

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF THE APPLICATION OF)
PNM RESOURCES INC., AND TEXAS-NEW)
MEXICO POWER CO FOR APPROVAL OF)
PNM RESOURCES' ACQUISITION OF TNP)
ENTERPRISES, INC.; FOR APPROVAL OF)
APPLICANTS' PROPOSED REGULATORY)
PLAN; AND FOR ALL OTHER APPROVALS)
AND AUTHORIZATIONS REQUIRED)
TO EFFECTUATE AND IMPLEMENT)
THE ACQUISITION,)
)
PNM RESOURCES INC., AND TEXAS-)
NEW MEXICO POWER CO.,)
)
Applicants.)

Case No. 04-00315-UT

2005 MAR -3 PM 4:00

APPROVED
COMMISSION

PNM RESOURCES, INC.'S RESPONSE TO BENCH REQUEST

PNM Resources, Inc. ("PNM Resources") hereby responds to the Bench Request issued by New Mexico Public Regulation Commission ("Commission"). These responses discuss how the Stipulation filed in this proceeding on February 28, 2005 addresses the questions in the Bench Request in a preliminary fashion. More in-depth information and discussion of transaction benefits the issues in the Bench Request will follow in the pre-filed testimony in support of the settlement to be filed by PNM Resources and the Commission Staff on March 11, 2005. In these responses PNM Resources refers to Public Service Company of New Mexico as PNM, Texas New Mexico Power Company as TNMP, and TNP Enterprises, Inc. as TNP Enterprises.

- 1. What, if anything, should be done to equalize retail rates paid by New Mexico TNMP and PNM customers during the period between the effective date of the transaction and the expiration of the current wholesale supply contract between TNMP and PNM?**

TOM SATEGNA RESPONSE

The parties to the Stipulation which are: PNM Resources, TNMP, the Commission's Utility Staff, the New Mexico Attorney General and the New Mexico Industrial Energy Consumers, Inc. agreed on two goals with respect to rate parity for PNM and TNMP customers. The first goal was to have an equalization of rates for PNM and TNMP-NM customers. The second was that in

order to achieve the first goal, there should not be significant costs shifted to customers in PNM's current service territory. The parties recognized that there were two factors that prevented achieving both goals in the near term. First, it is more expensive to provide transmission and distribution ("T&D") service to rural areas than urban areas. Second, customers in PNM's current service area have the advantage of low cost coal-fired and nuclear generation, while TNMP has no generation assets to serve its load.

In view of these facts, the parties to the Stipulation agreed to several measures in an effort to eventually be able to have an equalization of rates. First, if the Commission approves the Stipulation, TNMP's New Mexico rates will be reduced by 1.851¢ per kilowatt-hour beginning 1/1/06 and there will be two additional TNMP rate reductions, each of .1¢ per kilowatt hour, effective 1/1/08 and 1/1/09. Overall, TNMP's New Mexico customers will receive rate reductions in excess of \$52.6 million over the five-year rate path (2006-2010). This reduces current rates by approximately 15% over the five-year period. These rate reductions will reduce the disparity between TNMP and PNM rates, but TNMP's rates will remain higher than PNM's because of the significantly higher cost of serving TNMP's customers. To achieve full rate parity, TNMP's NM customers' rates would have to be further reduced by approximately \$18-\$19 million annually. Second, the Stipulation provides for the integration of TNMP's New Mexico retail electric operations and assets into PNM beginning January 2007, and directs PNM, within 45 days of approval of the Stipulation, to file a resource plan to include both PNM and TNMP-NM as an integrated system and as stand-alone utilities. The consolidation of TNMP's operations into PNM's is a necessary first step in establishing a single set of rate schedules based on the combined costs of serving both service areas. Third, the parties to the Stipulation are in agreement that PNM's and TNMP's retail electric customers in New Mexico should continue to be served under separate rate schedules, based on their respective costs of service, at least until July 1, 2015, unless the use of a combined cost of service to set uniform rates for both service areas can be accomplished without adding more than \$1.5 million to the cost of service for customers in PNM's current service area. In other words, the parties share the view that rate equality should be achieved only when the costs of serving the two service areas are approximately equal.

2. As a general matter, how can the Commission effectively regulate a retail electric provider that buys wholesale power from an arm of a company with common ownership, and is it congruent with the philosophy underpinning New Mexico's regulation of retail electric sales to allow PNM to earn wholesale profits on sales to retail customers within the jurisdiction who are served by a distribution utility under common ownership?

TOM SATEGNA RESPONSE

The Stipulation addresses the Commission's concern about inter-affiliate power sales in several ways. First, as stated in response to Request No. 1, the Stipulation provides for a substantial reduction in TNMP's electric rates (an average rate reduction of \$10.5 million per year) beginning January 1, 2006, a full year before the termination of the PNM/TNMP wholesale power agreement. The parties to the Stipulation have agreed that the early rate reduction along with the five-year rate path results in just and reasonable rates for TNMP's customers on a going forward basis and the Stipulation eliminates uncertainty associated with power supply, both in availability and cost during 2006-2010. Second, if the Stipulation is approved by the Commission, TNMP's New Mexico operations will be integrated into PNM's effective January 1, 2007, and PNM will supply power to retail customers in TNMP's former service area, as PNM does to its current retail customers in New Mexico, and will be subject to the same regulatory requirements. TNMP will no longer purchase power from PNM under a wholesale power supply agreement. Third, the Stipulation requires that any changes to or extensions of the existing PNM/TNMP wholesale power supply agreement must be approved by the Commission before they can take effect. Thus, the Commission has ample means to effectively regulate inter-affiliate wholesale power purchases by PNM and TNMP, if any were to occur, to assure that the price paid is consistent with prices paid in arms-length market transactions.

The existing PNM/TNMP wholesale power supply agreement was a result of arms-length negotiations between unaffiliated companies and reflects the cost of power in the marketplace at the time it was made and the parties' independent judgments about future market prices. Nevertheless, with the early rate reduction agreed to in the Stipulation, TNMP's customers receive substantial rate relief effective January 1, 2006 even though the term of the power supply agreement extends through December 31, 2006.

3. The Commission believes it is the case that the current wholesale supply contract between PNM and TNMP contains provisions for fuel cost adjustments, and that TNMP has a purchased power cost adjustment clause for its New Mexico retail tariffs. How can the Commission rely on TNMP to conduct an arms-length assessment of fuel cost adjustments claimed by PNM?

TOM SATEGNA RESPONSE

The rates for capacity/energy charged by PNM to TNMP under the power supply agreement are fixed. Therefore, any changes in PNM's cost to serve TNMP are

not passed on to TNMP customers through their purchased power cost adjustment clause.

The Commission is correct however that TNMP does have a purchased power cost adjustment clause. This adjustment clause is simply utilized to account for changes in the amount of energy or capacity sold to TNMP's customers. Under the terms of the Stipulation, TNMP's purchased power cost adjustment clause will terminate December 31, 2005, provided, however, the mechanism will continue to operate through March 31, 2006 in order to account for over/under collections due to changes in energy/capacity sold to TNMP customers prior to January 1, 2006.

4. How can the Commission be assured that a successor contract, if any, to the current wholesale supply contract between PNM and TNMP will fairly allocate risks and costs to the retail utility?

TOM SATEGNA RESPONSE

As stated in answer to Request No. 2 above, if the Commission approves the Stipulation, TNMP's New Mexico retail customers will become PNM's retail customers beginning January 1, 2007, upon termination of the current wholesale power supply contract. Thus, there is no successor contract contemplated.

5. What are the operational barriers to consolidating TNMP's New Mexico retail operations into PNM retail operations?

EDDIE PADILLA RESPONSE

If the Stipulation is approved by the Commission, TNMP's New Mexico retail operations will be consolidated into PNM's retail operations effective January 1, 2007. Consolidation presents challenges arising from geographic distances, physical system differences and differences in IT support systems. In addition, certain Human Resources issues will have to be addressed and resolved. None of these issues, however, presents a barrier to consolidation; it is just a matter of the time needed to address these issues and accomplish the integration.

6. Would there be any economies of scale from such a consolidation, beyond the "synergies" identified in PNM's direct testimony?

TOM SATEGNA RESPONSE

As used in PNM's direct testimony the word "synergies" indicates savings resulting from the consolidation of administrative functions, not the consolidation

of TNMP's New Mexico retail operations into PNM's retail operations. As provided in the Stipulation, consolidation of TNMP's New Mexico operations with PNM will occur on January 1, 2007. Whether and to what extent the consolidation will produce savings is not known at this time. If such consolidation at the operational level produces additional savings and economies of scale, the Stipulation provides that such savings would be included in the appropriate future rate case and thus, all such savings would inure to the benefit of customers.

7. Direct Testimony of Brent L. Rice at pp. 16-17 mentions severance and other costs associated with consolidating the senior executive ranks of \$5.4 million. What are the associated savings?

BRENT RICE RESPONSE

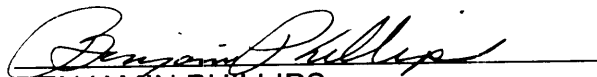
The costs-to-achieve of \$5.4 million on page 17, lines 4-5 of the Direct Testimony of Brent L. Rice include the change in control and severance costs associated with position reductions in legal, finance, accounting and executive functions. These costs-to-achieve are necessary to achieve a total of \$14.0 million savings during the first five years after the transaction closes, as noted on page 16, line 2 of the Direct Testimony.

Respectfully Submitted,

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