BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF THE APPLICATION OF PUBLIC SERVICE COMPANY OF NEW MEXICO FOR REVISION OF ITS RETAIL ELECTRIC RATES PURSUANT TO ADVICE NOTICE NO. 513	)	**Case No. 15-00261-UT**
PUBLIC SERVICE COMPANY OF NEW MEXICO,	)	
Applicant	)	

DIRECT TESTIMONY AND EXHIBITS

OF

HENRY E. MONROY

August 27, 2015

NMPRC CASE NO. 15-00261-UT
INDEX TO THE DIRECT TESTIMONY OF HENRY E. MONROY
WITNESS FOR
PUBLIC SERVICE COMPANY OF NEW MEXICO

DIRECT TESTIMONY OF
HENRY E. MONROY
NMPRC CASE NO. 15-00261-UT

I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Henry E. Monroy. I am the Director, Cost of Service and Internal Audit for PNM Resources, Inc. ("PNM Resources"). My address is 414 Silver Avenue, SW, Albuquerque, New Mexico 87102.

Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS DIRECTOR, COST OF SERVICE AND INTERNAL AUDIT.

A. As Director, Cost of Service and Internal Audit, I am responsible for revenue requirement-related work for all regulated subsidiaries of PNM Resources, including Public Service Company of New Mexico ("PNM" or "Company") and Texas New Mexico Power Company ("TNMP"). This responsibility includes preparation of revenue requirement analyses and supporting testimony for regulatory filings. I am also responsible for the oversight of the Internal Audit function at PNM Resources.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN UTILITY REGULATION PROCEEDINGS?

A. Yes. My educational background and professional experience is summarized in PNM Exhibit HEM-1, which includes a list of cases in which I have testified before the New Mexico Public Regulation Commission ("NMPRC" or

"Commission"), Public Utility Commission of Texas, and Federal Energy Regulatory Commission ("FERC").

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to:

(1) Present and support the reasonableness of the Base Period, adjusted Base Period, and Test Period cost of service[1] studies, as well as certain related schedules required to be filed pursuant to 17.9.530 NMAC ("Rule 530"), as supplemented by 17.1.3 NMAC ("FTY Rule");

(2) Provide a summary of how the total PNM cost of service is allocated among its various jurisdictions;

(3) Support PNM's request for continuation of Renewable Energy Rider No. 36 ("Renewable Energy Rider" or "Rider 36") in this proceeding;

(4) Explain the methodologies used to allocate costs from PNMR Services Company ("Shared Services") and PNM Resources to PNM;

(5) Describe and provide support for a number of adjustments to the Base Period to develop an adjusted Base Period;

(6) Explain the methodology used to develop the Test Period cost of service, and provide the necessary support for adjustments made in the linkage data to develop the Test Period cost of service;

[1] Throughout my testimony, the terms "cost of service" and "revenue requirements" are used interchangeably.

(7) Describe and explain the functionality of the electronic files for the cost of service models and supporting workpapers, as required by NMAC Rule 17.1.3.11; and

(8) Request Commission approvals relating to the establishment and recovery of specific regulatory assets and liabilities.

Q. PLEASE LIST THE SCHEDULES THAT YOU ARE SPONSORING.

A. I am sponsoring the following Rule 530 Schedules: A-1, A-3 through A-5, B-3, B-7, C-1 through C-3, D-1, D-2, E-1 through E-4, F-1, H-1, H-4 through H-8, H-14 through H-16, I-1 through I-3, K-1, K-5, P-4, P-7, and Q-6. Each of these schedules was prepared by me or under my direct supervision. Rule 530 Schedules A-5, B-3, B-7, C-1, E-2, E-3, H-1, and H-7 are filed in executable electronic format and are included as part of the cost of service functional model, which I describe in more detail later in my testimony. Rule 530 Schedules C-2, C-3, D-1, D-2, H-6, H-16, and Q-6 are not being filed in executable electronic format, but are being provided in hardcopy. All other Rule 530 Schedules I sponsor are being provided in executable electronic format on a DVD-ROM, but are neither fully functional nor required to be filed as fully functional under the FTY Rule.

Q. ARE YOU ALSO SPONSORING ANY EXHIBITS AS PART OF YOUR DIRECT TESTIMONY?

A. Yes, I am sponsoring PNM Exhibits HEM-1 through HEM-5, which were also prepared by me or under my direct supervision.

II. SUMMARY OF KEY CONCLUSIONS

Q. WHAT TEST PERIOD AND BASE PERIOD DID PNM USE TO DEVELOP THE REVENUE REQUIREMENTS SUPPORTING THE COMPANY'S RATE REQUEST IN THIS PROCEEDING?

A. The test period used to determine the revenue requirements for the rates requested by PNM in this proceeding is the projected twelve-month period ending September 30, 2016 ("Test Period"). The base period consisting of a full twelve months of actual Company books and records data from which the Test Period revenue requirement was developed, is the twelve months ending March 31, 2015 ("Base Period").

Q. PLEASE SUMMARIZE THE RESULTS OF PNM'S RETAIL TEST PERIOD REVENUE REQUIREMENT STUDY.

A. The Test Period revenue requirement is $981,455,795, based on a Test Period rate base of $2,458,087,082, and a capital structure comprised of 50.00% long-term debt, 0.39% preferred stock, and 49.61% common equity, reflecting a return on equity ("ROE") of 10.50% and a cost of debt of 5.87%. The total revenue requirement consists of a non-fuel revenue requirement of $763,800,031 and a fuel revenue requirement of $217,655,764.

PNM is requesting a rate increase to cover a deficiency in Test Period revenue of $123,498,612, consisting of a $121,704,111 increase related to non-fuel revenue and an increase of $1,794,501 related to fuel revenue.

PNM total projected revenue requirement includes $42,588,667 that PNM proposes to collect under PNM's Renewable Energy Rider. Table HEM-1 below provides a summary of the proposed revenue requirements and provides a comparison to existing revenues.

Table HEM-1

Line No.	Description	PNM Retail	Renewables	PNM Combined Retail
1	Non-Fuel Revenue	$ 642,095,920	$ 43,049,577	$ 685,145,497
2	Base Fuel Revenue	215,861,263	-	215,861,263
3	**Total Revenues at existing rates**	$ 857,957,183	$ 43,049,577	$ 901,006,760
4				
5				
6	**Revenue Requirement Requested**			
7	Non-Fuel Revenue Requirement	$ 763,800,031	$ 42,588,667	$ 806,388,698
8	Fuel Revenue Requirement	217,655,764	-	217,655,764
9	**Total Test Period Revenues per Revenue Requirement**	$ 981,455,795	$ 42,588,667	$ 1,024,044,462
10				
11	**Deficiency**			
12	Non-Fuel Deficiency - As Requested	$ 121,704,111	$ (460,910)	$ 121,243,201
13	Fuel Deficiency - As Requested	1,794,501	-	1,794,501
14	**Rate Deficiency - As Requested**	**$ 123,498,612**	**$ (460,910)**	**$ 123,037,702**
15				
16	**Rate Deficiency Percent Increase** *(Line 14 divided by Line 3)*	14.39%	-1.07%	13.66%

Q. PLEASE PROVIDE A BRIEF SUMMARY OF THE DEVELOPMENT OF THE REVENUE REQUIREMENTS UNDERLYING THE RATES BEING REQUESTED IN THIS PROCEEDING.

A. The Test Period rate base is based on projected balances as of September 30, 2016, except for amounts associated with working capital, which are reflected based on a thirteen-month average. In addition, PNM is requesting Construction Work In Progress ("CWIP"), based on projected balances as of September 30, 2016, for capital projects that are projected to be used and useful and in-service by February 28, 2017, or five months after the end of the Test Period. The revenue requirements are derived using a future test year period as that term was recently defined by the Commission in PNM's prior rate case in Case No. 14-00332-UT ("2014 Rate Case"), and were developed in accordance with the requirements of the FTY Rule and the applicable provisions of Rule 530.

To develop the Test Period revenue requirements, PNM began with unadjusted per-book data for the Base Period, which for this rate case is the twelve months ending March 31, 2015. PNM made certain adjustments to develop adjusted Base Period data, and then made additional adjustments in the linkage data to develop the future test year period. The assumptions and methodology used to develop these revenue requirements are discussed in detail below.

Q. HOW ARE THE BASE PERIOD, ADJUSTED BASE PERIOD AND TEST PERIOD REVENUE REQUIREMENTS STUDIES PRESENTED IN THE COMPANY'S RATE CASE FILING?

A. PNM Exhibits HEM-3 and HEM-4, which I am sponsoring as part of my direct testimony, together constitute the cost of service model supporting the revenue requirements and rate increase requested by PNM in this case. These exhibits have been filed in both hard copy and in fully-functional electronic format. PNM Exhibit HEM-3 provides the unadjusted Base Period cost of service, adjustments made to derive an adjusted Base Period cost of service and the Test Period cost of service. PNM Exhibit HEM-4 provides the electronic workpapers used to develop the adjusted Base Period and the Test Period cost of service that is provided in PNM Exhibit HEM-3. PNM Exhibits HEM-3 and HEM-4 are being provided electronically on a DVD-ROM, so the amounts in schedules and workpapers can be easily traced, and assumptions used to develop the Test Period are provided in working electronic files. These two exhibits provide PNM's compliance with the fully functional executable file required by the Commission's FTY Rule.

Q. PLEASE EXPLAIN THE METHODOLOGY USED TO DEVELOP THE TEST PERIOD REVENUE REQUIREMENT.

A. The Test Period revenue requirement was developed beginning with the adjusted Base Period. PNM developed the Test Period by utilizing escalation rates or specifically forecasted items based on discrete assumptions. In addition, capital additions and certain capital-related items were based on Company budget information and PNM has provided the required documentation for these items under the Commission's FTY Rule. Where budget information was not used, PNM's revenue requirement study, along with the cost comparisons and variance explanations required under the FTY Rule, are presented based on the accounts prescribed under the FERC Uniform System of Accounts ("USOA"), including cost elements, as applicable.

Q. WHEN WERE PNM'S CURRENT RATES ESTABLISHED?

A. PNM's current rates were established in Case No. 10-00086-UT ("2010 Rate Case") and became effective on August 21, 2011. PNM is seeking to change its base rates for the first time in approximately five years.

Q. PLEASE SUMMARIZE THE KEY DRIVERS UNDERLYING THE DEFICIENCY IN REVENUE UNDER THE RATES SET IN THE 2010 RATE CASE.

A. Since the 2010 Rate Case, PNM has invested significant amounts of capital in its transmission and distribution systems necessary to provide safe and reliable service to its customers. In addition, by the end of the Test Period, PNM will have made substantial capital additions to its electric generation fleet, including the La Luz facility, 40 MW of solar facilities, and the installation of Selective Non Catalytic Reduction Technology ("SNCR") and Balanced Draft Technology ("BDT") equipment on San Juan Generating Station ("SJGS") Units 1 and 4.

Another key driver of the revenue requirement deficiency is the decline in retail sales in the PNM service territory since the 2010 Rate Case, as described in more detail by PNM Witnesses Ortiz and Chan.

Finally, PNM must update its depreciation rates, to properly reflect its depreciation expense, as supported by the Depreciation Rate Study sponsored by PNM Witness Watson. PNM's proposed revisions to its depreciation rates result in a significant increase over the current depreciation expense.

Q. IS O&M EXPENSE A KEY DRIVER IN THE REVENUE DEFICIENCY?

A. No. Overall, Operations and Maintenance ("O&M") expenses are not a major driver of the revenue deficiency, as PNM has effectively managed its O&M expenses over the past five years to control O&M cost increases. Customers are also receiving the benefit of the fifty percent reduction in expenses associated with 104 MW of Unit 1 leases and the 10 MW Unit 2 lease in the Palo Verde Nuclear Generating Station ("Palo Verde" or "PVNGS").

III. BASE PERIOD AND ADJUSTED BASE PERIOD COST OF SERVICE

Q. WHAT PERIOD WAS USED TO DEVELOP THE BASE PERIOD AND ADJUSTED BASE PERIOD REVENUE REQUIREMENTS?

A. The Base Period presentation reflects PNM operations for the twelve-month period ended March 31, 2015. The unadjusted Base Period data comes from

PNM's financial accounting books and records. Please refer to the testimony of PNM Witness Peters for further discussion on the prescribed accounting practices followed by PNM for its books and records. PNM Exhibit HEM-3 COS BASE ADJ presents the Base Period and a summary of adjustments made to the Base Period to develop the adjusted Base Period revenue requirements. The adjustments are developed in supporting workpapers included in PNM Exhibit HEM-4 and discussed later in my testimony.

Q. PLEASE DESCRIBE THE UNADJUSTED BASE PERIOD.

A. The unadjusted Base Period data includes PNM's production, transmission and distribution operations of the Company. PNM also is allocated costs from Shared Services, a subsidiary of PNM Resources that provides administrative and other support services to PNM Resources and its subsidiaries, including PNM. Similarly, as explained below, certain costs at the PNM Resources level are allocated to PNM and included in the cost of service.

Q. WHAT COSTS ARE ALLOCATED FROM SHARED SERVICES OR PNM RESOURCES TO PNM?

A. Costs incurred by Shared Services are allocated to PNM based on Cost Allocation Manual ("CAM") and are reflected as Administrative and General ("A&G") expenses. Please refer to the testimony of PNM Witness Peters for discussion of the CAM. For the purposes of this filing, these services will be referred to as Shared Services. In addition, certain common assets that are reflected on the accounting records of either PNM Resources or Shared Services, including the headquarters building and computer software and hardware, are allocated to PNM based on the parameters set forth in the CAM. Because these assets are not recorded on the financial books and records of PNM, the allocated cost of these assets and related Accumulated Deferred Income Taxes ("ADIT") are reflected through adjustments to the Base Period, as discussed later in my testimony. The allocated costs related to these assets are included in the revenue requirements as they are necessary for PNM to provide electric service to its customers.

Q. WHAT PNM JURISDICTIONS RECEIVE ALLOCATIONS OF THE ADJUSTED BASE PERIOD REVENUE REQUIREMENTS?

A. The total PNM revenue requirement is allocated to the following jurisdictions:

- PNM Combined Retail. For purposes of this filing, PNM Combined Retail consists of PNM Retail and Renewables. PNM's Retail customers include all residential, commercial, industrial, and other public authority customers that receive retail electric service from PNM in New Mexico. PNM Retail jurisdiction comprises the revenue requirements associated with the base rates for which PNM is requesting Commission approval in this proceeding. The Renewables jurisdiction covers all cost components, including rate base, operating expenses, income tax credits, and return that PNM is entitled to collect under Rider 36;
- FERC Wholesale Generation. FERC Wholesale Generation customers include Navopache Electric Cooperative ("NEC"), City of Gallup, City of

Aztec and the Jicarilla Apache Nation. PNM's wholesale contract with the City of Aztec expires in June 2016. PNM was participating in the City of Aztec's current Request for Proposal ("RFP") process, but was not selected to be the future supplier for the City of Aztec. As such, PNM has reflected the anticipated expiration of the City of Aztec contract in the Test Period revenue requirement allocations. PNM's wholesale contract with the City of Gallup expired on June 29, 2014. As such, PNM has reflected the expiration of the City of Gallup contract in the adjusted base and Test Period revenue requirement allocations. The Jicarilla Apache Nation has filed public comments with the Commission stating their intent to provide notice of contract termination and to seek alternative providers effective during the future Test Period. Therefore, PNM has reflected this change in the development of the Test Period jurisdictional allocators, and through proposed revenue credits to PNM Retail in the Fuel and Purchased Power Cost Adjustment Clause ("FPPCAC") in the event that contract is not terminated;

- FERC Wholesale Transmission. FERC Wholesale Transmission customers include those who take network transmission service and long-term firm point-to-point service; and
- Excluded. This jurisdiction includes costs not allocated to the other jurisdictions, primarily PNM's interest in PVNGS Unit 3 and other costs not allocated to the other jurisdictions described above.

Q. HAVE YOU INCLUDED THE REVENUE REQUIREMENTS ASSOCIATED WITH COSTS PROPOSED TO BE COLLECTED UNDER THE RENEWABLE ENERGY RIDER IN YOUR CALCULATION OF THE OVERALL REVENUE REQUIREMENTS IN THIS CASE?

A. Yes, for illustrative purposes. PNM is required to seek renewal of its Renewable Energy Rider in this case. The costs currently authorized by the Commission and being recovered under Rider 36 have been included in PNM's revenue requirements for the adjusted Base Period. PNM has also included the projected costs associated with the renewable energy procurements that were approved by the Commission in NMPRC Case No. 14-00158-UT in the linkage data and in the Test Period. If the continuation of Rider 36 is approved, these costs will not be recovered through base rates.

Q. ARE THE COSTS ASSOCIATED WITH THE 40 MW SOLAR FACILITIES TO BE CONSTRUCTED IN 2015 TREATED AS RENEWABLE ENERGY RIDER COSTS?

A. No. Pursuant to the Stipulation approved by the Commission in Case No. 14-00158-UT, PNM has included the 40 MW Solar facilities to be constructed in 2015 ("40 MW Solar Facility") as a system resource and has included the allocated share of those costs in PNM Retail rather than Renewables.

Q. WHAT ARE THE PROJECTED REVENUE REQUIREMENTS TO BE COLLECTED UNDER RIDER 36 DURING THE TEST PERIOD?

A. PNM has projected the estimated costs to be collected under Rider 36 to be $42,588,667. PNM has projected the 2015 annual revenue requirement to be collected under Rider 36 to be $43,049,577, as referenced in NMPRC Case No. 12-00007-UT (2014 Renewable Reconciliation Filing) filed February 27, 2015. PNM is projecting a decrease in Rider 36 revenue requirements of $460,910, as shown in Table HEM-1 above and discussed earlier in my testimony.

Q. WHY IS PNM PROPOSING CONTINUATION OF THE RENEWABLE ENERGY RIDER?

A. The rider allows rates to more closely reflect PNM's actual costs under the renewable program. A principal advantage to customers of the use of a rate rider to recover costs of renewable resources is that they receive the benefit of declining rate base in the revenue requirement calculation promptly through the annual reset of the rider rate. If renewable energy costs are recovered through Rider 36, the decline in annual revenue requirements for the 65.5 MW of PNM-owned solar facilities now in service will be reflected in the annual rate rider, as the net book value of the investment declines due to the on-going depreciation of the facility and changes related to ADIT, which impact the rate base associated with these assets. In addition, PNM customers will ultimately bear only the actual revenue requirement associated with these procurements, as the Renewable Rider provides for a true-up for the difference between revenues collected and expenses incurred. PNM customers are currently receiving a credit of approximately $2.3 million related to an over-collection of revenues under Rider 36 during 2014. Absent the Renewable Energy Rider, customers would not be able to receive these benefits. PNM Witness Gerard Ortiz provides additional justification for continued use of Rider 36 in his direct testimony.

Q. WHY HAS PNM PRESENTED REVENUE REQUIREMENTS FOR THE RENEWABLES JURISDICTION IN THIS PROCEEDING?

A. If the Commission does not approve the continuation of Rider 36 in this proceeding, then the Renewables revenue requirements included in the Test Period cost of service will need to be consolidated with the PNM Retail revenue requirements and incorporated into the base rates set in this proceeding. However, if the Commission were to approve the continued use of Rider 36, the rates collected under Rider 36 would continue to be subject to review and approval by the Commission in PNM's annual renewable energy procurement plan proceedings. PNM has filed its request to reset Rider 36 rate for calendar year 2016 in NMPRC Case No. 15-00166-UT.

Q. HOW WERE COSTS ALLOCATED AMONG THE PNM RETAIL, RENEWABLES, FERC WHOLESALE GENERATION, FERC WHOLESALE TRANSMISSION, AND EXCLUDED JURISDICTIONS?

A. Most allocations between the PNM Retail and FERC jurisdictions are based on customer demand, customer energy, and plant-related values. Costs allocated to

Renewables and Excluded are typically directly assigned based on the costs associated with those generating resources. However, certain indirect costs -- *i.e.*, general and intangible plant ("G&I") and A&G expense -- are allocated based on the specific allocators shown in PNM Exhibit HEM-3 COS BASE ALLC and PNM Exhibit HEM-3 COS TEST.

Q. HOW WERE THE ALLOCATORS FOR GENERATION DEMAND AND ENERGY AND TRANSMISSION DEMAND CALCULATED FOR PNM'S RETAIL AND FERC WHOLESALE GENERATION CUSTOMERS?

A. The generation and transmission demand allocators were calculated as follows:

- Generation Demand: Based on a 12-month coincident peak ("12 CP") demand calculation on the generation system, reflecting loads from PNM Retail and FERC Wholesale Generation customers;
- Generation Energy: Based on a 12-month average of energy, reflecting loads from PNM Retail and FERC Wholesale Generation customers. Please refer to the testimony of PNM Witness Chan for further discussion on the development of the generation demand and energy allocators.
- Transmission Demand: Based on a 12 CP demand on the transmission system, which often will occur at a different hour or day from the generation demand peak, due to the heavy third-party use of PNM's transmission system. PNM Retail customers and FERC network integration transmission service customers are allocated costs on a 12 CP allocator based on their system peak. Long-term firm point-to-point customers under PNM's Open Access

Transmission Tariff ("OATT") are allocated costs based on their contract reservations, regardless of their use coincident with the transmission system peak hour.

The support for the generation demand and energy, and transmission demand allocators for the adjusted Base Period is included in PNM Exhibit HEM-4 WP AL.

Q. WHAT CAPITAL STRUCTURE WAS USED IN THE DETERMINATION OF THE ADJUSTED BASE PERIOD REVENUE REQUIREMENTS?

A. As discussed by PNM Witness Eden, the capital structure used in the determination of adjusted Base Period revenue requirements is PNM's actual capital structure as of March 31, 2015. The resulting capital structure for the adjusted Base Period consists of 48.58% long-term debt, 0.46% preferred stock, and 50.96% common equity, as shown in Rule 530 Schedule A-5.

Q. WHAT RETURN ON EQUITY ("ROE") DID PNM USE IN THE DEVELOPMENT OF ADJUSTED BASE PERIOD REVENUE REQUIREMENTS?

A. The ROE used in the adjusted Base Period is 10.0%, as approved by the NMPRC in the 2010 Rate Case.

Q. WHAT COST OF DEBT DID PNM USE IN THE DEVELOPMENT OF ADJUSTED BASE PERIOD REVENUE REQUIREMENTS?

A. PNM used its actual embedded cost of debt of 6.35% for the debt component of the capital structure in the development of adjusted Base Period revenue requirements. The support for the calculation of the cost of debt is included in Rule 530 Schedule G-3.

Q. WHAT COST OF PREFERRED STOCK WAS USED IN THE DETERMINATION OF ADJUSTED BASE PERIOD REVENUE REQUIREMENTS?

A. PNM is using its actual embedded cost of 4.62% for the preferred stock component of the capital structure in the adjusted Base Period. The support for the cost of preferred stock is included in Rule 530 Schedule G-5.

Q. PLEASE SUMMARIZE THE ADJUSTMENTS THAT WERE MADE TO RATE BASE ITEMS TO DEVELOP THE ADJUSTED BASE PERIOD RATE BASE.

A. PNM made the following rate base adjustments to the Base Period to develop its adjusted Base Period rate base:

- Net Plant In-Service: Removed the balances associated with the Palo Verde Asset Retirement Costs, removed balances associated with the anticipated ownership of an additional 132 MW in SJGS, reflected the ownership of the

Palo Verde Unit 2 Trust as ownership[2], and included the allocation of plant in-service assets recorded on Shared Services and PNM Resources' books. The Palo Verde Asset Retirement Obligations ("ARO") and the Asset Retirement Costs included in plant in-service are not included in rate base, as costs associated with final decommissioning of PVNGS are ultimately funded through an external trust, and PNM's recovery of these amounts in retail rates is based upon the funding amounts. This is consistent with the treatment followed in PNM's prior rate cases. See PNM Exhibit HEM-4 WP Plant-1, Column S through V. In addition, please refer to PNM Exhibit HEM-4 WP Plant-8 and WP Plant-9 for allocation of plant in-service assets to PNM.

- ADIT: Adjusted ADIT balances to reflect pro forma income tax calculations based on amounts that are included in the requested cost of service. Please refer to the testimony of PNM Witness Harland for further discussion of ADIT.
- Regulatory Assets and Liabilities: Adjusted Surface Coal Mine decommissioning regulatory asset balance to only reflect the portion related to buyout costs, as ordered in NMPRC Case No. 07-00077-UT. In addition, PNM adjusted the book balance amount related to the Palo Verde DOE Refund regulatory liability to reflect the current generation energy allocator. See PNM Exhibit HEM-4 WP RA-2, Column C and D.

[2] Under the accounting prescribed by FERC, the Palo Verde Unit 2 Trust owned by PNM is reflected as a subsidiary to PNM and the costs associated are reflected as lease expense. Pursuant to NMPRC Case No. 08-00305-UT, PNM reflects the Palo Verde Unit 2 Trust as ownership in its PNM retail rates and cost of service.

- Other Rate Base: Removed PVNGS ARO balances, and PVNGS Dry Cask Storage balances. As discussed above, PVNGS AROs are removed from rate base, as ultimate decommissioning costs associated with PVNGS are funded through an external trust. PVNGS Dry Cask Storage balances reflect a non-cash liability on the books and records of PNM, and therefore are removed from the cost of service. This is consistent with the treatment followed in PNM's prior rate cases. PNM adjusted balances recorded in Retirement Work In Progress ("RWIP") and Construction Work In Progress ("CWIP") to include only amounts that reflect expenditures associated with projects that are forecasted to be in-service within five months after the end of the Base Period. I discuss the development of CWIP included in the cost of service later in my testimony. See PNM Exhibit HEM-4 WP ORB-1, Column C through G.
- Working Capital: Adjusted working capital balances to reflect a 13-month average. See PNM Exhibit HEM-4 WP WC-1, Column E. In addition, based on the results of a recent lead-lag study, PNM has included a negative $1,109,154 as a cash working capital adjustment. See Rule 530, Schedule E-1 for the calculation of the cash working capital allowance. Please refer to the testimony of PNM Witness Peters for further discussion of the lead-lag study and its results.

Q. PLEASE SUMMARIZE THE ADJUSTMENTS THAT WERE MADE TO BASE PERIOD O&M EXPENSES TO DEVELOP THE ADJUSTED BASE PERIOD.

A. PNM made the following operating expense adjustments to the Base Period to develop its adjusted Base Period:

- Fuel-Related Expense: Included certain adjustments to fuel-related expenses as discussed and identified by PNM Witness Taylor. In addition, PNM normalized the surface and underground coal mine reclamation expenses recorded in the Base Period, to remove the impact from adjustments recorded during the Base Period to true-up the liability balance at the end of the accounting calendar year in accordance with GAAP. PNM has included the amortization of only $100 million of surface mine reclamation expenses in the allocation of costs to PNM Retail. See PNM Exhibit HEM-4 WP CMD-1, Column C and WP CMD-2.
- O&M Expense: A summary of adjustments made to O&M expense to develop the adjusted Base Period can be found in PNM Exhibit HEM-4 WP OM-3, Column C through O. The following adjustments were made:
  - Normalized planned outage expenses associated with PNM generation facilities based on a six-year historical average. See PNM Exhibit HEM-4 WP OM-7. Please refer to the testimony of PNM Witness Olson for further discussion on planned outages for PNM's generation facilities.

- Removed the portion of retiree pension expense that is attributed to employees formerly employed by gas operations when PNM owned a gas company. The portion removed is based on a 42% allocation that was established in NMPRC Case No. 08-00078-UT. See PNM Exhibit HEM-4 WP OM-5. Please refer to the testimony of PNM Witness Eden for further discussion on the portion of retiree pension obligations associated with its prior gas operations.
- Normalized active medical and dental to properly reflect current active medical and dental expense. See PNM Exhibit HEM-4 WP OM-6. Please refer to the testimony of PNM Witness Vavruska-Marcum for further discussion on active medical and dental expenses.
- Annualized and normalized labor expenses to reflect the current active positions and current salaries as of March 27, 2015 (the last payroll period in the Base Period). See PNM Exhibit HEM–4 WP LA-1. In addition, PNM adjusted the labor at SJGS to reflect the expected head count at SJGS for the Test Period. See PNM Exhibit HEM-3 WP LA-3 and WP LA-6. Please refer to the testimony of PNM Witness Olson for further discussion of labor at SJGS.
- Removed Energy Efficiency expenses from the Base Period, as these costs are recovered under a separate rate rider. See PNM Exhibit HEM-4 WP OM-3, Column I.
- As approved in NMPRC Case No. 07-00077-UT, adjusted transmission O&M expenses by the imputed value of a transmission

service exchange with Western Area Power Administration ("WAPA") to reflect 134 MW of transmission capacity provided to PNM by WAPA to deliver a portion of the Palo Verde output to New Mexico at Four Corners. This is consistent with the treatment followed in prior PNM rate cases. See PNM Exhibit HEM-4 WP-OM-8. Please refer to PNM Witness Johnson for further discussion of these agreements.

- Annualized and normalized O&M expenses associated with the Rio Bravo Generating Station ("Rio Bravo"). Rio Bravo was purchased by PNM in July, 2014. Therefore, the Base Period only reflected nine months of O&M expense in the Base Period. PNM normalized the O&M during the Base Period by removing a one-time credit received during the Base Period associated with an air permit at the facility, which is not expected to recur in the future. PNM annualized the Rio Bravo O&M Base Period expense to reflect a full year of O&M expense. See PNM Exhibit HEM-4 WP OM-9. Please refer to the testimony of PNM Witness Olson for further discussion of Rio Bravo O&M expense.
- Removed certain legal expenses from the Base Period not allowable under the Commission's ratemaking policies or for which the Company otherwise has elected to not seek recovery. Please refer to the testimony of PNM Witness Sanchez for further discussion. See PNM Exhibit HEM-4 WP OM-3, Column M.

- Removed certain advertising expenses from the Base Period not allowable under the Commission's ratemaking policies or for which the Company otherwise has elected to not seek recovery. Please refer to the testimony of PNM Witness Larsen for further discussion. See PNM Exhibit HEM-4 WP OM-3, Column N.
- Annualized cyber security insurance premiums. As the underlying insurance policy became effective January 1, 2015, the Base Period reflected only three months of cyber security insurance premium expense. See PNM Exhibit HEM-4 WP OM-15.

Q. PLEASE SUMMARIZE THE ADJUSTMENTS THAT WERE MADE TO SHARED SERVICES O&M EXPENSES TO DEVELOP THE ADJUSTED BASE PERIOD O&M EXPENSES.

A. PNM made two types of adjustments to O&M expenses related to Shared Services. Many of these adjustments are the same adjustments prepared in the O&M workpaper included in PNM Exhibit HEM-4.

First, PNM reclassified depreciation expense, payroll taxes and property taxes, and certain revenue credits recorded by Shared Services that are recorded as A&G expenses on PNM's books and records, and reclassified these expenses to the applicable sections in the cost-of-service analysis to ensure the costs are allocated to the appropriate jurisdictions. See PNM Exhibit HEM-4 WP SS-1, Column D, and Column F through H, for these reclassification adjustments.

Second, PNM made the following expense adjustments to the Base Period to develop its adjusted Base Period for Shared Services O&M:

- Removed other income and deductions recorded by Shared Services that are allocable to PNM. See PNM Exhibit HEM-4 WP SS-1, Column E;
- Removed the portion of Edison Electric Institute dues associated with lobbying expenses. See PNM Exhibit HEM-4 WP SS-10;
- Removed certain non-recurring expenses that were recorded during the Base Period that reflect one-time costs incurred to facilitate a process improvement initiative. See PNM Exhibit HEM-4 WP-SS-1, Column J;
- Removed the portion of incentive compensation not being requested in this proceeding, as discussed by PNM Witness Vavruska-Marcum. See PNM Exhibit HEM-4 WP SS-11;
- Similar to the treatment for general O&M identified above, normalized active medical and dental expenses, as discussed by PNM Witness Vavruska-Marcum. See PNM Exhibit HEM-4 WP SS-1, Column L;
- Removed employee miscellaneous expenses of Senior Executives that are not being requested for recovery in this proceeding. See PNM Exhibit HEM-4 WP SS-1, Column M;
- Similar to the treatment for general O&M identified above, annualized cyber security insurance premiums, as the Base Period only reflected three months of cyber security insurance premium expense on and after January 1, 2015. See PNM Exhibit HEM-4 WP SS-1, Column N;

- Similar to the treatment for general O&M identified above, removed non-allowable legal expenses recorded by Shared Services, as discussed by PNM Witness Sanchez. See PNM Exhibit HEM-4 WP SS-1, Column O;
- Similar to the treatment for general O&M expense identified above, removed non-allowable advertising expenses recorded by Shared Services, as discussed by PNM Witness Larsen. See PNM Exhibit HEM-4 WP SS-1, Column P; and
- Similar to the treatment for general O&M expense identified above, annualized labor expenses to reflect the current active positions and current salaries as of March 27, 2015 (the last payroll period in the Base Period). See PNM Exhibit HEM–4 WP LA-2 and WP LA-5.

Q. DID YOU MAKE ANY ADJUSTMENTS TO THE NEW MEXICO INSPECTION AND SUPERVISION ("I&S") FEES FOR PURPOSES OF THE ADJUSTED BASE PERIOD?

A. Yes. PNM removed I&S Fees from the Base Period. See PNM Exhibit HEM-4 WP GT-5, Column C. PNM recalculated Test Period I&S fees based on the adjusted Base Period revenue requirements calculation included in this filing. The I&S Fees are derived by multiplying the requested revenue requirements times the I&S rate, grossed up for income taxes. See PNM Exhibit HEM-3 COS BASE ADJ, Column R.

Q. PLEASE IDENTIFY ANY ADJUSTMENTS MADE TO DEPRECIATION EXPENSE TO DEVELOP THE ADJUSTED BASE PERIOD.

A. PNM adjusted depreciation to reflect the changes described earlier to net plant in-service related to the removal of Palo Verde Asset Retirement Costs, plant related to the 132 MW in SJGS Unit 4, and to reflect the Palo Verde Unit 2 Trust as ownership. See Rule 530 Schedule H-7, Columns K through N, as included in PNM Exhibit HEM-4 WP Plant.

Q. PLEASE IDENTIFY ANY OTHER ADJUSTMENTS MADE TO OTHER MISCELLANEOUS TAXES TO DEVELOP THE ADJUSTED BASE PERIOD.

A. PNM removed amounts related to gross receipts and franchise taxes recorded in the Base Period. PNM removed these amounts as these taxes are collected outside of base rates. See PNM Exhibit HEM-4 WP GT-5, Column D.

Q. WHAT ADJUSTMENTS WERE MADE RELATED TO REVENUE CREDITS TO DERIVE THE ADJUSTED BASE PERIOD REVENUE REQUIREMENTS?

A. The Base Period includes revenues associated with a transmission redispatch contract that has since expired. Therefore, PNM removed the revenues associated with this contract.

Q. WHAT ADJUSTMENTS WERE MADE RELATED TO INCOME TAX EXPENSE FOR PURPOSES OF THE ADJUSTED BASE PERIOD?

A. PNM made certain income tax adjustments to properly reflect an adjusted Base Period. Please refer to the testimony of PNM Witness Harland for discussion of adjustments made to federal and state income tax expense.

Q. WHAT ADJUSTMENTS TO GENERATION ENERGY AND DEMAND ALLOCATORS AND TRANSMISSION DEMAND ALLOCATORS DID PNM MAKE REGARDING FERC WHOLESALE CUSTOMERS?

A. In developing the adjusted Base Period revenue requirements, PNM annualized the forecasted loads for the Jicarilla Apache Nation contract used in the calculation of the generation energy, generation demand, and transmission demand allocation factors. The adjustment is necessary as the Jicarilla Apache Nation agreement did not begin until May 2014. In addition, PNM removed the City of Gallup contract loads from the Base Period calculations associated with generation energy and generation demand allocators in order to reflect the expiration of this contract in June 2014. The City of Gallup will continue as a network service customer; hence, the City's demand will continued to be reflected in the transmission demand allocator. Please see PNM Exhibit HEM-4 WP AL-1 for summary of Base Period allocators.

Q. WHAT ARE THE ADJUSTED BASE PERIOD REVENUE REQUIREMENTS?

A. The total PNM retail adjusted Base Period revenue requirements are $928,648,370 and are provided in PNM Exhibit HEM-3 COS BASE ALLOC. These revenue requirements include $230,895,821 associated with Base Fuel costs and $697,752,549 associated with non-fuel revenue requirements.

Q. ARE THERE ANY CHANGES TO THE COST COMPONENTS INCLUDED IN BASE FUEL IN THE ADJUSTED BASE PERIOD FROM THE COMPONENTS CURRENTLY INCLUDED IN BASE FUEL AND PNM'S FPPCAC?

A. No. PNM used the cost components included in the base fuel calculations that were approved in PNM's most recent FPPCAC continuation proceeding, Case No. 13-00187-UT. As discussed by PNM Witness Taylor, PNM is requesting to include certain fuel-related components currently recovered in base rates and not in base fuel rates in its calculation and determination of base fuel revenue requirements in the Test Period.

IV. TEST PERIOD REVENUE REQUIREMENTS

Q. PLEASE DESCRIBE GENERALLY HOW PNM DEVELOPED THE TEST PERIOD REVENUE REQUIREMENTS.

A. The Test Period reflects PNM's projected operations for the twelve-month period ended September 30, 2016. The Test Period was developed through forecasts and certain information in the Company's annual operating plan, related to capital investments and capital loads. A detailed discussion of the methodologies used to develop the amounts included in the Test Period revenue requirements are discussed below. As required under the FTY Rule, 17.1.3.12(D) NMAC, PNM has included the required linkage data from the adjusted Base Period to the Test Period revenue requirements in the workpapers supporting the cost of service.

A. Rate Base

Q. IS PNM PROPOSING TO USE A YEAR-END RATE BASE OR AN AVERAGE RATE BASE IN THE DEVELOPMENT OF ITS TEST PERIOD REVENUE REQUIREMENT IN THIS CASE?

A. As mentioned above, PNM developed its Test Period rate base using projected balances as of September 30, 2016, which is the end of the Test Period, except for amounts associated with working capital, which are reflected based on a thirteen-month average. PNM is also proposing to include certain CWIP balances related to non-revenue producing plant projected to go into service within five months after the end of the Test Period, reflecting projected plant in-service balances as of February 28, 2017.

Q. WHY DID PNM ELECT TO USE YEAR-END PLANT BALANCES IN DEVELOPING ITS TEST PERIOD RATE BASE INSTEAD OF USING AVERAGE BALANCES OTHER THAN FOR THE WORKING CAPITAL ACCOUNTS?

A. As a result of the Commission's ruling in PNM's 2014 Rate Case that provided a definition of the future test year period to be applied under the FTY Rule, PNM is proposing a relatively modest Test Period (October 1, 2015 - September 30, 2016) that extends only 5 to 17 months from the end of the Base Period (April 1, 2014 – March 31, 2015). By the time the rates approved by the Commission in this rate case are expected to go into effect, on or about July 1, 2016, the future Test Period will already be 75% completed. A primary goal of setting utility rates is to ensure that the rates charged customers are reflective of the utility's actual costs of providing service during the period in which the customers receive that service. Since the rates from this case will be in effect commencing around July 1, 2016, and are expected to be in effect for some time, a rate base developed using the Company's plant balances as of September 30, 2016 will be more reflective of the Company's actual capital investments than using average balances, which would reflect the approximate midpoint of the Test Period, or March 31, 2016.

Q. IS USE OF YEAR-END RATE BASE CONSISTENT WITH COMMISSION RULES AND PAST PRACTICE?

A. Use of year-end rate base is allowed under Rule 530 and the Commission's FTY Rule. In addition, the Commission regularly has approved rates in prior PNM rate cases, as well as in rate cases of other New Mexico public utilities, that were developed using year-end rate base. Although those cases did not involve a future test year, the underlying rationale for use of year-end rate base that I explain above was equally applicable. In addition, the Commission's FTY Rule only limits a utility's use of year-end rate base where the proposed future test year does not commence until one year or more after the Base Period. Specifically, 17.1.3.16(C) NMAC provides: "For a future test year period that begins at least 12 months after the end of the Base Period, the average rate base shall be used, utilizing the projected 13-month average of the future test year period."

Q. PLEASE EXPLAIN PNM'S PROPOSAL TO INCLUDE FIVE MONTHS OF CERTAIN CWIP IN RATE BASE.

A. As I explain below and as detailed further in the testimony of PNM Witnesses Johnson, Olson, and Mendez, PNM has included in the Test Period projected balances for CWIP related to generation, transmission, distribution, and general and intangible plant as of September 30, 2016, that is projected to be in-service within five months after the end of the Test Period. PNM is only seeking to include CWIP on projects that would not otherwise generate additional customer revenues as described later in my testimony.

Q. IS PNM'S INCLUSION IN RATE BASE OF FIVE MONTHS OF CERTAIN CWIP ALSO CONSISTENT WITH COMMISSION PRECEDENT AND THE COMMISSION'S FTY RULES?

A. Yes. The Commission approved inclusion in rate base of CWIP reflecting non-revenue producing plant expected to go into service within five months of the end of the Test Period in PNM's electric rate case in NMPRC Case No. 07-00077-UT and in PNM's gas rate case in NMPRC Case No. 06-00210-UT. Although those cases did not involve a future test year, the underlying rationale for inclusion of five months of certain CWIP is based on the same rationale that I explain above for use of year-end rate base. While the Commission's FTY Rules do not specifically mention CWIP, the Commission's 530 Rules provide for a utility to request inclusion of CWIP in the Test Period to justify a rate increase. See 17.9.530.14(B)(4)(b) NMAC. In addition, NMSA 1978, § 62-6-14(E) specifically provides that a utility may request to include certain CWIP in rate base for projects that are projected to be in-service the lesser of five months after the end of the Test Period or 24 months after the end of the Base Period. Therefore, PNM is requesting the inclusion of CWIP balances for projects with a projected in-service date by February 28, 2017.

Q. PLEASE DESCRIBE THE ADJUSTMENTS THAT WERE MADE TO RATE BASE IN THE TEST PERIOD COST OF SERVICE STUDY.

A. The rate base adjustments made in the Test Period cost of service study include adjustments to Net Plant in Service, ADIT, Regulatory Assets and Liabilities, Other Rate Base Items, and Working Capital. Please refer to PNM Witness Harland's testimony for a discussion of ADIT included in the Test Period revenue requirements. The other areas are discussed below.

Net Plant In-Service

Q. PLEASE DESCRIBE HOW THE NET PLANT IN-SERVICE WAS DEVELOPED FOR THE TEST PERIOD.

A. The net plant in-service balance included in the Test Period is based on the forecasted plant in-service balances as of September 30, 2016. PNM's net plant in-service balances for this period begin with the per book net plant in-service balances as of March, 31, 2015. PNM then added the forecasted net plant in-service balances for each month from April 2015 through September 2016.

Q. PLEASE EXPLAIN HOW THE FORECASTED NET PLANT IN-SERVICE BALANCES USED IN THE TEST PERIOD WERE DETERMINED.

A. Projected monthly plant clearings for generation, transmission, distribution, and G&I and projected plant retirements during the linkage and Test Period were added to the gross plant balances at the end of the Base Period to derive the monthly gross plant in-service balances. See PNM Exhibit HEM-4 WP Plant-2 and WP Plant-3 for PNM and PNM Exhibit HEM-4 WP Plant-10 and WP Plant 11 for Shared Services. Please refer to PNM Witnesses Olson, Johnson, and

Mendez for discussion of the projected capital investment clearings included in the linkage data and Test Period revenue requirements.

The accumulated depreciation balances were developed by taking the actual accumulated depreciation balances as of March 31, 2015, including calculated monthly depreciation expense based on the forecasted plant-in service balances as adjusted for forecasted retirements and cost of removal. See PNM Exhibit HEM-4 WP Plant-4, WP Plant-5, and WP Plant-6 for PNM and PNM Exhibit HEM-4 WP Plant-12 WP Plant-13, and WP Plant-14 for Shared Services. The monthly depreciation expense linkage for April 2015 through September 2015 is calculated using PNM's currently approved depreciation rates. PNM applied the proposed new depreciation rates requested in this proceeding from October 2015 through September 2016, the Test Period in this case. See PNM Exhibit HEM-4 WP Plant-7. I discuss the requested change to depreciation rates, which are supported by PNM Witness Watson, later in my testimony.

Q. PLEASE IDENTIFY OTHER PNM WITNESSES THAT DISCUSS THE CAPITAL BUDGET PROCESS AND THE SPECIFIC CAPITAL PROJECTS INCLUDED IN THE LINKAGE DATA AND TEST PERIOD.

A. PNM Witness Olson discusses capital investments forecasted for generation assets, PNM Witness Johnson discusses capital investments forecasted for transmission and distribution assets, and PNM Witness Mendez discusses capital investments forecasted for Business Technology Services ("BTS") projects and

General Services projects forecasted by Shared Services. PNM Witness Buchanan discusses the process PNM and Shared Services employs to identify, plan and approve capital projects in our forecasts, addresses how the Company forecasts capital retirements and cost of removal, and discusses the application of Allowance for Funds Used During Construction ("AFUDC"). PNM Witness Peters discusses the application of capital loads, excluding AFUDC, to the capital projects.

Q. HAVE YOU PREPARED A SCHEDULE THAT PROVIDES THE MONTHLY NET PLANT IN-SERVICE BALANCES FROM THE END OF THE BASE PERIOD TO THE END OF THE TEST PERIOD?

A. Yes. PNM Exhibit HEM– 4 WP Plant-1 provides a schedule of monthly net plant in-service balances from March 31, 2015, through September 30, 2016, the end of the Test Period.

Q. DID PNM INCLUDE THE 40 MW SOLAR FACILITY THAT WAS APPROVED BY THE COMMISSION IN CASE NO. 14-00158-UT?

A. Yes. As discussed earlier, PNM has included the 40 MW Solar facility as a system resource in the forecasted generation plant in-service monthly balances, in accordance with the Commission-approved Stipulation in NMPRC Case No. 14-00158-UT. PNM has forecasted the in-service date of this facility to be in the fourth quarter of 2015.

Q. HAS PNM USED THE CERTIFICATED COST SET BY THE COMMISSION FOR THE FORECASTED CAPITAL INVESTMENT IN THE 40 MW SOLAR FACILITY?

A. Yes. The forecasted generation capital investment associated with the 40 MW Solar facility is $79.3 million, which is at the certificated cost established by the Commission in NMPRC Case No. 14-00158-UT.

Q. DID PNM INCLUDE IN THE NET PLANT IN-SERVICE THE PROJECTED CAPITAL COST ASSOCIATED WITH ITS ACQUISITION OF LEASES OF 64 MW IN PALO VERDE UNIT 2?

A. Yes. PNM has included the ownership of 64 MW of Palo Verde Unit 2 as part of the projected production plant in-service in the Test Period. In addition, PNM has reflected an acquisition adjustment related to this transaction in rate base based upon an acquisition date of January 2016. As discussed further in my testimony below, PNM has removed the lease expense associated with these facilities from the Test Period revenue requirements. Please refer to PNM Witnesses Eden and Ortiz for further discussion of the Palo Verde Unit 2 lease acquisitions. PNM Witness Peters discusses the calculation and derivation of the acquisition adjustment proposed as the result of this transaction.

Q. HAS PNM INCLUDED ITS PROJECTED INVESTMENT IN THE 40 MW LA LUZ GAS GENERATING FACILITY APPROVED IN NMPRC CASE NO. 13-00175-UT?

A. Yes. PNM has included the 40 MW La Luz Gas Generating Facility in the production plant in-service, with a forecasted in-service date of December 2015. Please refer to PNM Witness Olson for further discussion of this capital investment.

Q. IS THE FORECASTED INITIAL PLANT IN-SERVICE BALANCE FOR THE LA LUZ FACILITY BELOW THE CERTIFICATED COST OF $56 MILLION ESTABLISHED IN NMPRC CASE NO. 13-00175-UT?

A. Yes. The forecasted capital construction cost for the La Luz Generating Station is included in rate base at a value of $56 million.

Q. HAS THE COMPANY REFLECTED THE CAPITAL INVESTMENT ON SNCR AND BDT EQUIPMENT ON SJGS UNITS 1 AND 4?

A. Yes. PNM has included the capital investments associated with these projects in net plant in-service, based on the projected in-service dates. The forecasted capital construction costs for SNCR and BDT equipment on SJGS Unit 1 and SJGS Unit 4 are $35.9 million and $42.3 million, respectively, and total $78.2 million. As discussed by PNM Witness Olson, this total includes $0.3 million of costs which do not clear during the linkage or Test Period. PNM is seeking recovery of the net capital investment in this proceeding of $64.8 million, after a reduction of $13.1 million related to the proposed acquisition of 132 MW in SJGS. If this proposed acquisition is approved by the Commission, PNM will seek recovery of the $13.1 million in a future rate case. PNM does not anticipate beginning the recovery of costs associated with the 132 MW in SJGS earlier than January 1, 2018, the date that PNM anticipates receiving benefits from the additional capacity. Please refer to PNM Witness Olson for further discussion of this capital investment.

Q. DOES THIS CONCLUDE YOUR DISCUSSION OF TEST PERIOD NET PLANT IN-SERVICE?

A. Yes.

Regulatory Assets and Liabilities

Q. HAVE YOU PREPARED AN EXHIBIT THAT SUMMARIZES THE REGULATORY ASSETS AND LIABILITIES INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. Yes. PNM Exhibit HEM–4 WP RA-2 is a summary of all Regulatory Assets and Liabilities in the Test Period. The Regulatory Assets and Liabilities are separated into two groups: (1) assets and liabilities that have been approved in prior Commission proceedings; and (2) assets and liabilities for which PNM is seeking approval in this proceeding.

Q. HOW DID PNM PROJECT THE TEST PERIOD BALANCES ASSOCIATED WITH REGULATORY ASSETS AND LIABILITIES THAT HAVE BEEN PREVIOUSLY APPROVED?

A. For regulatory assets and liabilities that have been previously approved or included PNM's prior rate cases, PNM projected the balances based on the existing amortization schedules for these regulatory assets and liabilities. Specifically:

- Surface Coal Mine Decommissioning – forecasted balance based on existing amortization schedule. PNM has only included the rate base portion attributable to the buyout costs, as approved in NMPRC Case No. 07-00077-UT. The amortization expense included in the PNM Retail revenue requirements reflects the amortization of the $100 million cap on surface reclamation costs for SJGS and Four Corners.
- Palo Verde Units 1 and 2 Prudence Audit and Combustion Engineering – forecasted balance based on existing amortization schedule. See PNM Exhibit HEM-4 WP OM-14.
- Deferred Coal Costs – forecasted balance based on amortization of deferred coal costs to align the costs incurred with the period that customers receive the benefit as discussed in Paragraph 47 of the Final Order in NMPRC Case No. 08-00092-UT. See PNM Exhibit HEM-4 WP RA-7.
- Las Vegas Decommissioning Regulatory Asset and Liability – implement two-year amortization period, beginning with the effective date of new rates in this proceeding. To reflect a full year of amortization, PNM has included an

annual amount of amortization associated with these balances in the Test Period. PNM is requesting recovery of these balances over a two-year period. The establishment of the regulatory assets and liabilities were authorized in NMPRC Case No. 10-00264-UT. However, the recovery period of these regulatory assets and liabilities were not defined in that proceeding. PNM is requesting recovery of these amounts over a two-year period. The request for a two-year period is explained later in my testimony. See PNM Exhibit HEM-4 WP RA-8 and WP RA-9.

- Pollution Control Bond Refinancing Hedge – reflect the loss associated with the reacquisition of debt. These amounts are included in the cost-benefit analysis performed on the loss on the reacquired debt, as discussed by PNM Witness Peters. Because PNM has demonstrated a net benefit to customers, the forecasted balance is included in rate base, consistent with the Commission's past treatment of similar costs.
- Renewables Federal Grant and State Credit – forecasted balances are amortized based on the useful life of the underlying renewable investment. These balances are recovered through the Renewable Energy Rider. As such, none of these amounts will be included in the test year rate base if the Commission approves continuation of the Renewable Energy Rider.

Q. PLEASE IDENTIFY THE REGULATORY ASSETS AND LIABILITIES FOR WHICH PNM IS REQUESTING COMMISSION APPROVAL IN THIS PROCEEDING.

A. PNM is requesting approval to establish: (1) a regulatory asset to defer and to begin recovering expenses incurred as a result of its exit from the Alvarado Square building in downtown Albuquerque and the consolidation of its offices into the PNM headquarters building (these deferred expenses are referred to as "Alvarado Square Lease regulatory asset"); (2) a regulatory asset to defer and to begin recovering expenses to be incurred to re-program PNM's Time of Use ("TOU") meters to accommodate proposed changes in PNM's TOU rates ("TOU regulatory asset"); (3) a regulatory asset to begin recovering incremental expenses incurred in this proceeding ("Rate Case Expenses regulatory asset"); (4) a regulatory liability to accumulate and begin passing on to customers certain DOE Spent fuel refunds received through the Base Period ("PV DOE Settlement regulatory liability"); (5) a new regulatory asset for costs incurred to implement a recurring credit card payment program ("Credit Card Program"); (6) a regulatory liability to recognize expenses associated with AROs recorded on a straight-line basis, instead of using the accretion method as otherwise required under GAAP, (7) a regulatory liability to recognize underground coal mine reclamation costs on a straight-line basis, instead of recovery under accretion expense, as otherwise required under GAAP; and (8) a regulatory asset to recover the impairment of state Net Operating Loss carryforwards, as discussed in more detail by PNM Witness Harland.

Q. PLEASE DESCRIBE THE COMPANY'S EXIT FROM ALVARADO SQUARE.

A. PNMR management made a decision to vacate the Alvarado Square building on December 27, 2011, and to consolidate employees in the PNM Headquarters building across the street in order to reduce costs and increase employee efficiency. As of that date, PNMR had undepreciated leasehold improvements at the Alvarado Square building of $4,557,557, an allocated portion of which was included in the rate base used in PNM's revenue requirements underlying the rates approved in the 2010 Rate Case. In order to properly vacate Alvarado Square, PNM had to incur certain additional costs as well. These costs included the demolition of the skywalk that connected the Alvarado Square and Headquarters buildings, separating the heating and cooling systems in order for each building to have stand-alone systems, and improvements to the Headquarters building necessary to accommodate the increased usage and capacity of the facility, including the remodeling of each floor and installation of additional cubicles.

Q. HAS PNM PREPARED A COST-BENEFIT ANALYSIS TO DETERMINE WHETHER THE DECISION TO VACATE ALVARADO SQUARE HAS RESULTED IN LOWER REVENUE REQUIREMENTS?

A. Yes. A cost-benefit analysis was performed to determine if there was an overall benefit to customers of the relocation after incurring the incremental costs to improve the Headquarters building and to vacate the Alvarado Square building. Based on the cost benefit analysis, there is an overall net benefit of $1.4 million in the form of revenue requirement savings. See PNM Exhibit HEM-4 RA-5. This net benefit factors in

PNM's recovery of the remaining net book value of the Alvarado Square leasehold improvements, as well as the costs incurred related to vacating Alvarado Square. In addition, the cost component of the analysis includes PNM's recovery of the additional capital investment to accomplish the relocation of employees.

Q. BASED ON THIS ANALYSIS, WHAT AMOUNT OF ALVARADO SQUARE EXIT COSTS IS PNM PROPOSING TO INCLUDE IN RATE BASE?

A. PNM is seeking to include in rate base $11.3 million of the improvements made to the Headquarters building as general plant, before corporate allocation, as well as a regulatory asset in the amount of $3.8 million to allow for recovery of the PNM Retail share of the Alvarado Square exit costs. Please see PNM Exhibit HEM-4 WP RA-4 for a calculation of the Alvarado Square Lease Regulatory Asset. The total costs deferred of approximately $4.9 million include the remaining balance of the Alvarado Square leasehold improvements as of December 31, 2012 and costs associated with the removal of the skyway between the Headquarters and Alvarado Square buildings, as well as the heating and cooling system modifications.

Q. WHAT HAS PNM INCLUDED IN THE TEST PERIOD RELATED TO RECOVERY OF THE ALVARADO SQUARE LEASE REGULATORY ASSET?

A. PNM is proposing to amortize and recover the Alvarado Square Lease Regulatory Asset over a five-year period and has included the first-year of amortization in the other allowable expenses in the Test Period cost of service. PNM has chosen a five-year amortization period, which is longer than the two-year amortization period for other regulatory assets and liabilities, to reflect the longer-term nature of this regulatory asset. PNM expects to be in the building for many years, and has chosen a longer amortization period for recovery. PNM has also included the unamortized balance in the other rate base section of the cost of service. Please refer to PNM Exhibit HEM-4 WP RA-4 and WP RA-10 for derivation of amortization expense and PNM Exhibit HEM-4 WP RA-2 for the calculation of rate base at the end of the Test Period.

Q. IS THE PROPOSED RATE TREATMENT FOR THE ALVARADO SQUARE LEASE REGULATORY ASSET CONSISTENT WITH PRIOR PNM RATE CASES?

A. Yes. In NMPRC Case No. 2262, PNM sought recovery for costs associated with PNM's efforts to reduce labor costs, termed Project Turnaround. PNM demonstrated that customers received a net benefit as a result of these labor reductions, and was allowed to recover the costs incurred to achieve those reductions. The proposed treatment of the Alvarado Square exit costs and employee relocation is consistent with the NMPRC Case No. 2262 precedent, in that if a benefit is achieved by a reduction to revenue requirements, then the Company should be allowed recovery of costs incurred to achieve those benefits.

Q. PLEASE DESCRIBE THE TOU REGULATORY ASSET.

A. PNM is proposing to modify its TOU pricing period for this rate case. Currently, PNM's TOU On-Peak hours are from 8 a.m. to 8 p.m., Monday through Friday. PNM proposes to adjust its TOU On-Peak hours from 10 a.m. to 10 p.m., Monday through Friday. Please refer to PNM Witness Aguirre for further discussion and support of the proposed change in the TOU pricing period.

Q. WHY IS PNM REQUESTING REGULATORY ASSET TREATMENT FOR THE TOU-RELATED EXPENSES?

A. As discussed by PNM Witness Aguirre, PNM expects to incur approximately $250,000 to reprogram the TOU meters as a result of the requested rate design changes. These costs are expected to be incurred in early 2016, during the Test Period, but are not expected to recur in a future period; therefore, it is not appropriate to include this expense as part of its forecasted on-going O&M expenses in the Test Period. Instead, PNM is appropriately requesting to establish a regulatory asset to normalize these costs and recover them over a two-year period. The basis for the two-year period is discussed in more detail below. PNM is not requesting rate base treatment for this requested balance, as PNM expects to incur these costs at the same time recovery of the costs will begin, upon the implementation of these new requested rates. PNM is only requesting the amortization expense of $125,000 in its requested revenue requirements for this case.

Q. WHAT AMOUNT IS PNM SEEKING TO RECOVER IN RATE CASE EXPENSES FOR THE CURRENT CASE?

A. PNM is seeking recovery of $4,034,109 in rate case expenses, as is detailed in PNM Exhibit HEM-4 WP OA-3. Rate case expenses include the out-of-pocket costs incurred by the Company to provide notice to customers, copying the filing, postage, and costs of outside consultants, accounting firms, and attorneys in preparing and litigating the case. PNM is requesting to establish a regulatory asset to recover these costs over a two-year period. The two-year period is based on the time period that rates from this proceeding are expected to be in place. For comparison purposes, PNM incurred approximately $3.5 million in rate case expenses for the 2010 Rate Case.

Q. HOW ARE THE RATE CASE EXPENSES ESTIMATED?

A. This case involves numerous complex issues and, based on past experience, PNM believes that many of these issues will be highly contested and, therefore, the costs of preparing and litigating this rate case will be significant. PNM has taken action to control expenses to the extent possible consistent with the need for thorough and effective presentation of PNM's positions. These actions include the assignment of qualified in-house counsel to oversee and participate in proceedings, and qualified outside counsel with substantial utility law experience. PNM Witness Sanchez discusses how legal costs are managed by the Company. In addition, it is both cost-effective and necessary to retain outside experts who have subject matter expertise not available in-house on specific issues inherent in a complex rate proceeding. In this case, PNM has sought the assistance of:

- Robert Hevert, Managing Partner of Sussex Economic Advisors, LLC, to provide expert financial evaluation and testimony concerning the cost of capital and the appropriate capital structure for ratemaking purposes, which are the main components in a rate of return determination;
- Dane Watson, Managing Partner of the Alliance Consulting Group, to provide testimony in support of the new depreciation rates which PNM proposes to implement;
- Dr. Ahmad Faruqui, Principal with The Brattle Group, to provide support for PNM's load forecast;
- Dr. Daniel G. Hansen, Vice President of Christensen Associates Energy Consulting, LLC, to provide support for certain elements of PNM's proposed rate design requests; and
- ScottMadden, Inc., a management consulting firm that, was retained to assist with the forecast and capital budget documentation required to support the filing of this case and provide assistance with rate case schedules.

PNM's engagement of these outside services for this case is a cost-effective means to meet the requirements of a complex rate case filing. PNM hires outside service firms to prepare and support its filing versus hiring full-time staff to provide these same services, as these services are cyclical in nature.

Also, 17.9.530.13(Q)(6) NMAC requires that PNM submit an opinion of an independent certified public accountant stating that an independent examination of the per book amounts and accounting adjustments in PNM's books and records has been made for the Base Period and that the results thereof are in all material respects in compliance with the Uniform System of Accounts prescribed by the Commission. The accounting firm of KPMG provided this opinion. Other costs included in rate case expenses for this case are necessary and reasonable due to the number of expected parties and witnesses, the anticipated level of document discovery and interrogatories, the anticipated length of the hearing and the complexity of the issues.

Q. IS PNM SEEKING TO RECOVER RATE CASE EXPENSES THAT RELATE EXCLUSIVELY TO THE PRIOR RATE CASE APPLICATION IN NMPRC CASE NO. 14-00332-UT THAT WAS DISMISSED BY THE COMMISSION?

A. No. Rate case expenses that relate exclusively to that proceeding have not been included in the rate case expenses for which we are seeking to recovery in this proceeding. PNM has included the reasonable and necessary rate case expenses that the Company has incurred or will incur to prepare, notice and defend this new rate case.

Q. WHAT IS THE BASIS FOR PNM USING A TWO-YEAR AMORTIZATION PERIOD FOR THESE RATE CASE EXPENSES?

A. This is the approximate length of time PNM expects the rates from this proceeding to be in effect. If the abandonment of San Juan Units 2 and 3 requested in NMPRC Case No. 13-00390-UT is approved, PNM is anticipating having a different power supply resource portfolio in place, which will require the filing of another general rate case in order to begin recovery. As such, it is anticipated that PNM will be filing another general rate case with rates expected to be in effect within two-years after the implementation date of rates in this filing.

Q. PLEASE EXPLAIN THE REQUEST TO ESTABLISH A REGULATORY LIABILITY RELATED TO THE PALO VERDE DOE NUCLEAR SPENT FUEL SETTLEMENT.

A. PNM has received refunds under a settlement agreement with the Department of Energy regarding nuclear spent fuel costs at PVNGS. These settlement amounts reflect reimbursement for spent fuel costs on all three units of PVNGS. Under the settlement agreement, PNM received a settlement payment in October 2014 in the amount of $3,784,423, as reimbursement for costs incurred through June 2011. In addition, PNM received a second settlement payment in 2015, for costs incurred from July 2011 through June 30, 2014, in the amount of $2,117,844. Currently, only PVNGS Units 1 and 2 are subject to Commission jurisdiction. PNM is proposing to record the amounts applicable to PNM Retail as a regulatory liability and will credit these settlement amounts back to customers over a proposed two-year period. Absent an order from the Commission to create a regulatory liability, PNM would record these received settlements as income in the period received. Please see PNM Exhibit HEM-4 WP RA-3 for the calculations of the PV DOE Settlement regulatory liability balances. PNM is proposing that this credit be refunded back to customers through base fuel and is reflected in the Test Period fuel as provided by PNM Witness Taylor.

Q. WHAT ACCOUNTING TREATMENT IS PNM PROPOSING RELATED TO THE CREDIT CARD PROGRAM?

A. As described by PNM Witness Ortiz, PNM is proposing to implement a Credit Card Program in July 2016, or upon implementation of rates from this proceeding, and to incur the discounted vendor fees associated with customers subscribing to recurring credit card payments. At this time, PNM is unable to predict the exact number of customers that may take advantage of this new program and so is unable to estimate the exact amount of costs it expects to incur for this program. Therefore, PNM is requesting the Commission allow PNM to establish a regulatory asset for the fees incurred in this customer service program. PNM would defer all expenses incurred related to the Credit Card Program upon implementation of the program through the effective date of new rates set in PNM's next rate case.

Q. PLEASE STATE THE PROPOSED CHANGE TO THE ACCOUNTING FOR ARO'S REQUESTED IN THIS PROCEEDING.

A. PNM is proposing to record ARO accretion expenses for its Production Plant, excluding Palo Verde, on a straight-line basis and to reflect these accretion expenses in its calculation of the ARO liabilities that are amortized and included in PNM's revenue requirements. PNM is requesting that the Commission approve the creation of a regulatory liability to recognize the difference between the accretion expense recorded on the straight-line expense proposed and the accretion expense otherwise applicable under GAAP accounting. Please refer to PNM Witness Peters for further discussion of the accounting for AROs under GAAP. PNM will continue to include the resulting ARO liability and will include the proposed ARO regulatory liability in rate base. Consistent with prior cases, PNM will exclude the ARO liabilities associated with Palo Verde.

Q. WHY IS PNM PROPOSING TO CHANGE HOW ACCRETION EXPENSES RELATED TO AROS ARE RECOVERED THROUGH RATES?

A. PNM is proposing to recover accretion expense for its Production Plant, excluding Palo Verde, on a straight-line basis because accretion expense increases as the balance of the ARO liability grows. Charging these costs to customers on a straight-line basis is more equitable to customers because it properly matches cost causation with the receipt of benefits from the use of the asset, and thus avoids intergenerational inequities. PNM proposes to record a regulatory liability resulting from timing differences between straight-line collection of decommissioning expense and accretion of the asset retirement obligation. Please refer to PNM Exhibit HEM-4 WP OA-5, which provides the calculation of the change in accretion expense to a straight-line recovery. PNM requests approval of this treatment and of the creation of a regulatory liability to reflect the difference between the accretion expenses that would be recorded under GAAP accounting compared to the amount to be expensed and deemed recovered by PNM under a straight-line approach.

Q. WHAT IS THE BENEFIT TO CUSTOMERS OF THE REGULATORY LIABILITY?

A. Under PNM's proposal, customers over time will pay actual ARO accretion expense, but will do so in a manner that mitigates intergenerational inequities. Given the nature of accretion expense, during the early life of the long-lived asset, the ARO accretion expense will be lower than straight-line recovery, resulting in a growing regulatory liability. As time progresses, the ARO accretion expense will exceed the straight-line recovery and the resulting reduction in the regulatory liability will accrue to customers.

Q. WHY ISN'T PNM PROPOSING A CHANGE TO THE RECOVERY OF PALO VERDE DECOMMISSIONING EXPENSE AND OTHER NON-PRODUCTION DECOMMISSIONING EXPENSES FOR WHICH THERE ARE AROS?

A. PNM recovers decommissioning expenses for Palo Verde based on contributions to the decommissioning trust. These contributions are similar from year to year, providing a mechanism to equitably recover these costs from customers contemporaneous with customers' receipt of the benefits from the operation of the plant. Decommissioning expenses related to other non-production AROs are not material. As of March 31, 2015, PNM's ARO liability balance for decommissioning costs not related to production plant was approximately $1.5 million and the Base Period accretion on such obligations is approximately $100,000. Based on this information, PNM is not proposing a change to the recovery of the non-production decommissioning expense associated with AROs.

Q. IS PNM REQUESTING ESTABLISHMENT OF A REGULATORY LIABILITY ASSOCIATED WITH UNDERGROUND COAL MINE RECLAMATION ACTIVITIES?

A. Yes. PNM is requesting similar treatment of cost recognition and cost recovery associated with underground coal mine reclamation as the treatment proposed above regarding AROs. The requested treatment will create the establishment of a regulatory liability that will reverse out over time. The requested accounting treatment of underground coal mine reclamation is discussed in more detail later in my testimony.

Q. IS PNM REQUESTING ESTABLISHMENT OF A REGULATORY ASSET ASSOCIATED WITH THE IMPAIRMENT OF STATE NET OPERATING LOSS CARRYFORWARDS?

A. Yes. PNM is requesting recovery of the impairment of state Net Operating Loss Carryforwards that PNM incurred due to the 2014 extension of bonus tax depreciation. PNM is requesting recovery of this expense over a two-year period and has reflected the additional amount in its determination of income tax expense in the Test Period cost of service. PNM is not seeking to include in rate base this requested regulatory asset. Please refer to the testimony of PNM Witness Harland for further discussion.

Q. DOES THIS CONCLUDE YOUR DISCUSSION OF REGULATORY ASSETS AND LIABILITIES?

A. Yes.

Other Rate Base Items

Q. PLEASE IDENTIFY THE "OTHER RATE BASE ITEMS" IN THE TEST PERIOD REVENUE REQUIREMENTS.

A. PNM has included the following items in the other rate base section of the Test Period revenue requirements. Please refer to PNM Exhibit HEM-4 WP ORB-2 for a summary of the following:

- Customer deposits – The Test Period balances match the adjusted Base Period balances as PNM does not forecast any significant changes to these balances.
- AROs – PNM has included the forecasted ARO liability balances, based on current accretion expense estimates. The accounting for the current accretion expense estimates is discussed in more detail by PNM Witness Peters.
- Injuries and Damages – The Test Period balances match the adjusted Base Period balances as PNM does not forecast any significant changes to these balances.
- Non-Qualified Retirement Plan ("NQRP") – PNM has included a reduction in rate base associated with the NQRP. The inclusion of the NQRP balance in rate base was approved in the final order in NMPRC Case No. 07-00077-UT. Please refer to the testimony of PNM Witness Peters for further discussion of the accounting for the NQRP. Please refer to the testimony of PNM Witness Eden for discussion of key assumptions, including contributions and forecasted expenses that impact the NQRP forecasted balance. See PNM Witness Peters Exhibit JAP-11 WP ORB-7.

- Palo Verde Units 1 and 2 Excess Gain Amortization – PNM has forecasted the balance based on the existing amortization schedule. This rate base reduction is allocated to FERC Wholesale Customers and does not impact PNM Retail. See PNM Exhibit HEM-4 OM-14.
- High Lonesome Mesa – PNM has forecasted the balance of this non-jurisdictional customer-funded interconnection transmission project. This rate base reduction is allocated to Excluded consistent with how plant in-service for this project is allocated. See PNM Exhibit HEM-4 WP ORB-9.
- Rights-of-Way – PNM has forecasted monthly rights-of-way balances, beginning with actual balances as of March 31, 2015, less monthly amortization from April 2015 through September 2016, plus any rights-of-way renewals projected during the same period. PNM included any forecasted amortization of rights-of-way renewals from April 2015 through September 2016. Rights-of-way amortization expense is included in operating expenses, as discussed below. Please refer to PNM Witness Johnson for a detailed discussion of rights-of-way renewals included in the linkage data and Test Period. See PNM Exhibit HEM–4 WP OM-16 and WP OM-17.
- Acquisition Adjustments – PNM has included in rate base the Eastern Interconnect Project ("EIP") Acquisition Adjustment and the Palo Verde Units 1 and 2 Acquisition Adjustments that were approved by the Commission in NMPRC Case No. 07-00077-UT. The balances included in the Test Period were developed based on straight-line amortization schedules through the estimated end of life of these assets. In addition, PNM has

included the acquisition adjustment associated with the purchase of the 64 MW of Palo Verde Unit 2 leases, as discussed earlier in my testimony. The amortization is based on straight-line amortization over the expected remaining useful life of Palo Verde Unit 2, which extends through 2046. PNM has requested an annualized amortization of the acquisition adjustment related to the 64 MW Palo Verde Unit 2 leases, as PNM has removed the associated lease expense related to the 64 MW that were also forecasted to occur during the Test Period. See PNM Exhibit HEM-4 WP OA-6.

- Prepaid Pension Asset – PNM has forecasted the balance of the Prepaid Pension Asset associated with PNM Retail's share of the defined benefit pension plan. Please refer to the testimony of PNM Witness Peters for the accounting for the prepaid pension asset. As discussed by PNM Witness Peters, PNM has included these items in rate base to the extent that customers receive a net benefit as a result of these transactions. See PNM Exhibit JAP-11 WP ORB-6. Please refer to the testimony of PNM Witness Eden for a discussion of the estimated pension expense and contributions, which impact the Prepaid Pension Asset balance.
- Unamortized loss on reacquired debt – PNM has forecasted the balances based on amortization periods based on the remaining life of the retired debt. As discussed by PNM Witness Peters, PNM has included these items in rate base to the extent that customers receive a net benefit as a result of these transactions. See PNM Exhibit JAP-11 WP RA-6.

- CWIP balances for projects that are forecasted to go into service by February 28, 2017, or five months after the end of the Test Period of September 30, 2016.

Q. HOW HAS THE COMPANY TREATED CWIP IN THIS PROCEEDING?

A. PNM has included in the Test Period projected balances for CWIP related to generation, transmission, distribution, and general and intangible plant as of September 30, 2016 that is projected to be in-service within five months after the end of the Test Period.

Q. WHAT IS THE AMOUNT OF CWIP THAT THE COMPANY IS REQUESTING IN THIS PROCEEDING?

A. The total amount of CWIP requested to be included in the Test Period rate base as of September 30, 2016, is $52,403,500 for PNM and $19,447,926 for Shared Services allocated to PNM. See PNM Exhibit HEM-4 WP ORB-3 and WP ORB-4. Because PNM is seeking to include CWIP balances in rate base, PNM would stop calculating and recording AFUDC as of July 1, 2016 for the CWIP projects included in rate base, as discussed in further detail by PNM Witness Buchanan.

Q. HOW DID THE COMPANY DETERMINE THE AMOUNT OF CWIP PROPOSED TO BE INCLUDED IN THE TEST PERIOD RATE BASE?

A. CWIP balances at September 30, 2016 were calculated for each individual project by including the lesser of CWIP balances at September 30, 2016 or clearings during the period October 2016 through February 2017. The Company excluded CWIP related to "revenue generating" projects and AFUDC on CWIP projects included in the Test Period rate base.

Q. PLEASE DESCRIBE WHY "REVENUE GENERATING" PROJECTS WERE EXCLUDED FROM THE COMPANY'S REQUEST FOR CWIP AND HOW THESE PROJECTS WERE IDENTIFIED.

A. Certain capital projects, by themselves, generate revenue for the Company. The costs of these projects are typically included in charges to specific customers for services rendered as a result of the project and include residential, commercial, and temporary line extensions and therefore generate additional revenues. As PNM has not projected additional revenues related to these capital projects in its Test Period billing determinants, it would not be appropriate to include these types of projects in the rate base request for CWIP.

Q. ARE THE CWIP PROJECTS REQUESTED IN THIS PROCEEDING SUPPORTED IN THE TESTIMONY OF OTHER PNM WITNESSES?

A. Yes. PNM Witnesses Olson, Johnson, and Mendez each support the capital projects proposed to be reflected in CWIP in testimony for generation, transmission and distribution, and BTS and General Services projects, respectively.

Q. DOES THIS CONCLUDE YOUR DISCUSSION ON OTHER RATE BASE ITEMS?

A. Yes.

<u>Working Capital</u>

Q. PLEASE DESCRIBE HOW YOU HAVE DEVELOPED THE TEST PERIOD BALANCES FOR NUCLEAR FUEL STOCK?

A. The nuclear fuel stock balances have been forecasted based on projected nuclear fuel amortization at PVNGS, plus any new nuclear fuel capital acquisitions. Please refer to the testimony of PNM Witness Olson for discussion on projected nuclear fuel capital acquisitions. Please refer to the testimony of PNM Witness Taylor for projections associated with the amortization of nuclear fuel. See Rule 530 Schedule B-7, as filed in PNM Exhibit HEM-4 WP WC.

Q. PLEASE DESCRIBE HOW YOU HAVE DEVELOPED THE TEST PERIOD BALANCES FOR PRODUCTION FUEL STOCK?

A. PNM has utilized the 13-month average balances for production fuel stock included in the adjusted Base Period as the balances in the Test Period revenue requirements. PNM does not forecast any significant changes in these balances and so the adjusted Base Period is a reasonable representation of balances expected during the Test Period. See Rule 530 Schedule E-2, as filed in PNM Exhibit HEM-4 WP WC.

Q. PLEASE DESCRIBE HOW YOU HAVE DEVELOPED THE TEST PERIOD BALANCES FOR MATERIALS AND SUPPLIES?

A. PNM has utilized the 13-month average balances for materials and supplies included in the adjusted Base Period as the balances in the Test Period revenue requirements. PNM does not forecast any significant changes in these balances and so the adjusted Base Period is a reasonable representation of balances expected during the Test Period. See Rule 530 Schedule E-2, as filed in PNM Exhibit HEM-4 WP WC.

Q. PLEASE DESCRIBE HOW YOU HAVE DEVELOPED THE TEST PERIOD BALANCES FOR PREPAYMENTS?

A. PNM has utilized the 13-month average balances for prepayments included in the adjusted Base Period as the balances in the Test Period revenue requirements. PNM does not forecast any significant changes in these balances and so the adjusted Base Period is a reasonable representation of balances expected during the Test Period. See Rule 530 Schedule E-2, as filed in PNM Exhibit HEM-4 WP WC.

Q. HOW DID PNM FORECAST THE TRANSMISSION PREPAYMENTS INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. The transmission prepayments consist of the following categories: 1) general prepayments including insurance that are allocated to the transmission function; 2) Navajo right-of-way renewal prepayments; and 3) EIP lease prepayments.

For general transmission prepayments, PNM used the 13-month average balances for prepayments included in the adjusted Base Period as the balances in the Test Period revenue requirements. PNM does not forecast any significant changes in these balances and so the adjusted Base Period is a reasonable representation of balances expected during the Test Period. See Rule 530 Schedule E-2, as filed in PNM Exhibit HEM-4 WP WC.

PNM makes an annual right-of-way payment to the Navajo Nation in April of each year for the following year. PNM has forecasted the expected annual payment to be made in April 2016 in order to develop the prepayment balance included in the linkage data and through the Test Period. Please refer to the testimony of PNM Witness Johnson for discussion of the Navajo Nation annual payments. See PNM Exhibit HEM-4 WP OM-17.

The EIP lease prepayments are set to expire before the beginning of the Test Period, as PNM will purchase the EIP transmission line at the expiration of the lease. PNM has reflected the expiration of the lease prepayment balance in the linkage data and has not included any balance associated with this item in the Test Period revenue requirements. See Rule 530 Schedule E-2, as filed in PNM Exhibit HEM-4 WP WC.

Q. WHAT AMOUNT OF CASH WORKING CAPITAL HAS PNM INCLUDED IN RATE BASE FOR THE TEST PERIOD?

A. PNM included a cash working capital amount of $345,571 in the Test Period revenue requirements. The cash working capital allowance is based on the lead-lag study performed by PricewaterhouseCoopers, LLP as discussed in more detail by PNM Witness Peters. The calculation of the cash working capital amount is included in Rule 530 Schedule E-1. This represents an increase in cash working capital. The main driver is the reduction of the semi-annual lease payments at Palo Verde Units 1 and 2 from the adjusted Base Period to the Test Period.

Q. DOES THIS CONCLUDE YOUR DISCUSSION OF WORKING CAPITAL?

A. Yes.

B. O&M Expenses

Q. PLEASE DESCRIBE THE COMPONENTS OF O&M EXPENSES INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS.

A. The categories of O&M expenses included in the test period revenue requirements include production, transmission, distribution, customer-related and A&G. The production O&M category includes specific FERC accounts that are classified as base fuel expense. Please refer to the testimony of PNM Witness Taylor for further discussion of base fuel expense.

Q. WHAT AMOUNT OF BASE FUEL EXPENSE IS INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. As discussed by PNM Witness Taylor, Test Period fuel expense, net of off-system sales margins, is $217,655,764. PNM is not proposing to reset the Base Fuel rate in this proceeding. The current Base Fuel rate is $0.02128 per kWh. The FFPCAC rate that would result just from the Test Period fuel is $0.004994 per kWh.

Q. ARE THERE FUEL-RELATED O&M COSTS INCLUDED IN THE REVENUE REQUIREMENTS THAT ARE NOT INCLUDED IN THE CALCULATION OF BASE FUEL?

A. Yes, there are three categories of fuel-related expenses that are not in PNM's Base Fuel calculation and will not be subject to the FPPCAC. These are costs associated with coal mine decommissioning, fixed gas transportation costs, and demand costs associated with the Valencia PPA. I will discuss the adjustments related to coal mine decommissioning in my testimony below. PNM Witness Taylor discusses the other two items in her testimony.

Q. HOW DID PNM FORECAST COAL MINE DECOMMISSIONING COSTS FOR THE TEST PERIOD?

A. PNM has continued the amortization of the surface mine reclamation costs, which are capped for recovery at $100 million. In addition, PNM has continued amortization of previously deferred underground mine reclamation costs in the annual amount of approximately $38,160. PNM has forecasted the reclamation costs associated with the underground coal mine, as discussed by PNM Witness Peters.

Q. PLEASE DESCRIBE HOW PNM PROPOSES TO RECOVER RECLAMATION COSTS ASSOCIATED WITH THE SJGS UNDERGROUND MINE.

A. Similar to our proposed treatment of accretion expenses associated with ARO's, PNM is proposing to recover these costs on a straight-line basis so that customers that benefit from the operation of the SJGS will bear their fair share of the costs of operating the plant, including future mine reclamation costs. Recovery of mine reclamation costs on a straight-line basis provides for more equitable recovery from customers today and in the future and removes potential intergenerational inequities. Otherwise, customers in the future would be responsible for a disproportionate amount of underground mine reclamation costs.

Q. WHAT AMOUNT IS INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS FOR UNDERGROUND MINE RECLAMATION COSTS?

A. PNM has included in the Test Period revenue requirements estimated costs of $1,695,715 associated with mine reclamation activities for the underground mine at SJGS. These revenue requirements are based on the remaining total projected costs to be incurred from October 2015 through the end of reclamation activities following mine depletion in 2066, divided by the total remaining years of expected cash outflows to reclaim the coal mine that serves SJGS. PNM included this amount in the coal mine decommissioning forecasted expense. See PNM Exhibit HEM-4 WP CMD-3.

Q. IS PNM REQUESTING SPECIFIC ACCOUNTING ORDERS FROM THE COMMISSION TO RECOVER THE RECLAMATION COSTS FROM THE UNDERGROUND MINE ON A STRAIGHT LINE BASIS?

A. Yes. PNM is asking the Commission for the authority to establish a regulatory liability to recognize the additional expense PNM has requested by recording the mine reclamation activities on a straight-line basis. Absent a specific Commission order, PNM would be required to continue to recognize the expense associated with the underground mine reclamation based on accretion expense, which will unfairly burden customers in the future. Using the GAAP methodology, accretion expense in the early years is lower and escalates over time, resulting in lower costs in the early years and higher costs in the later years. The straight-line approach requested by PNM will better match cost causation with the benefits received from operation of the mine. As the mine reclamation cash flows are not expected to occur for about 30 years, the straight-line method results in additional expense in the early years, which creates a regulatory liability on PNM's books and records. This regulatory liability will reverse out over time.

Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO O&M EXPENSES IN THE TEST PERIOD REVENUE REQUIREMENTS.

A. The starting point for the Test Period O&M was the adjusted Base Period O&M. Except for the specific items discussed below, Non-labor O&M expenses in the adjusted Base Period were escalated at the rate of 1.5% per year, to project test year O&M expense. I will discuss the bases supporting use of this escalator below. PNM Exhibit HEM-4 WP OM-2, Column H provides the calculation of the portion of Test Period O&M that is based on a 1.5% escalation factor. PNM Exhibit HEM-4 WP OM-4 provides a summary of the specific O&M items that were individually projected to develop Test Period levels. In addition, PNM Exhibit HEM-4 WP OM-2 provides a reconciliation of O&M expense from the Base Period, through the adjusted Base Period and into the Test Period revenue requirements.

Q. WHY DID YOU USE A 1.5 PERCENT ESCALATION RATE FOR NON-LABOR O&M EXPENSES?

A. PNM has historically applied the annual consumer price index ("CPI") to non-labor O&M in developing annual and long-range forecasts, and has effectively controlled O&M to stay within these projections. While no index will capture all of the specific business changes that PNM may experience in the Test Period, the CPI is a reasonable and conservative predictor of the increase in O&M costs that PNM will experience from the Base Period to the Test Period. PNM chose to use a 1.5% escalation in this filing to capture expected cost increases based on a conservative assessment of the trend indicated by recent CPI data.

Q. WHY IS USE OF THE 1.5% ESCALATION FOR DETERMINING TEST PERIOD O&M EXPENSES REASONABLE IN THIS CASE?

A. We chose the 1.5% escalator because it reflects a conservative estimate of the trending increase of O&M expenses between the Base Period and Test Period used in this case. As reflected in PNM Exhibit HEM-5, the 1.5% escalator is well below the compound annual growth rate of the CPI both for the five-year period 2010-2014 (1.76%) and for the year 2014 (1.675%). It is also well below the compound annual growth rate of the Gross Domestic Product ("GDP") Deflator for both the same five-year period (2.16%) and for 2014 (1.976%). The CPI measures the change that occurs over time in the prices of consumer goods that every household buys, while the GDP Deflator measures the total value of all the products produced in the country over a specific period of time. The compound annual growth rate calculates the year-over-year growth rate over a specified period of time. Further evidence of the conservative nature of the Company's proposed 1.5% escalation factor is the projected compound annual growth rates ranging between 1.884% and 2.209% for the CPI and GDP Deflator for 2016 and 2017, which is the period when the rates from this case will be in effect.

Q. PLEASE SUMMARIZE THE O&M EXPENSE CATEGORIES INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS THAT ARE FORECASTED BASED ON ALREADY ESTABLISHED AMORTIZATION SCHEDULES OR OTHER FIXED TERMS.

A. PNM Exhibit HEM–4 WP OM-4 provides a summary of all adjustments to O&M that have been specifically identified, including those based on already established amortization schedules as follows:

- Right-of-way Amortizations – Amortization of existing rights-of-way balances have been included in the Test Period revenue requirements based on existing amortization schedules, which typically follow the expected term of the underlying right-of-way agreement. In addition, PNM has included in the right-of-way amortization the right-of-way renewals expected to occur between April 2015 and September 2016, and also included the projected amortization of these right-of-way renewals in the Test Period. Refer to PNM Witness Johnson for a detailed discussion of proposed rights of way renewals. See PNM Exhibit HEM–4 WP OM-16, WP OM-17, and WP OM-18.

    - Palo Verde Adjustments –

- Palo Verde Unit 1 and Unit 2 Lease Expense – PNM has included the lease expense associated with Palo Verde Unit 1 leases based on their scheduled lease payments. PNM has reduced lease expenses associated with Palo Verde Unit 1 leases, beginning in 2015, to reflect that PNM has exercised its option to extend the Unit 1 leases, which results in the lease expense being reduced 50%, as compared to corresponding amounts reflected in the adjusted Base Period. PNM has reflected the elimination of the Palo Verde Unit 2 lease expense for the 64 MW that PNM will acquire from the current lease owners in January 2016 as a result of the exercise of its purchase option. In addition, PNM reflected the reduction in lease expense associated with the 10 MW of Palo Verde Unit 2 leases, beginning in 2016, as PNM exercised its option to extend the Unit 2 10 MW lease. See PNM Exhibit HEM-3 WP OM-10.
- Palo Verde Combustion and Engineering, Prudency Audit – PNM reflected the expected credits included in the Test Period based on existing amortization schedules of these balances. Please see PNM Exhibit HEM-3 WP OM-14.

Q. PLEASE SUMMARIZE THE O&M EXPENSES INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS THAT ARE FORECASTED INDIVIDUALLY.

A. PNM Exhibit HEM–3 WP OM-4 provides a summary of the adjustments to O&M that have been specifically identified and forecasted based on individual factors. Specifically, these adjustments include Labor, including overtime expense, Retiree Pension and Retiree Medical, Active Medical and Dental expense, EIP lease expense, loadings of A&G, Injuries and Damages, and Pension and Benefits on capital projects, the Palo Verde Decommissioning Credit, insurance premiums associated with cyber security, and the Wholesale Power Marketing Incentive Plan ("WPM Plan"). In addition, PNM forecasted O&M expenses associated with the 40 MW Solar facility and the 40 MW La Luz gas peaking facility, and forecasted O&M expenses related to urea costs to operate the SNCR equipment at SJGS. Adjustments made to O&M expenses that are recorded on the books of Shared Services are identified and discussed separately below.

Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO LABOR EXPENSES FROM THE ADJUSTED BASE PERIOD TO THE TEST PERIOD REVENUE REQUIREMENTS.

A. Base labor and overtime expense was escalated from the adjusted Base Period using a 2.5% annual labor escalator for non-union employees and a 2.0% annual labor escalator for union employees, effective April of each year. The 2.5% labor escalator is based on historical trends of average pay raises. The 2.0% labor escalator for union employees is based on current collective bargaining agreements. Please refer to PNM Witness Vavruska-Marcum for further discussion of these escalation rates. See PNM Exhibit HEM-4 WP LA-4 and WP LA-6.

Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO RETIREE PENSION AND RETIREE MEDICAL EXPENSE FROM THE ADJUSTED BASE PERIOD TO THE TEST PERIOD REVENUE REQUIREMENTS.

A. PNM has forecasted retiree pension and medical expenses in the Test Period based on information provided by PNM's actuaries, Towers Watson. The 2015 retiree pension and medical expense is based on the actuarial defined pension expense for the 2015 calendar year and agrees with the last three months of expense recorded in the Base Period. The 2016 retiree pension and medical expense is based on updates to the 2015 assumptions provided by the actuaries. See PNM Exhibit EAE-7 for the Towers Watson update and PNM Exhibit HEM-4 WP OM-5 for the calculation. Consistent with the similar adjustment for the Base Period, PNM has removed the portion of retiree pension expense associated with former gas business employees covered under the retiree pension plan in the Test Period revenue requirements.

Q. HOW DID PNM FORECAST THE A&G, INJURIES AND DAMAGES, AND PENSION AND BENEFITS CAPITAL LOADS FOR THE TEST PERIOD REVENUE REQUIREMENTS?

A. The amount of capital loads included in the Test Period revenue requirements are based on the projected capital spend that is included in the Test Period. The resulting capital loads are included as a reduction to O&M expense, reflected in the A&G expense accounts. Please see PNM Witness Peters for discussion of the derivation of capital loads applied to capital projects. See PNM Exhibit HEM-4 WP OM-4, Column M and Column V.

Q. DOES PNM NORMALIZE THE PLANNED OUTAGE EXPENSES INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. Yes. Planned outage expenses occur at various times depending on the type of generating plant and the operational and maintenance needs of the plant. PNM typically expends large amounts of O&M and capital dollars during planned major outages. Given the variability in the occurrence of planned outages, the amount of O&M expense related to planned outages can vary significantly from year to year. Consequently, PNM normalized the amount of planned outage expenses included in its Test Period revenue requirements. Including a normalized level of planned outage expense is a reasonable approach in setting rates. If outages are not normalized, the result is to embed the volatility associated with the timing of outages in rates. PNM Witness Olson discusses further the nature of planned outages at the generation facilities.

Q. HOW DID PNM CALCULATE THE PLANNED OUTAGE EXPENSE FOR THE TEST PERIOD REVENUE REQUIREMENTS?

A. PNM calculated the average planned outage expenses at each generating unit for six years, except for SJGS Units 2 and 3, from 2009 through 2014. PNM then escalated the historical averages using the 1.5% escalation rate discussed earlier to derive the planned outage expense for each unit in the adjusted Base Period. PNM then escalated the adjusted Base Period planned outage expenses by the annual 1.5% escalation rate for one period to determine planned outage expense in the Test Period.

Q. WHY DID PNM EXCLUDE SJGS UNITS 2 AND 3 FROM THE PLANNED OUTAGE ADJUSTMENT?

A. PNM excluded the planned outage expense associated with SJGS Units 2 and 3, because PNM is forecasting the abandonment of these units as of December 31, 2017, and does not expect any significant planned outages through the end of the Test Period.

Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO EIP LEASE EXPENSES FROM THE ADJUSTED BASE PERIOD TO THE TEST PERIOD REVENUE REQUIREMENTS.

A. As discussed by PNM Witness Johnson, PNM has purchased its previous leased 40% interest in the EIP transmission line. PNM is including this investment in rate base and has removed the EIP lease expense from the adjusted Base Period and is forecasting no lease expense in the Test Period revenue requirements.

Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO SJGS O&M EXPENSES TO REFLECT THE COST OF CHEMICALS TO OPERATE THE SNCR EQUIPMENT INSTALLED ON SJGS UNITS 1 AND 4 IN THE TEST PERIOD REVENUE REQUIREMENTS.

A. PNM included the cost of chemicals for the SNCR equipment installed on SJGS Units 1 and 4. PNM forecasted this expense to begin in 2016, once the SNCR equipment is installed. Please see PNM Exhibit CMO-5 sponsored by PNM Witness Olson.

Q. HOW DID PNM FORECAST THE CYBER LIABILITY INSURANCE IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. PNM acquired insurance for cyber security beginning in 2015. PNM annualized the insurance premium expense recorded in the last three months of the Base Period as an adjustment to the Base Period. To develop the insurance premium expense for 2016, PNM utilized a 10% escalation. The 10% escalation is based on discussions with insurance providers and based on market indications that cyber liability insurance costs are expected to increase significantly in the future as cyber security risks continue to increase. See PNM Exhibit HEM-4 WP OM-15.

Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO THE WPM INCENTIVE PLAN O&M EXPENSES FROM THE ADJUSTED BASE PERIOD TO THE TEST PERIOD REVENUE REQUIREMENTS.

A. PNM Witness Vavruska-Marcum discusses the assumptions included to develop the forecast of the expense associated with the WPM Incentive Plan. The forecasted Test Period expense is $767,571 and is based on WPM headcount and salaries as of March 31, 2015, escalated at 2.5%, and multiplied by the forecasted 2016 WPM Plan rates. These amounts are included in PNM Exhibit HEM-4 WP SS-11.

Q. PLEASE DESCRIBE THE O&M EXPENSES FORECASTED FOR THE 40 MW SOLAR FACILITY FOR THE TEST PERIOD REVENUE REQUIREMENTS.

A. The 40 MW Solar Facility was not in-service during the Base Period. Therefore, the O&M expenses are based on the forecasted O&M expenses expected to run this facility once it is in-service, which is expected in the fourth quarter of 2015. PNM estimated the annual O&M expense associated with this facility to be $724,766. Please refer to PNM Witness Olson for further discussion of the development of forecasted O&M for the 40 MW Solar Facility. See PNM Exhibit CMO-8.

Q. PLEASE DESCRIBE THE O&M EXPENSES FORECASTED FOR THE LA LUZ GAS PEAKING FACILITY FOR THE TEST PERIOD REVENUE REQUIREMENTS.

A. The La Luz plant was not in-service during the Base Period. Therefore, the O&M expenses are based on the forecasted O&M expenses expected to operate this facility. PNM estimated the annual O&M expense associated with this facility to be $615,208. Please refer to PNM Witness Olson for further discussion of the development of forecasted O&M for the La Luz plant. See PNM Exhibit CMO- 6 and CMO-7.

Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO THE PALO VERDE DECOMMISSIONING CREDIT IN THE TEST PERIOD REVENUE REQUIREMENTS.

A. PNM is requesting recovery of Palo Verde Units 1 and 2 decommissioning costs based on the current funding requirements for the nuclear decommissioning trust. Please refer to the testimony of PNM Witness Eden for further discussion on funding requirements. See PNM Exhibit HEM-4 WP OA-4 for the calculation of the decommissioning credit to seek recovery of nuclear decommissioning funding requirements in its Test Period revenue requirements.

Q. PLEASE SUMMARIZE THE O&M EXPENSES INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS THAT ARE ALLOCATED FROM SHARED SERVICES.

A. The starting point for the Test Period O&M was the adjusted Base Period O&M. Except for the specific items discussed below, Non-labor O&M expenses in the adjusted Base Period were escalated at the rate of 1.5% for one year to project the Test Period O&M expense. PNM Exhibit HEM–4 WP SS-1 provides a summary of the adjustments to O&M that have been specifically identified and forecasted based on individual factors. Specifically, these include Labor, including overtime expense, Incentive Compensation, and insurance premiums associated with cyber security. Except for incentive compensation, the adjustments made for Shared Services are the same as those discussed above for these types of expenses when incurred directly by PNM.

Q. WHAT INCENTIVE COMPENSATION HAS PNM INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. The development of incentive compensation amounts for the Test Period revenue requirements is discussed in more detail by PNM Witness Vavruska-Marcum. PNM Exhibit HEM-4 WP SS-11 provides the detail of incentive compensation amounts included in the Test Period revenue requirements.

Q. HOW WERE SHARED SERVICES O&M EXPENSES ALLOCATED TO PNM IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. PNM used the proposed 2016 CAM allocation rates to allocate adjusted O&M expenses from Shared Services to PNM for the Test Period. Please refer to PNM Witness Peters for discussion on the development of 2016 CAM allocation rates. See PNM Exhibit HEM-4 WP SS-1B for 2016 CAM allocation rates. All adjustments referenced in my testimony related to Shared Services reflect total amounts, a portion of which are allocated to PNM. Please refer to PNM Exhibit HEM-4 WP-SS-11 for allocation of costs to PNM.

Q. DOES THIS CONCLUDE YOUR DISCUSSION OF TEST PERIOD REVENUE REQUIREMENTS RELATED TO O&M?

A. Yes, it does.

C. Depreciation and Amortization Expense

Q. IS PNM PROPOSING NEW DEPRECIATION RATES IN THIS FILING?

A. Yes. As testified to by PNM Witness Watson, PNM engaged the Alliance Consulting Group to perform a depreciation study. Pursuant to 17.3.340.10(D) NMAC, PNM is filing this study as PNM Exhibit DAW-2 and is proposing that new depreciation rates become effective with the rates set in this case, upon approval by the Commission in accordance with Rule 340.

Q. HOW DO THE REQUESTED DEPRECIATION RATES IMPACT REVENUE REQUIREMENTS?

A. PNM Exhibit HEM-4 WP Plant- 1b shows the impact of the requested change in depreciation rates. The updated depreciation rates were applied to plant balances beginning October 1, 2015 to reflect a full year of new depreciation rates in the Test Period. PNM has reflected the new depreciation expense and also reflected the impacts of the new depreciation expense in the accumulated reserve balances in net plant in-service, which reduces rate base. The impact to PNM Retail's depreciation expense as the result of the proposed depreciation rates based on the forecasted Test Period is an increase of $20,602,731.

Q. HOW HAS PNM PROJECTED DEPRECIATION AND AMORTIZATION EXPENSES FOR THE TEST PERIOD?

A. Depreciation expense on plant additions and existing assets for the Test Period is based upon the depreciation rates proposed in this case, as supported by the Depreciation Study sponsored by PNM Witness Watson. See PNM Exhibit DAW-2. PNM has also adjusted the Test Period accumulated depreciation reserve to reflect the effect of depreciation expense accruals based on the new depreciation rates.

Depreciation expense for plant additions was included in the Test Period based on projected clearings of CWIP to plant in-service. For example, if a plant addition was forecasted to be in service in July 2016, then the additional depreciation expense and associated accumulated depreciation reserve were determined for the period August through September 2016. This was done instead of annualizing depreciation to reflect a full year of depreciation expense on the addition, as would be the case if a historical test period were being proposed. Please see PNM Exhibit HEM–4 WP Plant-4.

Q. HAS PNM ANNUALIZED THE DEPRECIATION EXPENSE ASSOCIATED WITH THE ACQUISITION OF THE 64 MW OF PALO VERDE UNIT 2 LEASES?

A. Yes. PNM has reflected an annualized amount of depreciation expense related to the acquisition of the 64 MW of Palo Verde Unit 2 leases. Due to the timing of the Test Period, PNM will incur three more months of lease expense related to the 64 MW of Palo Verde. However, PNM chose not to reflect these three months of lease expense in the Test Period. Instead, PNM has removed the lease expense and annualized the depreciation expense associated with the acquisition of the 64 MW leases. See PNM Exhibit HEM-4 WP Plant -1b, Column H.

Q. DOES THIS CONCLUDE YOUR TESTIMONY ON DEPRECIATION EXPENSE IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. Yes.

D. General Taxes

Q. PLEASE DESCRIBE HOW PROPERTY TAXES WERE DERIVED IN THE TEST PERIOD REVENUE REQUIREMENT.

A. Property taxes are derived in the Test Period by multiplying the taxable gross plant in-service forecasted balance by the prior year balance times the expected property tax rates to be in place. For example, the property tax expense for the first nine months of 2016 was estimated based on the forecasted plant in-service balance as of December 2015 multiplied by the forecasted property tax rates to be in effect in 2016. Please refer to the testimony of PNM Witness Harland for further discussion on projections of property tax rates for 2015 and 2016. See PNM Exhibit HEM-3 WP GT-2 for calculation of property tax expense reflected in the Test Period revenue requirements and PNM Exhibit HEM-3 WP GT-3 for calculation of property tax rates for 2015 and 2016.

Q. PLEASE DESCRIBE HOW PAYROLL TAXES WERE DERIVED IN THE TEST PERIOD REVENUE REQUIREMENTS.

A. As discussed earlier, PNM normalized the labor expenses included in the Test Period revenue requirements. In addition, PNM adjusted the labor expenses to reflect expected annual merit increases for wages paid to PNM employees. PNM calculated the expected payroll tax expense to be incurred in the Test Period, based on the forecasted labor dollars. The percentage applied to base labor dollars to calculate the cost of social security, Medicare and federal and state unemployment taxes for PNM (other than San Juan), San Juan, and Shared Services were: 7.00%, 6.74%, and 8.79%, respectively. These percentages are based on effective rates, taking into consideration wage-based limits on certain payroll taxes, and are calculated in determination of the capital loads. Please refer to the testimony of PNM Witness Peters for discussion of payroll loads included in capital loads. PNM has not calculated a credit to the payroll tax expense for capitalized labor in the general taxes section based on the methodology used to forecast the payroll tax expense in the linkage data and Test Period. PNM only included payroll tax expense expected to be incurred for labor that is recorded to the income statement, and not for labor that is capitalized. As a result, the amount of payroll taxes included in the Test Period revenue requirements is already reflected net of any payroll taxes that would be capitalized. See PNM Exhibit HEM-4 WP LA-6, WP LA-7, WP LA-8, WP LA-9 and WP LA-10. Also, see WP GT-4 for summary of payroll taxes included in the Test Period.

Q. WHAT ARE THE OTHER COMPONENTS OF GENERAL TAXES AND HOW WERE THEY DERIVED IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. The other components of general taxes include Native American taxes, and other miscellaneous taxes paid on jointly owned facilities, including Four Corners and PVNGS. After removing gross receipts taxes and franchise tax recorded in the Base Period, PNM used the general escalation factor of 1.5% for one period to develop the Test Period revenue requirements. See PNM Exhibit HEM-4 WP GT-5.

E. Other Allowable Expenses

Q. PLEASE IDENTIFY THE COMPONENTS INCLUDED FOR RECOVERY IN OTHER ALLOWABLE EXPENSES BASED ON AMORTIZATION SCHEDULES.

A. PNM Exhibit HEM-3 WP OA-2 summarizes the requested other allowable expenses used to develop the Test Period revenue requirements, and includes the following:

- Amortization of the renewable federal grant;
- Amortization of renewable regulatory assets included in the Renewable Energy Rider;
- Amortization of previously approved EIP and Palo Verde Units 1 and 2 acquisition adjustments, and proposed Palo Verde Unit 2 64 MW lease acquisition adjustment, as discussed earlier in my testimony;
- Amortization of regulatory assets and liabilities requested in this proceeding, including Las Vegas Decommissioning Regulatory Asset and Liability, TOU Regulatory Asset, Alvarado Square Lease Regulatory Asset, Rate Case Expenses Regulatory Asset – PNM has included in the Test Period revenue requirement the amortization of these assets and liabilities in the Test Period revenue requirements. There is no amortization expense associated with these assets and liabilities in the adjusted Base Period or the linkage data as amortization does not begin until rates from this proceeding are effective. To

reflect a full year of amortization, PNM has reflected the amortization beginning October 1, 2015;[3] and

- Amortization of loss on reacquired debt – Inclusion of loss on reacquired debt has been reflected in the linkage data and the Test Period revenue requirements based on existing amortization schedules. Loss on reacquired debt is amortized over the remaining life of the term of the bonds that were issued and reacquired.

Q. PLEASE IDENTIFY THE OTHER COMPONENTS INCLUDED FOR RECOVERY IN OTHER ALLOWABLE EXPENSES AND ASSUMPTIONS USED TO DEVELOP THE TEST PERIOD REVENUE REQUIREMENTS.

A. Consistent with past rate case treatment, PNM included recovery of interest on customer deposits. PNM does not expect any significant changes to customer deposit balances or to the interest charged on customer deposits, so PNM used the amounts included in the adjusted Base Period as the forecast for the Test Period revenue requirements. In addition, other allowable expenses include recovery of accretion expense associated with AROs, as was discussed earlier in my testimony.

[3] PNM's proposals in this rate case to implement new or changed amortization expense amounts associated with regulatory assets are all based upon an effective date coincident with the effective date of new rates approved by the Commission in this proceeding. In order to assure that a full year of amortization expense is included in the Test Period revenue requirement, an earlier implementation date has been reflected in the cost-of–service model, PNM Exhibits HEM-3 and HEM-4.

F. Income Tax Calculation

Q. HOW HAS PNM CALCULATED THE INCOME TAX EXPENSES INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. The income tax expense included in the Test Period revenue requirements is based on the applicable 35% federal and 6.68% state income tax rates that are expected to be effective in the Test Period. The state income tax rate is lower than reflected in the Base Period and adjusted Base Period as a result of tax law changes that phase in lower state corporate tax rates over five years. Please refer to PNM Witness Harland for further discussion of the income tax expense included in the Test Period revenue requirements.

G. Revenue Credits

Q. PLEASE DESCRIBE THE COMPONENTS OF THE REVENUE CREDITS INCLUDED IN PNM'S REVENUE REQUIREMENTS.

A. Revenue credits consist of the following, and are summarized in PNM Exhibit HEM-4 WP RC-1:

- Rent for electric property – represents revenues received by PNM from third parties who connect to our existing transmission and distribution assets or tenants who occupy space in PNM Resources facilities.
- Late Payment Charges and Miscellaneous Charges revenues – reflects revenues collected under Rate 16, "Special Charges."

- Other retail revenue – other distribution revenues reflect revenues received from certain FERC transmission wholesale customers for payment for the use of certain distribution assets, and other transmission revenues reflect revenues received from participation in OATT West Connect programs. See PNM Exhibit HEM-4 WP RC-3.
- Generation-related transmission revenues – include generation ancillary services provided to other utilities as well as reimbursement of financial power losses incurred on PNM's transmission system.
- Transmission-related ancillary services – include revenues collected from PNM's OATT Ancillary Service Schedule 1 and include revenues collected under bi-lateral agreements collected from participants in SJGS who utilize the SJGS transmission switchyard. See PNM Exhibit HEM-4 WP RC-4.
- Economy service customer revenue credits – services charged to economy service customer for PNM to provide certain transmission and sub-transmission services to deliver the power to the customer.
- As discussed earlier, revenue credits include PNM's share of miscellaneous revenue credits recorded at Shared Services. These revenues consist primarily of rental income received from tenants in PNM Resources' buildings.

Q. HOW WERE THE AMOUNTS FOR THE REVENUE CREDITS DEVELOPED FOR PURPOSES OF THE TEST PERIOD REVENUE REQUIREMENTS?

A. For all of the above revenue credits, except for the Rate 16 "Special Charges," PNM has forecasted an increase in revenues based on the general escalation rate of 1.5% consistent with the proposed escalation reflected in general O&M, as discussed in more detail above. With regard to Late Payment Charges and Miscellaneous Charges revenues, PNM is requesting a change in rates charged under Rate 16 in this rate case, as discussed in more detail by PNM Witness Aguirre. Accordingly, PNM has forecasted the Test Period revenue credits based on the adoption of the new rates proposed in this filing. See PNM Exhibit HEM-4 WP RC-2.

H. Other Miscellaneous Items

Q. HOW HAS PNM DETERMINED THE GENERATION ENERGY AND DEMAND ALLOCATORS INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. The generation energy and demand allocators are based on forecasted load and demand data supported by PNM Witness Chan. The demand allocator is calculated using 12 months of Coincident Peak data as supplied by PNM Witness Chan to determine each jurisdiction's contribution to peak at the peak hour. The energy allocator is calculated using data from PNM Witness Chan to calculate a

12-month average of energy reflecting loads from PNM Retail and FERC Wholesale Generation customers. The City of Aztec contract is set to expire in June 2016. Accordingly, PNM has removed the City of Aztec demand and energy revenues in developing these allocators. As discussed earlier, PNM has removed the Jicarilla Apache Nation from the forecasted generation energy and demand allocators due to the uncertainty surrounding the continuation of the contract. PNM is proposing to reflect revenues received from the Jicarilla Apache Nation, if any, through the fuel clause, as discussed by PNM Witness Taylor.

Q. HOW HAS PNM DETERMINED THE TRANSMISSION DEMAND ALLOCATORS INCLUDED IN THE TEST PERIOD REVENUE REQUIREMENTS?

A. The Test Period allocators are the same as the allocators supported during the Base Period. PNM is not aware of any changes to the network service customers or any long-term point-to-point customers through the linkage and end of the Test Period. The support for the transmission demand allocator for the Test Period is included in PNM Exhibit HEM-4 WP AL-2.

Q. WHAT ROE IS PNM PROPOSING TO USE IN THE DETERMINATION OF THE TEST PERIOD REVENUE REQUIREMENTS?

A. PNM is proposing to use an ROE of 10.5% in the Test Period, as recommended by PNM Witness Hevert. See Rule 530 Schedule A-5 Test for the capital structure utilized in the determination of the Test Period revenue requirements.

V. DISCUSSION ON FULLY FUNCTIONAL EXECUTABLE MODELS

Q. HAS PNM COMPLIED WITH RULE 17.1.3.11 NMAC REGARDING ELECTRONIC FILING REQUIREMENTS?

A. Yes. PNM is providing PNM Exhibit HEM-3 and HEM-4 in fully functional, electronic format. PNM Exhibit HEM-3 provides the unadjusted Base Period cost of service, adjustments made to derive both the adjusted Base Period cost of service and the Test Period cost of service. PNM Exhibit HEM-4 provides the electronic workpapers used to develop the adjusted Base Period and Test Period cost of service provided in PNM Exhibit HEM-3. These files are being provided electronically on a DVD-ROM, so the amounts in schedules and workpapers can be easily traced, and assumptions used to develop the Test Period are provided in working electronic files. The combination of these two exhibits represents the cost of service functional model.

Q. BEFORE YOU BEGIN, CAN YOU DEFINE SOME GENERAL TERMS WHEN DESCRIBING THE WORKING MODELS?

A. Yes. The term “workbook” means an entire Microsoft® Excel file and “worksheet” refers to an individual tab within a Microsoft® Excel workbook. A linked workbook refers to an external Microsoft® Excel workbook outside of the existing Microsoft® Excel workbook. A linked worksheet refers to a worksheet within the existing Microsoft® Excel workbook.

Q. PLEASE IDENTIFY THE WORKBOOKS THAT COMPOSE THE COST OF SERVICE FUNCTIONAL MODEL.

A. The following workbooks compose the cost of service working model:

- Folder – HEM-3 – Cost of Service
    - PNM Exhibit HEM-3 - WP COS.xlsx
- Folder – HEM-4 - Workpapers
    - WP Plant – Net Plant workpaper.xlsx
    - WP Plant – Corporate Net Plant workpaper.xlsx
    - WP RA – Regulatory Asset and Liability workpaper.xlsx
    - WP ORB – Other Rate Base workpaper.xlsx
    - WP WC – Working Capital workpaper.xlsx
    - WP OM – O&M workpaper.xlsx
    - WP LA – Labor workpaper.xlsx
    - WP SS – Shared Services workpaper.xlsx
    - WP GT – General Taxes workpaper.xlsx
    - WP OA – Other Allowable Exp workpaper.xlsx
    - WP RC – Revenue Credits workpaper.xlsx
    - WP AL – Allocators workpaper.xlsx
    - WP CMD – Coal Mine Decommissioning.xlsx
    - PNM Exhibit SAT-2.xlsx

Each workbook should be used concurrently and all workbooks should be open at the same time when attempting to modify or adjust any calculations in the cost of service models. This is further explained in PNM Exhibit HEM-2, as discussed below.

Q. HAVE YOU PROVIDED OPERATING INSTRUCTIONS ON HOW TO UTILIZE THE FUNCTIONAL MODEL FOR COST OF SERVICE?

A. Yes. PNM Exhibit HEM-2 provides operating instructions on how users need to utilize the electronic files for cost of service included with this filing. It is important that users read these instructions before attempting to utilize the cost of service functional model.

Q. PLEASE DESCRIBE THE GENERAL FORMAT OF THE FULLY FUNCTIONAL WORKBOOKS.

A. The first worksheet within each workbook will be the workbook lead sheet. The lead sheet provides a table of contents listing each worksheet included in the workbook, a brief description of the worksheet, the purpose of the worksheet, and the purpose of each worksheet. In addition, the lead sheet summarizes where information required on that worksheet is provided from another linked workbook or linked worksheet as well as provides where information on the worksheet is linked to another linked worksheet or linked workbook. Further, the printed copy of certain worksheets includes summations of groups of data for which the underlying detail is too voluminous to be printed in a meaningful format, but can be readily viewed on-line in the electronic spreadsheet format.

Q. HAVE YOU IDENTIFIED ANY SECTIONS WITHIN THE COST-OF-SERVICE MODEL THAT ARE NOT FULLY FUNCTIONAL AS DESCRIBED BY THE FTY RULE?

A. Yes. As provided for in the FTY Rule, PNM has identified the following cost of service sections as not fully functional:

- ADIT. Please refer to the testimony of PNM Witness Harland
- Test Period Fuel. Fuel calculations as provided by PROMOD. Please refer to the testimony of PNM Witness Taylor for further discussion.
- Income Taxes. Please refer to the testimony of PNM Witness Harland for further discussion.
- Cash Working Capital. This calculation is not fully functional and is not linked electronically to the Cost of Service Functional Model. However, PNM has provided Rule 530 Schedule E-1 in executable electronic format on a DVD-ROM. Users can manually change the inputs to recalculate cash working capital in this schedule.

Q. HAVE YOU IDENTIFIED SPECIFIC CALCULATIONS WITHIN THE COST-OF-SERVICE WORKING MODELS THAT ARE NOT FULLY FUNCTIONAL?

A. Yes. PNM has identified on each worksheet what information is provided as a hard input, and has provided references to testimony identifying the reasons for not providing a fully functional calculation. These can include calculations that are supported by other PNM witnesses and are not contained in the linked workbooks within the cost-of-service functional model. In addition, accounting and other relevant data are extracted and formatted from PNM's existing software programs and used to populate the cost of service functional model. All Base Period information is reflected as hard inputs and referenced to the Company's books and records.

VI. CONCLUSIONS

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS WITH REGARD TO PNM'S COST OF SERVICE STUDY AND THE RESULTING REVENUE REQUIREMENT PROPOSED BY PNM.

A. PNM's cost of service study meets the requirements of Rule 530 and the FTY Rule and presents PNM's reasonable costs of providing retail service to its customers during the Base Period and the Test Period. In addition, PNM's cost of service study has been provided in a fully-functional model format, except as otherwise explained, pursuant to the FTY Rule. PNM's Base Period data is taken from its historical books and records. PNM has provided linkage data and additional information through its testimony, exhibits and Rule 530 Schedules that fully explains how the Base Period historical data from PNM's books and records have been developed in the Test Period to fully justify the forecasted reasonable costs of providing service at the time when PNM's proposed rates are expected to be in effect. The resulting proposed revenue requirement of $981,455,795 is reasonable and should be approved by the Commission.

The revenue requirement established by the Commission in this rate case should recognize that the procurement of renewable energy and related costs associated with complying with the Renewable Energy Act will continue to be recovered through PNM's Renewable Energy Rider, rather than in base rates.

Q. PLEASE SUMMARIZE THE AUTHORIZATIONS PNM IS REQUESTING WITH RESPECT TO REGULATORY ASSETS AND LIABILITIES IN THIS PROCEEDING?

A. PNM is requesting the following Commission approvals related to regulatory assets and liabilities: (1) to establish and to begin recovery of the Alvarado Square Lease regulatory asset; (2) to establish and to begin recovery of the TOU regulatory asset; (3) to establish and to begin recovery of the proposed Rate Case Expenses regulatory asset; (4) to establish and begin recovery of the amortization of the PV DOE Settlement regulatory liability through PNM's FPPCAC; (5) to establish a regulatory asset for costs incurred to implement the requested Credit Card Program; (6) to establish a regulatory liability associated with recovery of AROs on a straight-line basis, instead of using the accretion method as otherwise required under GAAP; (7) to establish a regulatory liability associated with recovery of underground coal mine reclamation costs on a straight-line basis, instead of recovery of booked accretion expense, as otherwise required under GAAP; and (8) to establish and begin recovery of a regulatory asset associated with impaired state Net Operating Loss carryforwards. In addition, PNM seeks approval to begin recovery of a previously approved regulatory asset/regulatory liability related to the decommissioning of the Las Vegas Generating Station over a two-year period.

Q. WHAT ARE YOUR GENERAL CONCLUSIONS?

A. PNM's cost of service was developed in accordance with the Commission's FTY Rule, including providing the linkage data and adjusted Base Period to trace the development of the Test Period results. The details of the Base Period, adjusted Base Period, linkage data and the Test Period are properly shown on the Rule 530 Schedules in accordance with Rule 530 as supplemented by the FTY Rule. PNM has provided fully functional executable models as required under the FTY Rule. The Test Period results demonstrate revenue requirements that are just and reasonable, as further supported by other PNM witnesses.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

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