19,474
	Outplacement		25,000
<b>John A. Whitacre</b>	Severance		487,708
	Settlement of Unvested Equity Awards <sup>(2)</sup>	737,296	n/a
	Lump Sum Equivalent for Pension Service		245,958
	Welfare Benefit Continuation		21,360
	Outplacement		25,000
<b>Steven P. Busser</b>	Severance		464,880
	Settlement of Unvested Equity Awards <sup>(2)</sup>	574,199	n/a
	Lump Sum Equivalent for Pension Service		33,062
	Welfare Benefit Continuation		22,444
	Outplacement		25,000

(1) Amounts in this table do not include the excise tax gross-up that, as described above, was eliminated in March 2007. At December 31, 2006, the estimated cost of this tax gross-up for each Named Executive Officer was \$2,920,238 for Mr. Hedrick, \$910,873 for Mr. Wilson, \$1,140,206 for Mr. Bates, \$497,863 for Mr. Whitacre, and \$345,760 for Mr. Busser.

(2) Represents the spread value of all unvested options, restricted stock and performance shares as of December 31, 2006, based on accelerated vesting of all awards upon a change in control under the terms of our equity incentive plan.



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**CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS**

**Compensation Committee Interlocks and Insider Participation**

During 2006, none of the Company's executive officers served on the compensation committee or board of another company, one of whose executive officers served on the Company's Board or Compensation Committee.

**Policies and Procedures**

The Nominating and Corporate Governance Committee of the Board of Directors is responsible for reviewing and approving all related party transactions. This procedure is set forth in writing in our Nominating and Corporate Governance Committee Charter. A copy of the charter may be found on the Company's internet website at [www.epelectric.com](http://www.epelectric.com). Related party transactions are those that involve any of our directors or executive officers, certain of our shareholders and their immediate family members.

To identify related party transactions, each year the Company submits and requires the directors and officers to complete director and officer questionnaires identifying transactions with the Company in which the director or officer or their family members have an interest. The Company reviews related party transactions due to the potential for a conflict of interest. A conflict of interest occurs when an individual's private interest interferes, or appears to interfere, in any way with the Company's interests. The Company's Code of Ethics requires all directors, officers and employees who may have a potential or apparent conflict of interest to immediately notify our General Counsel.

Directors, officers and employees of the Company are expected to act and make decisions that are in the best interests of the Company. Directors, officers and employees are prohibited from taking any action that may make it difficult for them to perform their duties, responsibilities and services for the Company in an objective and fair manner. In addition, the Company prohibits personal loans to, or guaranteeing the personal obligations of, any director or executive officer.

A copy of the Company's Code of Ethics is available at [www.epelectric.com](http://www.epelectric.com).

**Table of Contents****SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth, as of March 5, 2007 (except as indicated in the footnote to the table), certain information regarding ownership of Common Stock by (i) each person known to the Company to own beneficially more than 5% of its Common Stock; (ii) each of the current directors, including those who have been nominated to serve as Class I Directors of the Company; (iii) the persons who served as Chief Executive Officer and Chief Financial Officer of the Company during the year ended December 31, 2006; (iv) the top three most highly compensated employees other than the Chief Executive Officer and Chief Financial Officer; and (v) all directors and current officers of the Company as a group (26 persons).

<u>Name and Address of Beneficial Owner</u>	<u>Amount and Nature of Beneficial Ownership</u>	<u>Percent of Class</u>
Barclays Global Investors, N.A.  45 Fremont Street  San Francisco, California 94105	3,366,865 <sup>(1)</sup>	7.21%*
T. Rowe Price Associates, Inc.  100 E. Pratt Street  Baltimore, Maryland 21202	3,153,100 <sup>(2)</sup>	6.7%*
GAMCO Investors, Inc.  One Corporate Center  401 Theodore Fremd Avenue  Rye, NY 10580-1433	2,707,480 <sup>(3)</sup>	5.59%*
Wellington Management, Inc.  75 State Street  Boston, MA 02109	2,613,837 <sup>(4)</sup>	5.60%*
George W. Edwards, Jr.	222,222 <sup>(5)</sup>	**
John Robert Brown	16,500 <sup>(6)</sup>	**
James W. Cicconi	33,779 <sup>(7)</sup>	**
Ramiro Guzmán	41,643 <sup>(8)</sup>	**
James W. Harris	55,040 <sup>(9)</sup>	**
Kenneth R. Heitz	63,322 <sup>(10)</sup>	**
Patricia Z. Holland-Branch	21,889 <sup>(11)</sup>	**
Michael K. Parks	50,879 <sup>(12)</sup>	**
Eric B. Siegel	47,299 <sup>(13)</sup>	**
Stephen N. Wertheimer	27,711 <sup>(14)</sup>	**
Charles A. Yamarone	17,794 <sup>(15)</sup>	**
Gary R. Hedrick	41,545 <sup>(16)</sup>	**
Scott D. Wilson	35,942 <sup>(17)</sup>	**



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Julius F. Bates	198,771 <sup>(18)</sup>	**
John A. Whitacre	114,013 <sup>(19)</sup>	**
Steven P. Busser	45,357 <sup>(20)</sup>	**
Other Executive Officers	296,430 <sup>(21)</sup>	**
All directors and executive officers as a group	1,330,136 <sup>(22)</sup>	2.84%

(26 persons)

\* Actual percentage may differ due to stock transactions made subsequent to beneficial owner's filing date.

\*\* Less than 1%.

(1) Information regarding ownership of Common Stock by Barclays Global Investors, NA., ( Barclays Global ) Barclays Global Fund Advisors ( Barclays Advisors ), and Barclays Global, LTD ( Barclays Investors (collectively, the Barclays Reporting Parties )) is included in reliance on information set forth in a Schedule 13-G filed with the SEC on January 23, 2007,

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reflecting ownership as of December 31, 2006. Barclays Global is listed as a bank pursuant to Rule 13d-1(b) of the Act, and as defined in Section 3(a)(6) of the Act (15 U.S.C. 78c). Barclays Advisors is an Investment Advisor pursuant to Rule 13d-1(b) as defined in Section 240.13d(b)(1)(ii)(E) of the Act. According to the filing, Barclays Global beneficially owns 1,843,693 shares (3.95%) of Common Stock with sole voting and dispositive power over 1,691,777 reporting shares. Barclays Advisors owns 1,493,460 shares (3.20%) of Common Stock with sole voting and dispositive power. Barclays Investors, LTD owns 29,712 shares (0.06%) of Common Stock with sole voting and dispositive power. The aggregate amount beneficially owned by the Barclays Reporting Parties is 3,366,865 (7.21%) shares of Common Stock with sole voting and dispositive power over 3,214,949 shares of Common Stock.

- (2) Information regarding ownership of Common Stock by T. Rowe Price Associates, Inc. ( Price Associates ) is included herein in reliance on information set forth in Amendment No. 3 in Schedule 13-G filed on February 13, 2007, with the SEC, reflecting ownership as of December 31, 2006. According to the filing, Price Associates beneficially owns 3,153,100 (6.7%) shares of Common Stock as of December 31, 2006. Price Associates maintains sole dispositive power over their shares of the Company s Common Stock, but only has the power to vote 867,100 reported shares of Common Stock.
- (3) Information regarding ownership of Common Stock by GGCP, Inc. formerly known as Gabelli Group Capital Partners, Inc. ( GGCP ), GAMCO Investors, Inc. formerly known as Gabelli Asset Management Inc. ( GBL ), Gabelli Funds, LLC ( Gabelli Funds ), GAMCO Asset Management Inc. formerly known as GAMCO Investors, Inc. ( GAMCO ), Gabelli Advisers, Inc. ( Gabelli Advisers ) Gabelli Securities, Inc. ( GSI ), Gabelli & Company, Inc. ( Gabelli & Company ), MJG Associates, Inc. ( MJG Associates ), Gabelli Foundation, Inc. ( Foundation ), Mario Gabelli, and Interactive (collectively the Gabelli Reporting Parties ) is included herein in reliance on information set forth on Amendment No. 7 in Schedule 13-D filed with the SEC, reflecting ownership as of October 27, 2006. Updated ownership information is included herein in reliance on IR Channel information of Gabelli s ownership as of December 31, 2006. Pursuant to Rule 13d-2(b), Gabelli was not required to file an amended Schedule 13-D for the year ended 2006. GGCP is the parent company of GBL. GBL is the parent company for a variety of companies engaged in the securities business, including GAMCO, Gabelli Funds, Gabelli Advisers and GSI. GSI is an investment manager and the parent company of Gabelli & Company, and Gabelli & Company is a registered broker-dealer under the Act. GAMCO and Gabelli Funds are each investment advisers, and GAMCO and Gabelli Funds are each registered under the Investment Advisers Act of 1940. GGCP, GBL, GAMCO and Gabelli & Company are New York corporations. GSI, Gabelli Advisers and Interactive are Delaware corporations, and Gabelli Funds is a New York limited liability corporation. MJG Associates is a Connecticut corporation, and the Foundation is a Nevada corporation. Mario J. Gabelli is the majority shareholder and Chief Executive Officer of GGCP and GBL and Chief Investment Officer for each of the Reporting Parties. The Gabelli Reporting Parties do not admit that they constitute a group.

According to the filing, Gabelli Funds beneficially owns 1,203,500 shares of Common Stock (2.48%) and has sole voting and dispositive power over the shares, and GAMCO beneficially owns 1,503,980 shares (3.10%) and maintains sole dispositive power over 1,503,980 shares, but only has the power to vote 1,439,730 shares of Common Stock. According to the filing, the aggregate amount beneficially owned by the Gabelli Reporting Parties is 2,707,480 shares (5.59% per the 10/27/06 filing). According to IR Channel, Gabelli owned 2,624,230 shares (or 5.71%) of Common Stock as of December 31, 2006.

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Mario Gabelli is deemed to have beneficial ownership of the Common Stock owned by each of the Reporting Parties. GSI is deemed to have beneficial ownership of the Common Stock owned by Gabelli & Company. GBL and GGCP are deemed to have beneficial ownership of the Common Stock owned beneficially by each of the foregoing persons other than Mario Gabelli and the Foundation.

- (4) Information regarding ownership of Common Stock by Wellington Management Company, LLP ( Wellington Management ) is included herein in reliance on information set forth in a Schedule 13-G filed with the SEC on February 14, 2007, reflecting ownership as of December 31, 2006. Wellington Management is an Investment Advisor in accordance with Rule 13d-1(b) as defined in Section 240.13d(b)(1)(ii)(E) of the Act. According to the filing, Wellington Management beneficially owns 2,613,837 shares (5.60%) of Common Stock with shared dispositive power over 2,565,937 shares, but only has shared power to vote 1,605,900 shares of Common Stock.
- (5) Includes (i) 10,000 shares of Common Stock that Mr. Edwards has the right to acquire by exercising options granted under the 1996 Long-Term Incentive Plan (the 1996 Plan ); (ii) 201,376 shares over which he has sole voting and investment power; and (iii) 10,846 shares over which he has voting power but no investment power.
- (6) Includes (i) 13,000 shares of Common Stock over which Mr. Brown has sole voting and investment power; and (ii) 3,500 shares over which he has voting power but no investment power.
- (7) Includes (i) 5,000 shares of Common Stock that Mr. Cicconi has the right to acquire by exercising options granted under the 1996 Plan; (ii) 25,279 shares over which he has sole voting and investment power; and (iii) 3,500 shares over which he has voting power but no investment power.
- (8) Includes (i) 5,000 shares of Common Stock that Mr. Guzmán has the right to acquire by exercising options granted under the 1996 Plan; (ii) 33,143 shares over which he has sole voting and investment power; and (iii) 3,500 shares over which he has voting power but no investment power.
- (9) Includes (i) 10,000 shares of Common Stock that Mr. Harris has the right to acquire by exercising options granted under the 1996 Plan; (ii) 41,540 shares over which he has sole voting and investment power; and (iii) 3,500 shares over which he has voting power but no investment power.
- (10) Includes (i) 12,948 shares of Common Stock that Mr. Heitz has the right to acquire by exercising options granted under the 1996 and 1999 Plans; (ii) 44,002 shares over which he has sole voting and investment power; and (iii) 6,372 shares over which he has voting power but no investment power.
- (11) Includes (i) 5,000 shares of Common Stock that Ms. Holland-Branch has the right to acquire by exercising options granted under the 1996 Plan; (ii) 10,811 shares over which she has sole voting and investment power; and (iii) 6,078 shares over which she has voting power but no investment power.
- (12) Includes (i) 10,000 shares of Common Stock that Mr. Parks has the right to acquire by exercising options granted under the 1996 Plan; (ii) 32,225 shares over which he has sole voting and investment power; and (iii) 8,654 shares over which he has voting power but no investment power.

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- (13) Includes (i) 10,000 shares of Common Stock that Mr. Siegel has the right to acquire by exercising options granted under the 1996 Plan; (ii) 33,799 shares over which he has sole voting and investment power; and (iii) 3,500 shares over which he has voting power but no investment power.
- (14) Includes (i) 5,000 shares of Common Stock that Mr. Wertheimer has the right to acquire by exercising options granted under the 1996 Plan; (ii) 19,211 shares over which he has sole voting and investment power; and (iii) 3,500 shares over which he has voting power but no investment power.
- (15) Includes (i) 10,000 shares of Common Stock that Mr. Yamarone has the right to acquire by exercising options granted under the 1996 Plan; (ii) 4,294 shares over which he has sole voting and investment power; and (iii) 3,500 shares over which he has voting power but no investment power.
- (16) Includes (i) 25,345 shares of Common Stock that Mr. Hedrick has sole voting and investment power; and (ii) 16,200 shares over which he has voting power but no investment power.
- (17) Includes (i) 23,500 shares of Common Stock that Mr. Wilson has the right to acquire by exercising options granted under the 1999 Plan; (ii) 3,742 shares over which he has sole voting and investment power; and (iii) 8,700 shares over which he has voting power but no investment power.
- (18) Includes (i) 160,000 shares of Common Stock that Mr. Bates has the right to acquire by exercising options granted under the 1996 and 1999 Plans; (ii) 34,771 shares over which he has sole voting and investment power; and (iii) 4,000 shares over which he has voting power but no investment power.
- (19) Includes (i) 100,000 shares of Common Stock that Mr. Whitacre has the right to acquire by exercising options granted under the 1999 Plan; (ii) 12,013 shares over which he has sole voting and investment power; and (iii) 2,000 shares over which he has voting power but no investment power.
- (20) Includes (i) 40,000 shares of Common Stock that Mr. Busser has the right to acquire by exercising options granted under the 1999 Plan; (ii) 3,907 shares over which he has sole voting and investment power; and (iii) 1,450 shares over which he has voting power but no investment power.
- (21) Includes (i) 255,000 shares of Common Stock that other officers currently have the right to acquire by exercising options granted under the 1996 and 1999 Plans; (ii) 30,780 shares over which the officers have sole voting and investment power; and (iii) 10,650 shares over which they have voting power but no investment power.
- (22) Includes (i) 661,448 shares of Common Stock related to stock options discussed above; (ii) 569,238 shares over which the directors and officers have sole voting and investment power; and (iii) 99,450 shares over which they have voting power but no investment power.

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**AUDIT COMMITTEE REPORT**

The Audit Committee assists the Board of Directors in reviewing the Company's financial reporting process. In fulfilling its responsibilities in 2006, the Audit Committee, among other things, (1) reviewed and discussed the interim financial information contained in each quarterly earnings announcement with the Company's Chief Financial Officer and independent auditors prior to public release; (2) reviewed and discussed the audited financial information contained in the Annual Report with the Company's management, including the Chief Financial Officer and independent auditors prior to public release; (3) obtained from the independent auditors a formal written statement describing all relationships between the auditors and the Company that might bear on the auditors' independence consistent with Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees; (4) discussed with the auditors any relationships that may impact their objectivity and independence, and satisfied itself as to the auditors' independence; (5) discussed with management, the internal auditors and the independent auditors the quality and adequacy of the Company's internal controls and the internal audit function's organization, responsibilities, budget and staffing; and (6) reviewed with both, the independent and the internal auditors, their audit plans, audit scope, and identification of audit risks.

In addition, the Audit Committee discussed and reviewed with the independent auditors all communications required by generally accepted accounting standards, including those described in Statement on Auditing Standards No. 61, as amended, Communication with Audit Committees and, with and without management present, discussed and reviewed the results of the independent auditors' examination of the financial statements. The Audit Committee also reviewed the results of the internal audit examinations.

The Audit Committee reviewed the audited financial statements of the Company as of and for the fiscal year ended December 31, 2006, with management and the independent auditors. Management is responsible for the preparation of the Company's financial statements and the independent auditors are responsible for the examination of those statements.

Based on the above-mentioned review and discussions with management and the independent auditors, the Audit Committee recommended to the Board of Directors that the Company's audited financial statements be included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006, for filing with the SEC. The Audit Committee also recommended the reappointment of KPMG LLP as the Company's independent auditors, and the Board of Directors concurred in such recommendation.

Submitted by the Audit Committee of the Company's Board of Directors:

Charles A. Yamarone Chairman

John Robert Brown

James W. Cicconi

Michael K. Parks

Eric B. Siegel



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**SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Act requires the Company's directors, officers and holders of more than 10% of the Company's Common Stock to file with the SEC initial reports of ownership and reports of changes in ownership of Common Stock and other equity securities of the Company. The Company believes that, during and for the fiscal year ended December 31, 2006, its directors, officers and 10% shareholders complied with all Section 16(a) filing requirements.

**SHAREHOLDER PROPOSALS AND NOMINATIONS**

Under certain circumstances, shareholders are entitled to present proposals at shareholders meetings. To be eligible for inclusion in the Proxy Statement for the Company's 2008 annual meeting of shareholders, a shareholder proposal must be received at the Company's principal executive offices on or prior to December 1, 2007. The Company will consider only those proposals which meet the requirements of applicable SEC rules. Under the Company's Bylaws, in order for a shareholder proposal that is not included in the Proxy Statement to be properly brought before the annual meeting of shareholders, notice of the proposal must be received at the Company's principal executive offices at least 80 days prior to the scheduled date of the annual meeting. A shareholder's notice should list each proposal and a brief description of the business to be brought before the meeting; the name and address of the shareholder proposing such business; the class and number of shares held by the shareholder; and any material interest of the shareholder in the business. If a shareholder wishes to nominate a director, the shareholder must provide the nomination to the Nominating and Corporate Governance Committee in writing at the Company's principal offices pursuant to the notice provisions provided in the Company's Bylaws.

**OTHER BUSINESS**

The Board of Directors knows of no business, other than as stated in the Notice of Annual Meeting of Shareholders, which will be presented for consideration at the Annual Meeting. If, however, other matters are properly brought before the Annual Meeting, it is the intention of the persons named in the accompanying form of proxy to vote the shares represented thereby on such matters in accordance with their discretion and judgment as to the best interests of the Company.

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**ANNUAL REPORT**

The Company's 2006 Annual Report, which includes financial statements, but which does not constitute a part of the proxy solicitation material, accompanies this Proxy Statement.

**SARBANES-OXLEY SECTION 302 CERTIFICATION**

On February 28, 2007, the Company filed with the SEC, as an exhibit to its Form 10-K, the Sarbanes-Oxley Act Section 302 certification regarding the quality of the Company's public disclosure.

**DELIVERY OF ADDITIONAL COPIES OF PROXY STATEMENT**

One Proxy Statement will be sent to shareholders sharing the same address. However, additional copies may be obtained by contacting, via oral or written communication, the Company at (915) 543-5711, 100 N. Stanton, El Paso, Texas 79901. If any shareholders are receiving multiple Proxy Statements and would rather receive a single Proxy Statement, a request may be submitted to the telephone number and/or address listed in the immediately preceding sentence.

EL PASO ELECTRIC COMPANY

By Order of the Board of Directors

Guillermo Silva, Jr.

Corporate Secretary

Dated: March 26, 2007



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**EXHIBIT A**

**El Paso Electric Company  
2007 Long-Term Incentive Plan**

**Effective May 2, 2007**

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### El Paso Electric Company 2007 Long-Term Incentive Plan

#### Article 1. Establishment, Purpose, and Duration

**1.1 Establishment.** El Paso Electric Company, a Texas corporation (hereinafter referred to as the Company ), establishes an incentive compensation plan to be known as the El Paso Electric Company 2007 Long-Term Incentive Plan (hereinafter referred to as the Plan ), as set forth in this document.

This Plan permits the grant of Non-qualified Stock Options, Incentive Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Shares, Performance Units, Cash-Based Awards, and Other Stock-Based Awards.

This Plan shall become effective upon shareholder approval (the Effective Date ) and shall remain in effect as provided in Section 1.3 hereof.

**1.2 Purpose of this Plan.** The purpose of this Plan is to provide a means whereby Employees and Directors of the Company develop a sense of proprietorship and personal involvement in the development and financial success of the Company, and to encourage them to devote their best efforts to the business of the Company, thereby advancing the interests of the Company and its shareholders. A further purpose of this Plan is to provide a means through which the Company may attract able individuals to become Employees or serve as Directors of the Company and to provide a means whereby those individuals can acquire and maintain stock ownership, thereby strengthening their concern for the welfare of the Company.

**1.3 Duration of this Plan.** Unless sooner terminated as provided herein, this Plan shall terminate ten (10) years from the Effective Date. After this Plan is terminated, no Awards may be granted but Awards previously granted shall remain outstanding in accordance with their applicable terms and conditions and this Plan's terms and conditions. Notwithstanding the foregoing, no Incentive Stock Options may be granted more than ten (10) years after the earlier of: (a) adoption of this Plan by the Board, or (b) the Effective Date.

#### Article 2. Definitions

Whenever used in this Plan, the following terms shall have the meanings set forth below, and when the meaning is intended, the initial letter of the word shall be capitalized:

- 2.1 Affiliate** shall mean any corporation or other entity (including, but not limited to, a partnership or a limited liability company) that is affiliated with the Company through stock or equity ownership or otherwise, and is designated as an Affiliate for purposes of this Plan by the Committee. For purposes of granting stock options or stock appreciation rights, an entity may not be considered an Affiliate if it results in noncompliance with Code Section 409A.



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- 2.2 Annual Award Limit** or **Annual Award Limits** have the meaning set forth in Section 4.3.
- 2.3 Award** means, individually or collectively, a grant under this Plan of Non-qualified Stock Options, Incentive Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Shares, Performance Units, Cash-Based Awards, or Other Stock-Based Awards, in each case subject to the terms of this Plan.
- 2.4 Award Agreement** or **Agreement** means either: (i) a written agreement entered into by the Company and a Participant setting forth the terms and provisions applicable to an Award granted under this Plan, or (ii) a written statement issued by the Company to a Participant describing the terms and provisions of such Award, including any amendment or modification thereof. The Committee may provide for the use of electronic, Internet, or other nonpaper Award Agreements, and the use of electronic, Internet, or other nonpaper means for the acceptance thereof and actions thereunder by a Participant.
- 2.5 Beneficial Owner** or **Beneficial Ownership** shall have the meaning ascribed to such term in Rule 13d-3 of the General Rules and Regulations under the Exchange Act.
- 2.6 Board** or **Board of Directors** means the Board of Directors of the Company.
- 2.7 Cash-Based Award** means an Award, denominated in cash, granted to a Participant as described in Article 10.
- 2.8 Change in Control** means any of the following events:
- (a) The acquisition by any individual, entity, or group (a **Person**), including any person within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act, of beneficial ownership within the meaning of Rule 13d-3 promulgated under the Exchange Act, of thirty percent (30%) or more of either: (i) the then outstanding shares of common stock of the Company (the **Outstanding Company Common Stock**), or (ii) the combined voting power of the then outstanding securities of the Company entitled to vote generally in the election of directors (the **Outstanding Company Voting Securities**); excluding, however, the following: (A) any acquisition directly from the Company (excluding any acquisition resulting from the exercise of an exercise, conversion, or exchange privilege unless the security being so exercised, converted, or exchanged was acquired directly from the Company); (B) any acquisition by the Company; (C) any acquisition by an employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company; or (D) any acquisition by any corporation pursuant to a transaction which complies with clauses (i), (ii), and (iii) of subsection (c) of this Section 2.8.

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- (b) Individuals who, as of the Effective Date, constitute the Board of Directors (the Incumbent Board ) cease for any reason to constitute at least a majority of such Board; provided that any individual who becomes a director of the Company subsequent to the Effective Date whose election, or nomination for election by the Company s shareholders, was approved by the vote of at least a majority of the directors then comprising the Incumbent Board shall be deemed a member of the Incumbent Board; and provided further, that any individual who was initially elected as a director of the Company as a result of an actual or threatened election contest, as such terms are used in Rule 14a-11 of Regulation 14A promulgated under the Exchange Act, or any other actual or threatened solicitation of proxies or consents by or on behalf of any Person other than the Board shall not be deemed a member of the Incumbent Board;
- (c) Consummation of a shareholder-approved reorganization, merger, or consolidation of the Company or sale or other disposition of all or substantially all of the assets of the Company (a Corporate Transaction ); excluding, however, a Corporate Transaction pursuant to which: (i) all or substantially all of the individuals or entities who are the beneficial owners, respectively, of the Outstanding Company Stock and the Outstanding Company Voting Securities immediately prior to such Corporate Transaction will beneficially own, directly or indirectly, more than sixty percent (60%) of, respectively, the outstanding shares of common stock, and the combined voting power of the outstanding securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Corporate Transaction (including, without limitation, a corporation which as a result of such transaction owns the Company or all or substantially all of the Company s assets either directly or indirectly) in substantially the same proportions relative to each other as their ownership, immediately prior to such Corporate Transaction, of the Outstanding Company Common Stock and the Outstanding Company Voting Securities, as the case may be; (ii) no Person (other than: the Company; any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company; the corporation resulting from such Corporate Transaction; and any Person which beneficially owned, immediately prior to such Corporate Transaction, directly or indirectly, thirty percent (30%) or more of the Outstanding Company Common Stock or the Outstanding Company Voting Securities, as the case may be) will beneficially own, directly or indirectly, thirty percent (30%) or more of, respectively, the outstanding shares of common stock of the corporation resulting from such Corporate Transaction or the combined voting power of the outstanding securities of such corporation entitled to vote generally in the election of directors; and (iii) individuals who were members of the Incumbent Board will constitute at least a majority of the members of the board of directors of the corporation resulting from such Corporate Transaction; or

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- (d) Approval by the shareholders of the Company of a plan of complete liquidation or dissolution of the Company.

Notwithstanding the foregoing, in no event shall a **Change in Control** be deemed to have occurred as a result of the formation of a Holding Company. For the purposes hereof, **Holding Company** shall mean an entity that becomes a holding company for the Company or its businesses as a part of any reorganization, merger, consolidation, or other transaction, provided that the outstanding shares of common stock of such entity and the combined voting power of such entity entitled to vote generally in the election of directors is, immediately after such reorganization, merger, consolidation, or other transaction, beneficially owned, directly or indirectly, by all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Company Voting Securities immediately prior to such reorganization, merger, consolidation, or other transaction in substantially the same proportions as their ownership, immediately prior to such reorganization, merger, consolidation, or other transaction, of such Outstanding Company Voting Securities.

- 2.9 Code** means the U.S. Internal Revenue Code of 1986, as amended from time to time. For purposes of this Plan, references to sections of the Code shall be deemed to include references to any applicable regulations thereunder and any successor or similar provision.
- 2.10 Committee** means the Compensation Committee of the Board or a subcommittee thereof, or any other committee designated by the Board to administer this Plan. The members of the Committee shall be appointed from time to time by and shall serve at the discretion of the Board. If the Committee does not exist or cannot function for any reason, the Board may take any action under the Plan that would otherwise be the responsibility of the Committee.

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- 2.11 Company** means El Paso Electric Company, a Texas corporation, and any successor thereto as provided in Article 20 herein.
- 2.12 Covered Employee** means any key Employee who is or may become a Covered Employee, as defined in Code Section 162(m), and who is designated by the Committee as a Covered Employee under this Plan for such applicable Performance Period.
- 2.13 Director** means any individual who is a member of the Board of Directors of the Company.
- 2.14 Disability** means the inability of the holder of an award to perform substantially such holder's duties and responsibilities for a continuous period of at least six months, as determined solely by the Committee.
- 2.15 Effective Date** has the meaning set forth in Section 1.1.
- 2.16 Employee** means any individual designated as an employee of the Company, its Affiliates, and/or its Subsidiaries on the payroll records thereof.
- 2.17 Exchange Act** means the Securities Exchange Act of 1934, as amended from time to time, or any successor act thereto.
- 2.18 Fair Market Value** or **FMV** means a price that is based on the opening, closing, actual, high, low, or average selling prices of a Share reported on the New York Stock Exchange or other established stock exchange (or exchanges) on the applicable date, the preceding trading day, the next succeeding trading day, or an average of trading days, as determined by the Committee in its discretion. Unless the Committee determines otherwise, Fair Market Value shall be deemed to be equal to the closing price of a Share on the most recent date on which Shares were publicly traded. In the event Shares are not publicly traded at the time a determination of their value is required to be made hereunder, the determination of their Fair Market Value shall be made by the Committee in such manner as it deems appropriate, provided that in the case of stock options and stock appreciation rights, such determination shall be made in compliance with Code Section 409A. Such definition(s) of FMV shall be specified in each Award Agreement and may differ depending on whether FMV is in reference to the grant, exercise, vesting, settlement, or payout of an Award.
- 2.19 Full-Value Award** means an Award other than in the form of an ISO, NQSO, or SAR, and which is settled by the issuance of Shares.



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- 2.20 Grant Price** means the price established at the time of grant of an SAR pursuant to Article 7, used to determine whether there is any payment due upon exercise of the SAR.
- 2.21 Incentive Stock Option** or **ISO** means an Option to purchase Shares granted under Article 6 to an Employee and that is designated as an Incentive Stock Option and that is intended to meet the requirements of Code Section 422, or any successor provision.
- 2.22 Insider** shall mean an individual who is, on the relevant date, an officer or Director of the Company, or a more than ten percent (10%) Beneficial Owner of any class of the Company's equity securities that is registered pursuant to Section 12 of the Exchange Act, as determined by the Board in accordance with Section 16 of the Exchange Act.
- 2.23 Non-employee Director** means a Director who is not an Employee.
- 2.24 Non-employee Director Award** means any NQSO, SAR, or Full-Value Award granted, whether singly, in combination, or in tandem, to a Participant who is a Non-employee Director pursuant to such applicable terms, conditions, and limitations as the Board or Committee may establish in accordance with this Plan.
- 2.25 Non-qualified Stock Option** or **NQSO** means an Option that is not intended to meet the requirements of Code Section 422, or that otherwise does not meet such requirements.
- 2.26 Option** means an Incentive Stock Option or a Non-qualified Stock Option, as described in Article 6.
- 2.27 Option Price** means the price at which a Share may be purchased by a Participant pursuant to an Option.
- 2.28 Other Stock-Based Award** means an equity-based or equity-related Award not otherwise described by the terms of this Plan, granted pursuant to Article 10.
- 2.29 Participant** means any eligible individual as set forth in Article 5 to whom an Award is granted.
- 2.30 Performance-Based Compensation** means compensation under an Award that is intended to satisfy the requirements of Code Section 162(m) for certain performance-based compensation paid to Covered Employees. Notwithstanding the foregoing, nothing in this Plan shall be construed to mean that an Award which does not satisfy the requirements for performance-based compensation under Code Section 162(m) does not constitute performance-based compensation for other purposes, including Code Section 409A.

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- 2.31 Performance Measures** means measures as described in Article 12 on which the performance goals are based and which are approved by the Company's shareholders pursuant to this Plan in order to qualify Awards as Performance-Based Compensation.
- 2.32 Performance Period** means the period of time during which the performance goals must be met in order to determine the degree of payout and/or vesting with respect to an Award.
- 2.33 Performance Share** means an Award under Article 9 herein and subject to the terms of this Plan, denominated in Shares, the value of which at the time it is payable is determined as a function of the extent to which corresponding performance criteria have been achieved.
- 2.34 Performance Unit** means an Award under Article 9 herein and subject to the terms of this Plan, denominated in units, the value of which at the time it is payable is determined as a function of the extent to which corresponding performance criteria have been achieved.
- 2.35 Period of Restriction** means the period when Restricted Stock or Restricted Stock Units are subject to a substantial risk of forfeiture (based on the passage of time, the achievement of performance goals, or upon the occurrence of other events as determined by the Committee, in its discretion), as provided in Article 8.
- 2.36 Plan** means the El Paso Electric Company 2007 Long-Term Incentive Plan.
- 2.37 Plan Year** means the calendar year.
- 2.38 Prior Plans** means the El Paso Electric Company 1999 Long-Term Incentive Plan and the El Paso Electric Company 1996 Long-Term Incentive Plan.
- 2.39 Restricted Stock** means an Award granted to a Participant pursuant to Article 8.
- 2.40 Restricted Stock Unit** means an Award granted to a Participant pursuant to Article 8, except no Shares are actually awarded to the Participant on the date of grant.

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- 2.41 Share** means a share of common stock of the Company, no par value per share.
- 2.42 Stock Appreciation Right** or **SAR** means an Award, designated as an SAR, pursuant to the terms of Article 7 herein.
- 2.43 Subsidiary** means any corporation or other entity, whether domestic or foreign, in which the Company has or obtains, directly or indirectly, a proprietary interest of more than fifty percent (50%) by reason of stock ownership or otherwise.

**Article 3. Administration**

**3.1 General.** The Committee shall be responsible for administering this Plan, subject to this Article 3 and the other provisions of this Plan. The Committee may employ attorneys, consultants, accountants, agents, and other individuals, any of whom may be an Employee, and the Committee, the Company, and its officers and Directors shall be entitled to rely upon the advice, opinions, or valuations of any such individuals. All actions taken and all interpretations and determinations made by the Committee shall be final and binding upon the Participants, the Company, and all other interested individuals.

**3.2 Authority of the Committee.** The Committee shall have full and exclusive discretionary power to interpret the terms and the intent of this Plan and any Award Agreement or other agreement or document ancillary to or in connection with this Plan, to determine eligibility for Awards and to adopt such rules, regulations, forms, instruments, and guidelines for administering this Plan as the Committee may deem necessary or proper. Such authority shall include, but not be limited to, selecting Award recipients, establishing all Award terms and conditions, including the terms and conditions set forth in Award Agreements, determining whether, to what extent, and under what circumstances Awards may be settled or exercised and the method or methods by which Awards may be settled, exercised, cancelled, forfeited, or suspended, granting Awards as an alternative to or as the form of payment for grants or rights earned or due under compensation plans or arrangements of the Company, construing any ambiguous provision of the Plan or any Award Agreement, and, subject to Article 18, adopting modifications and amendments to this Plan or any Award Agreement, including without limitation, any that are necessary to comply with the laws of the countries and other jurisdictions in which the Company, its Affiliates, and/or its Subsidiaries operate.

**3.3 Delegation.** The Committee may delegate to one or more of its members or to one or more officers of the Company and/or its Subsidiaries and Affiliates, or to one or more agents or advisors such administrative duties or powers as it may deem advisable, and the Committee or any individuals to whom it has delegated duties or powers as aforesaid may employ one or more individuals to render advice with respect to any responsibility the Committee or such individuals may have under this Plan.

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### **Article 4. Shares Subject to This Plan and Maximum Awards**

#### **4.1 Number of Shares Available for Awards.**

- (a) Subject to adjustment as provided in Section 4.4, the maximum number of Shares available for grant to Participants under this Plan on or after the Effective Date shall be one million (1,000,000) Shares (the **Share Authorization** ), which shall consist of: any Shares subject to the outstanding awards as of the Effective Date under the Prior Plans that on or after the Effective Date cease for any reason to be subject to such awards (other than by reason of exercise or settlement of the awards to the extent they are exercised for or settled in vested and nonforfeitable Shares).
- (b) No more than one million (1,000,000) Shares of the Share Authorization may be issued pursuant to Full-Value Awards.
- (c) The maximum number of Shares of the Share Authorization that may be issued pursuant to ISOs under this Plan shall be one million (1,000,000) Shares.

**4.2 Share Usage.** Shares covered by an Award shall be counted as used as of the date of grant. Any Shares related to Awards under this Plan or under Prior Plans which terminate by expiration, forfeiture, cancellation, or otherwise without the issuance of such Shares, are settled in cash in lieu of Shares, or are exchanged with the Committee's permission, prior to the issuance of Shares, for Awards not involving Shares, shall be available again for grant under this Plan. Moreover, if the Option Price of any Option granted under this Plan or the tax withholding requirements with respect to any Award granted under this Plan are satisfied by tendering Shares to the Company (by either actual delivery or by attestation), such tendered Shares shall again be available for grant under this Plan. Furthermore, if an SAR is exercised and settled in Shares, the difference between the total Shares exercised and the net Shares delivered shall again be available for grant under this Plan, with the result being that only the number of Shares issued upon exercise of an SAR are counted against the Shares available. The Shares available for issuance under this Plan may be authorized and unissued Shares or treasury Shares.

**4.3 Annual Award Limits.** Unless and until the Committee determines that an Award to a Covered Employee shall not be designed to qualify as Performance-Based Compensation, the following limits (each an **Annual Award Limit** and, collectively, **Annual Award Limits** ) shall apply to grants of such Awards under this Plan:

- (a) **Options:** The maximum aggregate number of Shares subject to Options granted in any one Plan Year to any one Participant shall be three hundred thousand (300,000).

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- (b) **SARs:** The maximum number of Shares subject to Stock Appreciation Rights granted in any one Plan Year to any one Participant shall be three hundred thousand (300,000).
- (c) **Restricted Stock or Restricted Stock Units:** The maximum aggregate grant with respect to Awards of Restricted Stock or Restricted Stock Units in any one Plan Year to any one Participant shall be one hundred fifty thousand (150,000) Shares.
- (d) **Performance Units or Performance Shares:** The maximum aggregate Award of Performance Units or Performance Shares that a Participant may receive in any one Plan Year shall be one hundred fifty thousand (150,000) Shares, or equal to the value of one hundred fifty thousand (150,000) Shares determined as of the date of vesting or payout, as applicable.
- (e) **Cash-Based Awards and Other Stock-Based Awards:** The maximum aggregate amount awarded or credited with respect to Cash-Based or Other Stock-Based Awards to any one Participant in any one Plan Year may not exceed the value of three million dollars (\$3,000,000) or one hundred fifty thousand (150,000) Shares determined as of the date of vesting or payout, as applicable.

**4.4 Adjustments in Authorized Shares.** In the event of any corporate event or transaction (including, but not limited to, a change in the Shares of the Company or the capitalization of the Company) such as a merger, consolidation, reorganization, recapitalization, separation, partial or complete liquidation, stock dividend, stock split, reverse stock split, split up, spin-off, or other distribution of stock or property of the Company, combination of Shares, exchange of Shares, dividend in-kind, or other like change in capital structure, the Committee, in order to prevent dilution or enlargement of Participants' rights under this Plan, shall substitute or adjust, as applicable, the number and kind of Shares that may be issued under this Plan or under particular forms of Awards, the number and kind of Shares subject to outstanding Awards, the Option Price or Grant Price applicable to outstanding Awards, the Annual Award Limits, and other value determinations applicable to outstanding Awards.

The Committee shall also make appropriate adjustments in the terms of any Awards under this Plan to reflect or related to such changes or distributions and to modify any other terms of outstanding Awards, including modifications of performance goals and changes in the length of Performance Periods. Notwithstanding anything herein to the contrary, following a Change in Control the Committee may not take any such action as described in this Section 4.4 if such action would result in a violation of the requirements of Code Section 409A. The determination of the Committee as to the foregoing adjustments, if any, shall be conclusive and binding on Participants under this Plan.

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Subject to the provisions of Article 18 and notwithstanding anything else herein to the contrary, without affecting the number of Shares reserved or available hereunder, the Committee may authorize the issuance or assumption of benefits under this Plan in connection with any merger, consolidation, acquisition of property or stock, or reorganization upon such terms and conditions as it may deem appropriate, subject to compliance with the rules under Code Sections 409A, 422, and 424, as and where applicable.

### **Article 5. Eligibility and Participation**

**5.1 Eligibility.** Individuals eligible to participate in this Plan include all Employees and Directors.

**5.2 Actual Participation.** Subject to the provisions of this Plan, the Committee may, from time to time, select from all individuals eligible to participate, those individuals to whom Awards shall be granted and shall determine, in its sole discretion, the nature of any and all terms permissible by law, and the amount of each Award.

### **Article 6. Stock Options**

**6.1 Grant of Options.** Subject to the terms and provisions of this Plan, Options may be granted to Participants in such number, and upon such terms, and at any time and from time to time as shall be determined by the Committee, in its sole discretion, provided that ISOs may be granted only to eligible Employees of the Company or of any parent or subsidiary corporation (as permitted under Code Sections 422 and 424). However, an Employee who is employed by an Affiliate and/or Subsidiary may only be granted Options to the extent the Affiliate and/or Subsidiary is part of: (i) the Company's controlled group of corporations, or (ii) a trade or business under common control, as of the date of grant as determined within the meaning of Code Section 414(b) or 414(c), and substituting for this purpose ownership of at least fifty percent (50%) of the Affiliate and/or Subsidiary to determine the members of the controlled group of corporations and the entities under common control.

**6.2 Award Agreement.** Each Option grant shall be evidenced by an Award Agreement that shall specify the Option Price, the maximum duration of the Option, the number of Shares to which the Option pertains, the conditions upon which an Option shall become vested and exercisable, and such other provisions as the Committee shall determine which are not inconsistent with the terms of this Plan. The Award Agreement also shall specify whether the Option is intended to be an ISO or an NQSO.

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**6.3 Option Price.** The Option Price for each grant of an Option under this Plan shall be determined by the Committee in its sole discretion and shall be specified in the Award Agreement; provided, however, the Option Price must be at least equal to one hundred percent (100%) of the FMV of the Shares as determined on the date of grant.

**6.4 Term of Options.** Each Option granted to a Participant shall expire at such time as the Committee shall determine at the time of grant; provided, however, no Option shall be exercisable later than the tenth (10<sup>th</sup>) anniversary date of its grant.

**6.5 Exercise of Options.** Options granted under this Article 6 shall be exercisable at such times and be subject to such restrictions and conditions as the Committee shall in each instance approve, which terms and restrictions need not be the same for each grant or for each Participant.

**6.6 Payment.** Options granted under this Article 6 shall be exercised by the delivery of a notice of exercise to the Company or an agent designated by the Company in a form specified or accepted by the Committee, or by complying with any alternative procedures which may be authorized by the Committee, setting forth the number of Shares with respect to which the Option is to be exercised, accompanied by full payment for the Shares.

A condition of the issuance of the Shares as to which an Option shall be exercised shall be the payment of the Option Price. The Option Price of any Option shall be payable to the Company in full either: (a) in cash or its equivalent; (b) by tendering (either by actual delivery or attestation) previously acquired Shares having an aggregate Fair Market Value at the time of exercise equal to the Option Price (provided that except as otherwise determined by the Committee, the Shares that are tendered must have been held by the Participant for at least six (6) months (or such other period, if any, as the Committee may permit) prior to their tender to satisfy the Option Price if acquired under this Plan or any other compensation plan maintained by the Company or have been purchased on the open market); (c) by a cashless (broker-assisted) exercise; (d) by a combination of (a), (b), and/or (c); or (e) any other method approved or accepted by the Committee in its sole discretion.

Subject to any governing rules or regulations, as soon as practicable after receipt of written notification of exercise and full payment (including satisfaction of any applicable tax withholding), the Company shall deliver to the Participant evidence of book entry Shares, or upon the Participant's request, Share certificates in an appropriate amount based upon the number of Shares purchased under the Option(s).

Unless otherwise determined by the Committee, all payments under all of the methods indicated above shall be paid in U.S. dollars.

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**6.7 Restrictions on Share Transferability.** The Committee may impose such restrictions on any Shares acquired pursuant to the exercise of an Option granted under this Article 6 as it may deem advisable, including, without limitation, minimum holding period requirements or restrictions under applicable federal securities laws, under the requirements of any stock exchange or market upon which such Shares are then listed and/or traded, or under any blue sky or state securities laws applicable to such Shares.

**6.8 Termination of Employment.** Each Participant's Award Agreement shall set forth the extent to which the Participant shall have the right to exercise the Option following termination of the Participant's employment or provision of services to the Company, its Affiliates, and/or its Subsidiaries, as the case may be. Such provisions shall be determined in the sole discretion of the Committee, shall be included in the Award Agreement entered into with each Participant, need not be uniform among all Options issued pursuant to this Article 6, and may reflect distinctions based on the reasons for termination. Unless otherwise specified in the Award Agreement, if the employment with or service to the Company of the Participant terminates, each Option held by such Participant shall be exercisable, to the extent that such Option is exercisable on the effective date of such Participant's termination of employment or service, until and including the earliest to occur of (i) the date which is three (3) months (or such other period as set forth in the Award Agreement) after the effective date of such holder's termination of employment or service and (ii) the expiration date of the term of such Option; provided that, unless otherwise specified in the Award Agreement, if the Participant's employment with or service to the Company terminates by reason of death or Disability, each Option held by such Participant shall be exercisable, to the extent that such Option is exercisable on the effective date of such Participant's termination of employment or service, until and including the earliest to occur of (i) the date which is six (6) months (or such other period as set forth in the Award Agreement) after the effective date of such holder's termination of employment or service and (ii) the expiration date of the term of such Option.

**6.9 Notification of Disqualifying Disposition.** If any Participant shall make any disposition of Shares issued pursuant to the exercise of an ISO under the circumstances described in Code Section 421(b) (relating to certain disqualifying dispositions), such Participant shall notify the Company of such disposition within ten (10) days thereof.

**6.10 No Other Feature of Deferral.** No Option granted pursuant to this Plan shall provide for any feature for the deferral of compensation other than the deferral of recognition of income until the later of the exercise or disposition of the Option, or the time the stock acquired pursuant to the exercise of the Option first becomes substantially vested.



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### **Article 7. Stock Appreciation Rights**

**7.1 Grant of SARs.** Subject to the terms and conditions of this Plan, SARs may be granted to Participants at any time and from time to time as shall be determined by the Committee. However, an Employee who is employed by an Affiliate and/or Subsidiary may only be granted SARs to the extent the Affiliate and/or Subsidiary is: (i) part of the Company's controlled group of corporations, or (ii) a trade or business under common control, as of the date of grant as determined within the meaning of Code Section 414(b) or 414(c) and substituting for this purpose ownership of at least fifty percent (50%) of the Affiliate and/or Subsidiary to determine the members of the controlled group of corporations and the entities under common control.

Subject to the terms and conditions of this Plan, the Committee shall have complete discretion in determining the number of SARs granted to each Participant and, consistent with the provisions of this Plan, in determining the terms and conditions pertaining to such SARs.

The Grant Price for each grant of an SAR shall be determined by the Committee and shall be specified in the Award Agreement; provided, however, the Grant Price on the date of grant must be at least equal to one hundred percent (100%) of the FMV of the Shares as determined on the date of grant.

**7.2 SAR Agreement.** Each SAR Award shall be evidenced by an Award Agreement that shall specify the Grant Price, the term of the SAR, and such other provisions as the Committee shall determine.

**7.3 Term of SAR.** The term of an SAR granted under this Plan shall be determined by the Committee, in its sole discretion, and except as determined otherwise by the Committee and specified in the SAR Award Agreement, no SAR shall be exercisable later than the tenth (10<sup>th</sup>) anniversary date of its grant. Notwithstanding the foregoing, for SARs granted to Participants outside the United States, the Committee has the authority to grant SARs that have a term greater than ten (10) years.

**7.4 Exercise of SARs.** SARs may be exercised upon whatever terms and conditions the Committee, in its sole discretion, imposes.

**7.5 Settlement of SARs.** Upon the exercise of an SAR, a Participant shall be entitled to receive payment from the Company in an amount determined by multiplying:

- (a) The excess of the Fair Market Value of a Share on the date of exercise over the Grant Price; by
- (b) The number of Shares with respect to which the SAR is exercised.

At the discretion of the Committee, the payment upon SAR exercise may be in cash, Shares, or any combination thereof, or in any other manner approved by the Committee in its sole discretion. The Committee's determination regarding the form of SAR payout shall be set forth in the Award Agreement pertaining to the grant of the SAR.



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**7.6 Termination of Employment.** Each Award Agreement shall set forth the extent to which the Participant shall have the right to exercise the SAR following termination of the Participant's employment with or provision of services to the Company, its Affiliates, and/or its Subsidiaries, as the case may be. Such provisions shall be determined in the sole discretion of the Committee, shall be included in the Award Agreement entered into with Participants, need not be uniform among all SARs issued pursuant to this Plan, and may reflect distinctions based on the reasons for termination. Unless otherwise specified in the Award Agreement, if the employment with or service to the Company of the Participant terminates, each SAR held by such Participant shall be exercisable, to the extent that such SAR is exercisable, on the effective date of such Participant's termination of employment or service, until and including the earliest to occur of (i) the date which is three (3) months (or such other period as set forth in the Award Agreement) after the effective date of such holder's termination of employment or service and (ii) the expiration date of the term of such SAR; provided that, unless otherwise specified in the Award Agreement, if the Participant's employment with or service to the Company terminates by reason of death or Disability, each SAR held by such Participant shall be exercisable, to the extent that such SAR is exercisable on the effective date of such Participant's termination of employment or service, until and including the earliest to occur of (i) the date which is six (6) months (or such other period as set forth in the Award Agreement) after the effective date of such holder's termination of employment or service and (ii) the expiration date of the term of such SAR.

**7.7 Other Restrictions.** The Committee shall impose such other conditions and/or restrictions on any Shares received upon exercise of an SAR granted pursuant to this Plan as it may deem advisable or desirable. These restrictions may include, but shall not be limited to, a requirement that the Participant hold the Shares received upon exercise of an SAR for a specified period of time.

**7.8 No Other Feature of Deferral.** No SAR granted pursuant to this Plan shall provide for any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the SAR.

## **Article 8. Restricted Stock and Restricted Stock Units**

**8.1 Grant of Restricted Stock or Restricted Stock Units.** Subject to the terms and provisions of this Plan, the Committee, at any time and from time to time, may grant Shares of Restricted Stock and/or Restricted Stock Units to Participants in such amounts as the Committee shall determine. Restricted Stock Units shall be similar to Restricted Stock except that no Shares are actually awarded to the Participant on the date of grant.

**8.2 Restricted Stock or Restricted Stock Unit Agreement.** Each Restricted Stock and/or Restricted Stock Unit grant shall be evidenced by an Award Agreement that shall specify the Period(s) of Restriction, the number of Shares of Restricted Stock or the number of Restricted Stock Units granted, and such other provisions as the Committee shall determine.

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**8.3 Other Restrictions.** The Committee shall impose such other conditions and/or restrictions on any Shares of Restricted Stock or Restricted Stock Units granted pursuant to this Plan as it may deem advisable including, without limitation, a requirement that Participants pay a stipulated purchase price for each Share of Restricted Stock or each Restricted Stock Unit, restrictions based upon the achievement of specific performance goals, time-based restrictions on vesting following the attainment of the performance goals, time-based restrictions and/or restrictions under applicable laws or under the requirements of any stock exchange or market upon which such Shares are listed or traded, or holding requirements or sale restrictions placed on the Shares by the Company upon vesting of such Restricted Stock or Restricted Stock Units.

To the extent deemed appropriate by the Committee, the Company may retain the certificates representing Shares of Restricted Stock in the Company's possession until such time as all conditions and/or restrictions applicable to such Shares have been satisfied or lapse.

Except as otherwise provided in this Article 8 or in the applicable Award Agreement, Shares of Restricted Stock covered by each Restricted Stock Award shall become freely transferable by the Participant after all conditions and restrictions applicable to such Shares have been satisfied or lapse (including satisfaction of any applicable tax withholding obligations), and Restricted Stock Units shall be paid in cash, Shares, or a combination of cash and Shares as the Committee, in its sole discretion shall determine.

**8.4 Certificate Legend.** In addition to any legends placed on certificates pursuant to Section 8.3, each certificate representing Shares of Restricted Stock granted pursuant to this Plan may bear a legend such as the following or as otherwise determined by the Committee in its sole discretion:

The sale or transfer of Shares of stock represented by this certificate, whether voluntary, involuntary, or by operation of law, is subject to certain restrictions on transfer as set forth in the El Paso Electric Company 2007 Long-Term Incentive Plan, and in the associated Award Agreement. A copy of this Plan and such Award Agreement may be obtained from El Paso Electric Company.

**8.5 Voting Rights.** Unless otherwise determined by the Committee and set forth in a Participant's Award Agreement, or to the extent permitted or required by law, Participants holding Shares of Restricted Stock granted hereunder shall be granted the right to exercise full voting rights with respect to those Shares during the Period of Restriction. A Participant shall have no voting rights with respect to any Restricted Stock Units granted hereunder.

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**8.6 Termination of Employment.** Each Award Agreement shall set forth the extent to which the Participant shall have the right to retain Restricted Stock and/or Restricted Stock Units following termination of the Participant's employment with or provision of services to the Company, its Affiliates, and/or its Subsidiaries, as the case may be. Such provisions shall be determined in the sole discretion of the Committee, shall be included in the Award Agreement entered into with each Participant, need not be uniform among all Shares of Restricted Stock or Restricted Stock Units issued pursuant to this Plan, and may reflect distinctions based on the reasons for termination.

**8.7 Section 83(b) Election.** The Committee may provide in an Award Agreement that the Award of Restricted Stock is conditioned upon the Participant making or refraining from making an election with respect to the Award under Code Section 83(b). If a Participant makes an election pursuant to Code Section 83(b) concerning a Restricted Stock Award, the Participant shall be required to file promptly a copy of such election with the Company.

## **Article 9. Performance Units/Performance Shares**

**9.1 Grant of Performance Units/Performance Shares.** Subject to the terms and provisions of this Plan, the Committee, at any time and from time to time, may grant Performance Units and/or Performance Shares to Participants in such amounts and upon such terms as the Committee shall determine.

**9.2 Value of Performance Units/Performance Shares.** Each Performance Unit shall have an initial value that is established by the Committee at the time of grant. Each Performance Share shall have an initial value equal to the Fair Market Value of a Share on the date of grant. The Committee shall set performance goals in its discretion which, depending on the extent to which they are met, will determine the value and/or number of Performance Units/Performance Shares that will be paid out to the Participant.

**9.3 Earning of Performance Units/Performance Shares.** Subject to the terms of this Plan, after the applicable Performance Period has ended, the holder of Performance Units/Performance Shares shall be entitled to receive payout on the value and number of Performance Units/Performance Shares earned by the Participant over the Performance Period, to be determined as a function of the extent to which the corresponding performance goals have been achieved.

**9.4 Form and Timing of Payment of Performance Units/Performance Shares.** Payment of earned Performance Units/Performance Shares shall be as determined by the Committee and as evidenced in the Award Agreement. Subject to the terms of this Plan, the Committee, in its sole discretion, may pay earned Performance Units/Performance Shares in the form of cash or in Shares (or in a combination thereof) equal to the value of the earned Performance Units/Performance Shares at the close of the applicable Performance Period, or as soon as practicable after the end of the Performance Period. Any Shares may be granted subject to any restrictions deemed appropriate by the Committee. The determination of the Committee with respect to the form of payout of such Awards shall be set forth in the Award Agreement pertaining to the grant of the Award.

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**9.5 Termination of Employment.** Each Award Agreement shall set forth the extent to which the Participant shall have the right to retain Performance Units and/or Performance Shares following termination of the Participant's employment with or provision of services to the Company, its Affiliates, and/or its Subsidiaries, as the case may be. Such provisions shall be determined in the sole discretion of the Committee, shall be included in the Award Agreement entered into with each Participant, need not be uniform among all Awards of Performance Units or Performance Shares issued pursuant to this Plan, and may reflect distinctions based on the reasons for termination.

**Article 10. Cash-Based Awards and Other Stock-Based Awards**

**10.1 Grant of Cash-Based Awards.** Subject to the terms and provisions of the Plan, the Committee, at any time and from time to time, may grant Cash-Based Awards to Participants in such amounts and upon such terms as the Committee may determine.

**10.2 Other Stock-Based Awards.** The Committee may grant other types of equity-based or equity-related Awards not otherwise described by the terms of this Plan (including the grant or offer for sale of unrestricted Shares) in such amounts and subject to such terms and conditions as the Committee shall determine. Such Awards may involve the transfer of actual Shares to Participants, or payment in cash or otherwise of amounts based on the value of Shares, and may include, without limitation, Awards designed to comply with or take advantage of the applicable local laws of jurisdictions other than the United States.

**10.3 Value of Cash-Based and Other Stock-Based Awards.** Each Cash-Based Award shall specify a payment amount or payment range as determined by the Committee. Each Other Stock-Based Award shall be expressed in terms of Shares or units based on Shares, as determined by the Committee. The Committee may establish performance goals in its discretion. If the Committee exercises its discretion to establish performance goals, the number and/or value of Cash-Based Awards or Other Stock-Based Awards that will be paid out to the Participant will depend on the extent to which the performance goals are met.

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**10.4 Payment of Cash-Based Awards and Other Stock-Based Awards.** Payment, if any, with respect to a Cash-Based Award or an Other Stock-Based Award shall be made in accordance with the terms of the Award, in cash or Shares as the Committee determines.

**10.5 Termination of Employment.** The Committee shall determine the extent to which the Participant shall have the right to receive Cash-Based Awards or Other Stock-Based Awards following termination of the Participant's employment with or provision of services to the Company, its Affiliates, and/or its Subsidiaries, as the case may be. Such provisions shall be determined in the sole discretion of the Committee, shall be included in an agreement entered into with each Participant, need not be uniform among all Awards of Cash-Based Awards or Other Stock-Based Awards issued pursuant to the Plan, and may reflect distinctions based on the reasons for termination.

## **Article 11. Transferability of Awards**

**11.1 Transferability.** Except as provided in Section 11.2 below, during a Participant's lifetime, his or her Awards shall be exercisable only by the Participant. Awards shall not be transferable other than by will or the laws of descent and distribution; no Awards shall be subject, in whole or in part, to attachment, execution, or levy of any kind; and any purported transfer in violation hereof shall be null and void. The Committee may establish such procedures as it deems appropriate for a Participant to designate a beneficiary to whom any amounts payable or Shares deliverable in the event of, or following, the Participant's death, may be provided.

**11.2 Committee Action.** The Committee may, in its discretion, determine that notwithstanding Sections 11.1 and 11.3, any or all Awards (other than ISOs) shall be transferable to and exercisable by such transferees, and subject to such terms and conditions, as the Committee may deem appropriate; provided, however, no Award may be transferred for value (as defined in the General Instructions to Form S-8).

**11.3 Domestic Relations Orders.** Without limiting the generality of Section 11.1, no domestic relations order purporting to authorize a transfer of an Award shall be recognized as valid.

## **Article 12. Performance Measures**

**12.1 Performance Measures.** The performance goals upon which the payment or vesting of an Award to a Covered Employee that is intended to qualify as Performance-Based Compensation shall be limited to the following Performance Measures:

- (a) Net earnings or net income (before or after taxes);
- (b) Earnings per share;

- (c) Net sales or revenue growth;
- (d) Net operating profit;
- (e) Return measures (including, but not limited to, return on assets, capital, invested capital, equity, sales, or revenue);

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- (f) Cash flow (including, but not limited to, operating cash flow, free cash flow, cash flow return on equity, and cash flow return on investment);
- (g) Earnings before or after taxes, interest, depreciation, and/or amortization;
- (h) Gross or operating margins;
- (i) Productivity ratios;
- (j) Share price (including, but not limited to, growth measures and total shareholder return);
- (k) Expense targets;
- (l) Margins;
- (m) Operating efficiency;
- (n) Market share;
- (o) Customer satisfaction;
- (p) Working capital targets; and
- (q) Economic value added or EVA<sup>®</sup> (net operating profit after tax minus the sum of capital multiplied by the cost of capital).

Any Performance Measure(s) may be used to measure the performance of the Company, Subsidiary, and/or Affiliate as a whole or any business unit of the Company, Subsidiary, and/or Affiliate or any combination thereof, as the Committee may deem appropriate, or any of the above Performance Measures as compared to the performance of a group of comparator companies, or published or special index that the Committee, in its sole discretion, deems appropriate, or the Company may select Performance Measure (j) above as compared to various stock market indices. The Committee also has the authority to provide for accelerated vesting of any Award based on the achievement of performance goals pursuant to the Performance Measures specified in this Article 12.

**12.2 Evaluation of Performance.** The Committee may provide in any such Award that any evaluation of performance may include or exclude any of the following events that occur during a Performance Period: (a) asset write-downs; (b) litigation or claim judgments or settlements; (c) the effect of changes in tax laws, accounting principles, or other laws or provisions affecting reported results; (d) any reorganization and restructuring programs; (e) extraordinary nonrecurring items as described in Accounting Principles Board Opinion No. 30 and/or in management's discussion and analysis of financial condition and results of operations appearing in the Company's annual report to shareholders for the applicable year; (f) acquisitions or divestitures; and (g) foreign exchange gains and losses. To the extent such inclusions or exclusions affect Awards to Covered Employees, they shall be prescribed in a form that meets the requirements of Code Section 162(m) for deductibility.

**12.3 Adjustment of Performance-Based Compensation.** Awards that are intended to qualify as Performance-Based Compensation may not be adjusted upward. The Committee shall retain the discretion to adjust such Awards downward, either on a formula or discretionary basis, or any combination as the Committee determines.

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**12.4 Committee Discretion.** In the event that applicable tax and/or securities laws change to permit Committee discretion to alter the governing Performance Measures without obtaining shareholder approval of such changes, the Committee shall have sole discretion to make such changes without obtaining shareholder approval provided the exercise of such discretion does not violate Code Section 409A. In addition, in the event that the Committee determines that it is advisable to grant Awards that shall not qualify as Performance-Based Compensation, the Committee may make such grants without satisfying the requirements of Code Section 162(m) and base vesting on Performance Measures other than those set forth in Section 12.1.

**Article 13. Non-employee Director Awards**

**13.1 Eligibility.** Each Non-employee Director shall receive a Restricted Stock Award in accordance with this Article 13.

**13.2 Restricted Stock Awards.** Unless the Board determines otherwise, on the date of each annual meeting of shareholders of the Company, the following Restricted Stock Awards shall be made to each person who is a Non-employee Director immediately after such meeting of shareholders:

- (a) Each Non-employee Director, other than the Chairman of the Board and the Vice Chairman of the Board, shall receive a Restricted Stock Award of three thousand five hundred (3,500) Shares;
- (b) The Vice Chairman of the Board shall receive a Restricted Stock Award equal to the sum of (i) three thousand five hundred (3,500) Shares and (ii) an amount of Shares equal to one hundred thousand dollars (\$100,000) divided by the closing price of the stock on the date of grant; and
- (c) The Chairman of the Board shall receive a Restricted Stock Award of sixteen thousand (16,000) Shares less the number of Shares awarded the Vice Chairman pursuant to Section 13.2(b)(ii).

If a person first becomes a Non-employee Director (other than through a termination of employment) on a date other than an annual meeting of shareholders of the Company, the above amounts shall be prorated based on the portion of the year for which services are provided.

**13.3 Period of Restriction for Awards.** Unless the Board determines otherwise, and unless the Restricted Stock Awards vest earlier pursuant to Article 17 herein, Restricted Stock Awards shall become one hundred percent (100%) vested on the date of the first anniversary of the date of grant, provided that the Non-employee Director continues service on the Board through such first anniversary.

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**13.4 Changes to Non-employee Director Awards.** The Board shall have full discretion, without subsequent shareholder approval, to change grant practices for Non-employee Directors, including but not limited to the persons eligible to receive Awards, the size of the Awards, the form of the Awards, and the terms and conditions of such Awards.

### **Article 14. Dividend Equivalents**

Any Participant selected by the Committee may be granted dividend equivalents based on the dividends declared on Shares that are subject to any Award, to be credited as of dividend payment dates during the period between the date the Award is granted and the date the Award is exercised, vests, or expires, as determined by the Committee. Such dividend equivalents shall be converted to cash or additional Shares by such formula and at such time and subject to such limitations as may be determined by the Committee; provided, however, that no dividend equivalents may be granted on any Award of stock Options or SARs.

### **Article 15. Beneficiary Designation**

Each Participant under this Plan may, from time to time, name any beneficiary or beneficiaries (who may be named contingently or successively) to whom any benefit under this Plan is to be paid in case of his death before he receives any or all of such benefit. Each such designation shall revoke all prior designations by the same Participant, shall be in a form prescribed by the Committee, and will be effective only when filed by the Participant in writing with the Company during the Participant's lifetime. In the absence of any such beneficiary designation, benefits remaining unpaid or rights remaining unexercised at the Participant's death shall be paid to or exercised by the Participant's executor, administrator, or legal representative.

### **Article 16. Rights of Participants**

**16.1 Employment.** Nothing in this Plan or an Award Agreement shall interfere with or limit in any way the right of the Company, its Affiliates, and/or its Subsidiaries to terminate any Participant's employment or service on the Board or to the Company at any time or for any reason not prohibited by law, nor confer upon any Participant any right to continue his employment or service as a Director for any specified period of time.

Neither an Award nor any benefits arising under this Plan shall constitute an employment contract with the Company, its Affiliates, and/or its Subsidiaries and, accordingly, subject to Articles 3 and 18, this Plan and the benefits hereunder may be terminated at any time in the sole and exclusive discretion of the Committee without giving rise to any liability on the part of the Company, its Affiliates, and/or its Subsidiaries.

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**16.2 Participation.** No individual shall have the right to be selected to receive an Award under this Plan, or, having been so selected, to be selected to receive a future Award.

**16.3 Rights as a Shareholder.** Except as otherwise provided herein, a Participant shall have none of the rights of a shareholder with respect to Shares covered by any Award until the Participant becomes the record holder of such Shares.

## **Article 17. Change in Control**

Notwithstanding any other provision of this Plan to the contrary, the provisions of this Article 17 shall apply in the event of a Change in Control, unless otherwise determined by the Committee in connection with the grant of an Award as reflected in the applicable Award Agreement.

- (a) All outstanding Options and Stock Appreciation Rights shall become immediately vested and exercisable;
- (b) All Restricted Stock and Restricted Stock Units shall become immediately vested and payable; and
- (c) The Performance Period applicable to Performance Shares and Performance Units shall end upon the occurrence of a Change in Control in the manner and on the date determined by the Committee in its sole discretion. The performance goals associated with such awards shall be measured based on performance achieved through the end of such shortened Performance Period and such awards shall become vested and payable on a prorated basis to reflect the shortened Performance Period, with the remaining portion of the awards terminating.

The Committee may, in its sole discretion, determine that any or all outstanding Awards granted under the Plan, whether or not exercisable, will be canceled and terminated and that in connection with such cancellation and termination the holder of such Award may receive for each Share of common stock subject to such Awards a cash payment (or the delivery of shares of stock, other securities or a combination of cash, stock and securities equivalent to such cash payment) equal to the difference, if any, between the consideration received by shareholders of the Company in respect of a Share of common stock in connection with such transaction and the purchase price per share, if any, under the Award multiplied by the number of Shares of common stock subject to such Award; provided that if such product is zero or less or to the extent that the Award is not then exercisable, the Awards may be canceled and terminated without payment therefore.

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**Article 18. Amendment, Modification, Suspension, and Termination**

**18.1 Amendment, Modification, Suspension, and Termination.** Subject to Section 18.3, the Committee may, at any time and from time to time, alter, amend, modify, suspend, or terminate this Plan and any Award Agreement in whole or in part; provided, however, that without the prior approval of the Company's shareholders and except as provided in Section 4.4, Options or SARs issued under this Plan will not be repriced, replaced (with any other Awards), or regranted through cancellation or by lowering the Option Price of a previously granted Option or the Grant Price of a previously granted SAR nor will any outstanding underwater Options or SARs under the Plan be purchased for cash, and no amendment of this Plan shall be made without shareholder approval if shareholder approval is required by law, regulation, or stock exchange rule.

**18.2 Adjustment of Awards Upon the Occurrence of Certain Unusual or Nonrecurring Events.** The Committee may make adjustments in the terms and conditions of, and the criteria included in, Awards in recognition of unusual or nonrecurring events (including, without limitation, the events described in Section 4.4 hereof) affecting the Company or the financial statements of the Company or of changes in applicable laws, regulations, or accounting principles, whenever the Committee determines that such adjustments are appropriate in order to prevent unintended dilution or enlargement of the benefits or potential benefits intended to be made available under this Plan. The determination of the Committee as to the foregoing adjustments, if any, shall be conclusive and binding on Participants under this Plan.

**18.3 Awards Previously Granted.** Notwithstanding any other provision of this Plan to the contrary (other than Section 18.4), no termination, amendment, suspension, or modification of this Plan or an Award Agreement shall adversely affect in any material way any Award previously granted under this Plan without the written consent of the Participant holding such Award.

**18.4 Amendment to Conform to Law.** Notwithstanding any other provision of this Plan to the contrary, the Board of Directors may amend the Plan or an Award Agreement, to take effect retroactively or otherwise, as deemed necessary or advisable for the purpose of conforming the Plan or an Award Agreement to any present or future law relating to plans of this or similar nature (including, but not limited to, Code Section 409A), and to the administrative regulations and rulings promulgated thereunder.

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### **Article 19. Withholding**

**19.1 Tax Withholding.** The Company shall have the power and the right to deduct or withhold, or require a Participant to remit to the Company, the minimum statutory amount to satisfy federal, state, and local taxes, domestic or foreign, required by law or regulation to be withheld with respect to any taxable event arising as a result of this Plan.

**19.2 Share Withholding.** With respect to withholding required upon the exercise of Options or SARs, upon the lapse of restrictions on Restricted Stock and Restricted Stock Units, or upon the achievement of performance goals related to Performance Shares or any other taxable event arising as a result of an Award granted hereunder, Participants may elect, subject to the approval of the Committee, to satisfy the withholding requirement, in whole or in part, by having the Company withhold Shares having a Fair Market Value on the date the tax is to be determined equal to the minimum statutory total tax that could be imposed on the transaction. All such elections shall be irrevocable, made in writing, and signed by the Participant, and shall be subject to any restrictions or limitations that the Committee, in its sole discretion, deems appropriate.

### **Article 20. Successors**

All obligations of the Company under this Plan with respect to Awards granted hereunder shall be binding on any successor to the Company, whether the existence of such successor is the result of a direct or indirect purchase, merger, consolidation, or otherwise, of all or substantially all of the business and/or assets of the Company.

### **Article 21. General Provisions**

**21.1 Forfeiture Events.** The Committee may specify in an Award Agreement that the Participant's rights, payments, and benefits with respect to an Award shall be subject to reduction, cancellation, forfeiture, or recoupment upon the occurrence of certain specified events, in addition to any otherwise applicable vesting or performance conditions of an Award. Such events may include, but shall not be limited to, termination of employment for cause, termination of the Participant's provision of services to the Company, Affiliate, and/or Subsidiary, violation of material Company, Affiliate, and/or Subsidiary policies, breach of noncompetition, confidentiality, or other restrictive covenants that may apply to the Participant, or other conduct by the Participant that is detrimental to the business or reputation of the Company, its Affiliates, and/or its Subsidiaries.

**21.2 Legend.** The certificates for Shares may include any legend which the Committee deems appropriate to reflect any restrictions on transfer of such Shares.

**21.3 Gender and Number.** Except where otherwise indicated by the context, any masculine term used herein also shall include the feminine, the plural shall include the singular, and the singular shall include the plural.

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**21.4 Severability.** In the event any provision of this Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of this Plan, and this Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

**21.5 Requirements of Law.** The granting of Awards and the issuance of Shares under this Plan shall be subject to all applicable laws, rules, and regulations, and to such approvals by any governmental agencies or national securities exchanges as may be required.

**21.6 Delivery of Title.** The Company shall have no obligation to issue or deliver evidence of title for Shares issued under this Plan prior to:

- (a) Obtaining any approvals from governmental agencies that the Company determines are necessary or advisable; and
- (b) Completion of any registration or other qualification of the Shares under any applicable national or foreign law or ruling of any governmental body that the Company determines to be necessary or advisable.

**21.7 Inability to Obtain Authority.** The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

**21.8 Investment Representations.** The Committee may require any individual receiving Shares pursuant to an Award under this Plan to represent and warrant in writing that the individual is acquiring the Shares for investment and without any present intention to sell or distribute such Shares.

**21.9 Employees Based Outside of the United States.** Notwithstanding any provision of this Plan to the contrary, in order to comply with the laws in other countries in which the Company, its Affiliates, and/or its Subsidiaries operate or have Employees or Directors, the Committee, in its sole discretion, shall have the power and authority to:

- (a) Determine which Affiliates and Subsidiaries shall be covered by this Plan.
- (b) Determine which Employees and/or Directors outside the United States are eligible to participate in this Plan.
- (c) Modify the terms and conditions of any Award granted to Employees and/or Directors outside the United States to comply with applicable foreign laws.



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- (d) Establish subplans and modify exercise procedures and other terms and procedures, to the extent such actions may be necessary or advisable. Any subplans and modifications to Plan terms and procedures established under this Section 21.9 by the Committee shall be attached to this Plan document as appendices.
- (e) Take any action, before or after an Award is made, that it deems advisable to obtain approval or comply with any necessary local government regulatory exemptions or approvals.

Notwithstanding the above, the Committee may not take any actions hereunder, and no Awards shall be granted, that would violate applicable law.

**21.10 Uncertificated Shares.** To the extent that this Plan provides for issuance of certificates to reflect the transfer of Shares, the transfer of such Shares may be effected on a noncertificated basis, to the extent not prohibited by applicable law or the rules of any stock exchange.

**21.11 Unfunded Plan.** Participants shall have no right, title, or interest whatsoever in or to any investments that the Company, and/or its Subsidiaries, and/or its Affiliates may make to aid it in meeting its obligations under this Plan. Nothing contained in this Plan, and no action taken pursuant to its provisions, shall create or be construed to create a trust of any kind, or a fiduciary relationship between the Company and any Participant, beneficiary, legal representative, or any other individual. To the extent that any individual acquires a right to receive payments from the Company, its Subsidiaries, and/or its Affiliates under this Plan, such right shall be no greater than the right of an unsecured general creditor of the Company, a Subsidiary, or an Affiliate, as the case may be. All payments to be made hereunder shall be paid from the general funds of the Company, a Subsidiary, or an Affiliate, as the case may be and no special or separate fund shall be established and no segregation of assets shall be made to assure payment of such amounts except as expressly set forth in this Plan.

**21.12 No Fractional Shares.** No fractional Shares shall be issued or delivered pursuant to this Plan or any Award. The Committee shall determine whether cash, Awards, or other property shall be issued or paid in lieu of fractional Shares or whether such fractional Shares or any rights thereto shall be forfeited or otherwise eliminated.

**21.13 Retirement and Welfare Plans.** Neither Awards made under this Plan nor Shares or cash paid pursuant to such Awards may be included as compensation for purposes of computing the benefits payable to any Participant under the Company's or any Subsidiary's or Affiliate's retirement plans (both qualified and non-qualified) or welfare benefit plans unless such other plan expressly provides that such compensation shall be taken into account in computing a Participant's benefit.

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**21.14 Deferred Compensation.** It is intended that any Award made under this Plan that results in the deferral of compensation (as defined under Code Section 409A) complies with the requirements of Code Section 409A.

**21.15 Nonexclusivity of this Plan.** The adoption of this Plan shall not be construed as creating any limitations on the power of the Board or Committee to adopt such other compensation arrangements as it may deem desirable for any Participant.

**21.16 No Constraint on Corporate Action.** Nothing in this Plan shall be construed to: (i) limit, impair, or otherwise affect the Company's or a Subsidiary's or an Affiliate's right or power to make adjustments, reclassifications, reorganizations, or changes of its capital or business structure, or to merge or consolidate, or dissolve, liquidate, sell, or transfer all or any part of its business or assets; or (ii) limit the right or power of the Company or a Subsidiary or an Affiliate to take any action which such entity deems to be necessary or appropriate.

**21.17 Governing Law.** The Plan and each Award Agreement shall be governed by the laws of the state of Texas, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Plan to the substantive law of another jurisdiction. Unless otherwise provided in the Award Agreement, recipients of an Award under this Plan are deemed to submit to the exclusive jurisdiction and venue of the federal or state courts of Texas, to resolve any and all issues that may arise out of or relate to this Plan or any related Award Agreement.

**21.18 Indemnification.** Subject to requirements of Texas law, each individual who is or shall have been a member of the Board, or a Committee appointed by the Board, shall be indemnified and held harmless by the Company against and from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by him or her in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action taken or failure to act under this Plan and against and from any and all amounts paid by him or her in settlement thereof, with the Company's approval, or paid by him or her in satisfaction of any judgment in any such action, suit, or proceeding against him or her, provided he or she shall give the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his/her own behalf, unless such loss, cost, liability, or expense is a result of his/her own willful misconduct or except as expressly provided by statute.

The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such individuals may be entitled under the Company's Articles of Incorporation, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

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[FORM OF PROXY CARD]

**EL PASO ELECTRIC COMPANY**

For the Annual Meeting of Shareholders

to be held May 2, 2007

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS**

The undersigned hereby nominate(s), constitute(s) and appoint(s) Gary R. Hedrick, Gary D. Sanders, and Guillermo Silva, Jr. and each of them, the attorneys, agents and proxies of the undersigned, with full powers of substitution to each, to attend and act as proxy or proxies of the undersigned at the Annual Meeting of Shareholders (the Annual Meeting ) of El Paso Electric Company (the Company ) to be held at the Stanton Tower Building, 100 N. Stanton, El Paso, Texas 79901, on Wednesday, May 2, 2007 at 10:00 a.m., MDT, or at any adjournments thereof, and vote as specified herein the number of shares that the undersigned, if personally present, would be entitled to vote.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ELECTION OF THE NOMINEES DESCRIBED IN THE PROXY STATEMENT AS CLASS I DIRECTORS.**

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE APPROVAL OF THE EL PASO ELECTRIC 2007 LONG-TERM INCENTIVE PLAN.**

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE RATIFICATION OF THE SELECTION OF KPMG LLP AS THE COMPANY S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE FISCAL YEAR ENDING DECEMBER 31, 2007.**

THIS PROXY WHEN PROPERLY EXECUTED WILL BE VOTED AS DIRECTED. IF NO DIRECTION IS MADE, IT WILL BE VOTED FOR THE ELECTION OF THE NOMINEES DESCRIBED IN THE PROXY STATEMENT AS CLASS I DIRECTORS AND FOR THE APPROVAL OF THE EL PASO ELECTRIC 2007 LONG-TERM INCENTIVE PLAN AS EXPLAINED IN THE PROXY STATEMENT AND FOR THE RATIFICATION OF THE SELECTION OF KPMG LLP AS THE COMPANY S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE FISCAL YEAR ENDING DECEMBER 31, 2007. IF ANY MATTERS NOT SPECIFIED IN THE NOTICE OF MEETING ARE PRESENTED, THIS PROXY WILL BE VOTED IN ACCORDANCE WITH THE BEST JUDGMENT AND IN THE DISCRETION OF THE NAMED PROXY HOLDERS. THIS PROXY MAY BE REVOKED PRIOR TO ITS EXERCISE BY FILING WITH THE SECRETARY OF THE COMPANY AN INSTRUMENT IN WRITING REVOKING THE PROXY OR A DULY EXECUTED PROXY BEARING A LATER DATE. THIS PROXY MAY ALSO BE REVOKED BY ATTENDING THE MEETING AND VOTING IN PERSON.

[REVERSE OF CARD]

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	<b>FOR</b> all nominees Listed below	<input checked="" type="checkbox"/>	<b>WITHHOLD AUTHORITY</b> to vote For all nominees listed below	<input checked="" type="checkbox"/>	<b>*EXCEPTIONS</b>	<input checked="" type="checkbox"/>
--	---	-------------------------------------	--	-------------------------------------	--------------------	-------------------------------------

1. Election of Directors Listed Below  
To serve for a term of three years to expire  
at the annual meeting in 2010

Nominees:   GEORGE W. EDWARDS, JR.       JOHN ROBERT BROWN       JAMES W. CICCONI       PATRICIA Z.  
HOLLAND-BRANCH

INSTRUCTIONS: To withhold authority to vote for any nominee, mark the Exceptions box and write that nominee's name on the space provided below

\*Exceptions

2. Approval of the El Paso Electric Company's 2007 Long Term Incentive Plan.	<b>FOR</b>	<input checked="" type="checkbox"/>	<b>AGAINST</b>	<input checked="" type="checkbox"/>	<b>ABSTAIN</b>	<input checked="" type="checkbox"/>
3. Ratify the selection of KPMG LLP as the Company's Independent Registered Public Accounting Firm for the Fiscal Year ending December 31, 2007.	<b>FOR</b>	<input checked="" type="checkbox"/>	<b>AGAINST</b>	<input checked="" type="checkbox"/>	<b>ABSTAIN</b>	<input checked="" type="checkbox"/>

*Address Changes and/or Comments*

Please date and sign exactly as name appears. If shares are held jointly, each should sign, if signing as attorney, executor, administrator, trustee or guarantee, etc., so indicate when signing. If a corporation, please sign in full corporate name by an authorized officer. If a partnership, please sign in partnership name by authorized person.

Dated

Signature

Signature if held jointly

Votes must be indicated  
(x) in Black or Blue ink.

Mark, Sign, Date and Return the Proxy Card Promptly Using the Enclosed Envelope.