

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

**IN THE MATTER OF PUBLIC SERVICE)
COMPANY OF NEW MEXICO’S APPLICATION)
FOR APPROVAL OF PURCHASED POWER)
AGREEMENTS, ENERGY STORAGE)
AGREEMENTS, AND CERTIFICATES OF PUBLIC)
CONVENIENCE AND NECESSITY FOR SYSTEM)
RESOURCES IN 2026,)
)
PUBLIC SERVICE COMPANY OF NEW MEXICO,)
)
Applicant)
_____)**

Case No. 23-00xxx-UT

**DIRECT TESTIMONY
OF
TIM NICHOLS**

October 25, 2023

**DIRECT TESTIMONY
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NMPRC CASE NO. 23-____-UT**

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

2 **A.** My name is Tim Nichols. I serve as Principal, Finance and Special Projects, for
3 PNMR Services Company and its affiliates, including Public Service Company of
4 New Mexico (“PNM” or the “Company”). My business address is Public Service
5 Company of New Mexico, 414 Silver SW, Mail Stop 0915, Albuquerque, NM
6 87102.

7
8 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
9 **PROFESSIONAL EXPERIENCE.**

10 **A.** I have worked in financial planning for PNM and PNM Resources, Inc. since 2000
11 and assumed my present position in 2022. During my 24-year career at PNM, I
12 have held a variety of finance and accounting positions, including Executive
13 Director of Strategic Financial Planning and Risk Management. I have extensive
14 experience with cash flow forecasting and utility finance and accounting. I have a
15 Master of Science degree in Accounting from Oklahoma State University.

16
17 **Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS PRINCIPAL,**
18 **FINANCE AND SPECIAL PROJECTS.**

19 **A.** As a senior member of the PNM Resources Finance Team, I provide guidance for
20 the financial planning of PNM Resources and its subsidiaries, including PNM. My
21 responsibilities include formulating strategies and plans to accomplish financial
22 objectives, supporting the preparation of financial forecasts such as the Long- Range
23 Plan and Annual Operating Plan, providing forecasts and analysis to rating agencies

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1 and financial institutions, and providing financial expertise in connection with
2 various strategic initiatives.

3

4 **Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY IN PROCEEDINGS**
5 **BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION**
6 **(“COMMISSION” OR “NMPRC”)?**

7 **A.** Yes, I testified previously in NMPRC Case No. 13-00004-UT, PNM’s Application
8 for Approval of a Certificate of Public Convenience and Necessity for the
9 Acquisition and Operation of the Delta Person Generating Station.

10

11 **Q. HAVE YOU PREPARED EXHIBITS?**

12 **A.** Yes, as follows:

13 **PNM Exhibit TN-1:** Calculation of Cost of Incremental Equity For Fixed Price
14 ESA

15 **PNM Exhibit TN-2:** Estimated Lease Liability and Imputed Debt for Previously
16 Executed Fixed Price ESAs

17

18 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

19 **A.** My testimony explains how the rating agencies treat lease liabilities associated with
20 long-term fixed payment obligations in calculating credit metrics, the impact of
21 imputed debt on PNM’s capital structure, and the need and costs to offset imputed
22 debt in PNM’s capital structure. I also discuss how PNM calculated the potential
23 impact of imputed debt associated with fixed price energy storage agreements

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1 (“ESAs”) considered in PNM’s 2026 resource request for proposals (“RFP”).
2 Finally, my testimony addresses the requirement of Rule 551.8(D)(7) to provide
3 evidence of the impact on PNM’s financial condition and financial metrics of the
4 purchased power agreement and energy storage agreements for which PNM seeks
5 approval in this Application.

6
7 **Q. WHY DID PNM NEED TO CONSIDER THE FINANCIAL IMPACT OF**
8 **IMPUTED DEBT ASSOCIATED WITH FIXED PRICE ESAS IN THE 2026**
9 **RFP?**

10 **A.** As discussed in PNM witness Feldman’s testimony, ratings agencies have indicated
11 that certain long-term fixed payment obligations—including fixed payments under
12 ESAs—will be treated as debt on a utility’s balance sheet. As a result, PNM had
13 to consider the impact of imputed debt associated with fixed price ESA bids to
14 determine the optimal set of resources and to consider alternative pricing options.

15
16 **Q. PLEASE EXPLAIN HOW LEASE LIABILITIES ASSOCIATED WITH**
17 **LONG-TERM FIXED PAYMENTS AFFECT PNM’S BALANCE SHEET.**

18 **A.** As PNM witness Monroy describes, PNM must classify certain long-term fixed
19 payment obligations as “lease liabilities.” Rating agencies view lease liabilities as
20 “debt-like” and impute some portion of the fixed obligation as debt to the utility
21 balance sheet for purposes of determining credit metrics for the subject utility, and
22 ultimately the utility’s credit rating.

23

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1 **Q. HAVE THE RATINGS AGENCIES DETERMINED HOW FIXED PRICE**
2 **ENERGY STORAGE AGREEMENTS WILL BE TREATED WHEN**
3 **CALCULATING CREDIT METRICS?**

4 **A.** Moody's and S&P, the two agencies that rate PNM's debt, both calculate credit
5 metrics by starting with PNM's quarterly and annual financial statements. They
6 then make standard adjustments to reported financial data, each using their own
7 methodology. One standard adjustment both agencies typically make is to include
8 lease liabilities as debt. PNM witness Feldman's testimony explains that the
9 rationale for debt imputation by the rating agencies is that the fixed payment
10 obligations transfer financial risk from the third-party developer/owner to the
11 purchasing utility. In some cases, generally accepted accounting principles require
12 PNM to treat ESAs as lease agreements that may result in imputed debt.

13
14 In reviewing the RFP in this case, PNM had to consider how the rating agencies
15 would treat the proposed bids and how that treatment would affect PNM's balance
16 sheet. To do this, PNM worked with the ratings agencies to determine how it would
17 treat the proposed RFP resources. Moody's indicated that it will not make an
18 adjustment to include PNM's lease liability for ESAs as debt. However, S&P
19 indicated they will make an adjustment to include some or all of the lease liability
20 as debt when calculating PNM's credit metrics. S&P has not yet made a final
21 determination regarding how much operating lease liability for ESAs they will
22 include as imputed debt, but their preliminary guidance is that at least 25% and up
23 to 50% of the lease liability will be treated as imputed debt.

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1 **Q. HOW DO RATING AGENCIES CONSIDER THE IMPACT OF IMPUTED**
2 **DEBT ON A COMPANY’S CREDIT RATINGS?**

3 **A.** The rating agencies use many factors to determine a company’s credit rating. For
4 regulated utilities, certainty and timeliness of cost recovery are key factors in
5 determining a specific company’s creditworthiness. The rating agencies also
6 evaluate the company’s credit metrics, like the debt-to-capital ratio and the
7 cashflow-to-debt ratio (typically referred to as funds from operations (“FFO”) to
8 debt), to determine credit ratings. Imputed debt increases the debt-to-capital ratio
9 and decreases the FFO-to-debt ratio. These adjustments weaken the company’s
10 credits metrics and put downward pressure on credit ratings. As a result, the
11 Company may need to increase equity to strengthen the balance sheet by offsetting
12 the imputed debt and improving credit metrics.

13

14 **Q. WILL THE ESAS INCLUDED IN THIS FILING RESULT IN IMPUTED**
15 **DEBT TO PNM?**

16 **A.** No. As discussed in PNM Witness Monroy’s testimony, PNM has negotiated
17 volumetric pricing for the ESAs which will result in no lease liability being reported
18 on PNM’s audited financial statements. The volumetric pricing structure avoids
19 creating imputed debt. As a result, the PPA and ESAs do not impact PNM’s
20 financial condition and financial metrics.

21

22 **Q. HOW DID PNM ANALYZE THE COSTS OF FIXED PRICE ESAS VERSUS**
23 **VOLUMETRIC ESAS?**

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1 **A.** As explained in PNM Witness Nagel’s testimony, PNM initially received only
2 fixed price ESAs in the RFP. Once PNM determined the risk that these fixed price
3 ESAs would result in lease liabilities and corresponding debt imputation, PNM
4 requested updated bids with volumetric pricing structures. To compare the fixed
5 price bids with the volumetric bids PNM utilized a template provided by the
6 independent evaluator and developed a model to calculate the incremental cost of
7 equity that would be needed to offset the imputed debt resulting from fixed price
8 ESAs.

9
10 This model (1) used PNM’s cost of capital from its last approved rate case, (2)
11 calculated the amount of debt that would be imputed in PNM’s credit metrics from
12 the fixed price ESA, (3) assumed that equity equal to 50 percent of that imputed
13 debt would be added to PNM’s capital structure and debt is reduced by an equal
14 amount, (4) calculated the cost of that incremental equity for each year of the ESA,
15 then (5) calculated the levelized cost of the incremental equity on a per kW basis.
16 Please see PNM Exhibit TN-1 for an example calculation of cost of imputed debt
17 for a fixed price ESA. Based on this hypothetical example, the cost of incremental
18 equity of the ESA will add 5 to 10 % to the stated contract price.

19
20 **Q.** **HOW DID PNM USE THIS ANALYSIS IN SELECTING THE 2026 RFP**
21 **RESOURCES?**

22 **A.** PNM incorporated this analysis into its 2026 RFP modeling as discussed in the
23 direct testimony of PNM witness Phillips.

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1 **Q. HAS PNM CONSIDERED HOW DEBT IMPUTED AS A RESULT OF**
2 **PREVIOUSLY EXECUTED PPAS AND ESAS WILL IMPACT PNM'S**
3 **CAPITALIZATION STRUCTURE AND OVERALL COST OF CAPITAL?**

4 **A.** Yes. By the end of 2024, PNM will have five previously executed ESAs that are
5 expected to be in service and reported as leases on PNM's financial statements.
6 The lease liability associated with the previously executed ESAs is currently
7 projected to be about \$545 million as of December 31, 2024. See PNM Exhibit
8 TN-2. Assuming S&P treats 25% to 50% of the lease liability as imputed debt,
9 PNM's credit ratios will reflect an additional \$136M to \$273M of imputed debt.

10

11 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

12 **A.** Yes, I have nothing further at this time.

GCG#531687

Cost of Incremental Equity for Fixed Price ESA

PNM Exhibit TN-1

Is contained in the following 2 pages.

Public Service Company of New Mexico
Exhibit TN-1
Calculation of Cost of Incremental Equity
for Fixed Price ESA

Size	100 MW		
Cost	\$10.00 \$/kW month		
Annual Cost	12,000,000		
Non-Lease Components	30%		
Interest Rate for Lease	6.25%	NPV of Incremental Cost	\$7,092,369
S&P Imputed Debt %	25%	Levelized Annual Cost	\$630,953
PNM's Long-Term Debt %	50%	\$/kW year	\$6.31
Pre-tax Cost of Debt	4.86%	\$/kW month	\$0.53
After Tax Cost of Equity	9.575%	% Increase	5.3%
Pre-tax Cost of Equity	12.835%		

Year	Annual ESA Cost	Operating Lease Portion	Operating Lease Liability	Imputed Debt	Equity Needed	Incremental Cost of Equity %	Incremental Cost of Equity \$
1	12,000,000	8,400,000	91,923,431	22,980,858	11,490,429	7.98%	916,705
2	12,000,000	8,400,000	89,268,645	22,317,161	11,158,581	7.98%	890,230
3	12,000,000	8,400,000	86,447,935	21,611,984	10,805,992	7.98%	862,101
4	12,000,000	8,400,000	83,450,931	20,862,733	10,431,366	7.98%	832,213
5	12,000,000	8,400,000	80,266,615	20,066,654	10,033,327	7.98%	800,458
6	12,000,000	8,400,000	76,883,278	19,220,820	9,610,410	7.98%	766,717
7	12,000,000	8,400,000	73,288,483	18,322,121	9,161,060	7.98%	730,868
8	12,000,000	8,400,000	69,469,013	17,367,253	8,683,627	7.98%	692,779
9	12,000,000	8,400,000	65,410,826	16,352,707	8,176,353	7.98%	652,308
10	12,000,000	8,400,000	61,099,003	15,274,751	7,637,375	7.98%	609,309
11	12,000,000	8,400,000	56,517,691	14,129,423	7,064,711	7.98%	563,622
12	12,000,000	8,400,000	51,650,046	12,912,512	6,456,256	7.98%	515,079
13	12,000,000	8,400,000	46,478,174	11,619,544	5,809,772	7.98%	463,503
14	12,000,000	8,400,000	40,983,060	10,245,765	5,122,883	7.98%	408,703
15	12,000,000	8,400,000	35,144,501	8,786,125	4,393,063	7.98%	350,478
16	12,000,000	8,400,000	28,941,033	7,235,258	3,617,629	7.98%	288,614
17	12,000,000	8,400,000	22,349,847	5,587,462	2,793,731	7.98%	222,883
18	12,000,000	8,400,000	15,346,713	3,836,678	1,918,339	7.98%	153,045
19	12,000,000	8,400,000	7,905,882	1,976,471	988,235	7.98%	78,841
20	12,000,000	8,400,000	-	-	-	-	-

Public Service Company of New Mexico
Exhibit TN-1
Calculation of Cost of Incremental Equity
for Fixed Price ESA

Size	100 MW		
Cost	\$10.00 \$/kW month		
Annual Cost	12,000,000		
Non-Lease Components	30%		
Interest Rate for Lease	6.25%	NPV of Incremental Cost	\$14,184,739
S&P Imputed Debt %	50%	Levelized Annual Cost	\$1,261,907
PNM's Long-Term Debt %	50%	\$/kW year	\$12.62
Pre-tax Cost of Debt	4.86%	\$/kW month	\$1.05
After Tax Cost of Equity	9.575%	% Increase	10.5%
Pre-tax Cost of Equity	12.835%		

Year	Annual ESA Cost	Operating Lease Portion	Operating Lease Liability	Imputed Debt	Equity Needed	Incremental Cost of Equity %	Incremental Cost of Equity \$
1	12,000,000	8,400,000	91,923,431	45,961,715	22,980,858	7.98%	1,833,410
2	12,000,000	8,400,000	89,268,645	44,634,323	22,317,161	7.98%	1,780,460
3	12,000,000	8,400,000	86,447,935	43,223,968	21,611,984	7.98%	1,724,201
4	12,000,000	8,400,000	83,450,931	41,725,466	20,862,733	7.98%	1,664,426
5	12,000,000	8,400,000	80,266,615	40,133,307	20,066,654	7.98%	1,600,915
6	12,000,000	8,400,000	76,883,278	38,441,639	19,220,820	7.98%	1,533,434
7	12,000,000	8,400,000	73,288,483	36,644,241	18,322,121	7.98%	1,461,736
8	12,000,000	8,400,000	69,469,013	34,734,507	17,367,253	7.98%	1,385,557
9	12,000,000	8,400,000	65,410,826	32,705,413	16,352,707	7.98%	1,304,617
10	12,000,000	8,400,000	61,099,003	30,549,502	15,274,751	7.98%	1,218,618
11	12,000,000	8,400,000	56,517,691	28,258,845	14,129,423	7.98%	1,127,244
12	12,000,000	8,400,000	51,650,046	25,825,023	12,912,512	7.98%	1,030,158
13	12,000,000	8,400,000	46,478,174	23,239,087	11,619,544	7.98%	927,006
14	12,000,000	8,400,000	40,983,060	20,491,530	10,245,765	7.98%	817,406
15	12,000,000	8,400,000	35,144,501	17,572,251	8,786,125	7.98%	700,956
16	12,000,000	8,400,000	28,941,033	14,470,516	7,235,258	7.98%	577,228
17	12,000,000	8,400,000	22,349,847	11,174,924	5,587,462	7.98%	445,767
18	12,000,000	8,400,000	15,346,713	7,673,356	3,836,678	7.98%	306,090
19	12,000,000	8,400,000	7,905,882	3,952,941	1,976,471	7.98%	157,683
20	12,000,000	8,400,000	-	-	-	-	-

Estimated Debt Imputation / Lease Liability for Previously

Executed Fixed Price ESAs

PNM Exhibit TN-2

Is contained in the following 1 page.

Public Service Company of New Mexico
Exhibit TN-2
Estimated Lease Liability and Imputed Debt
for Previously Executed Fixed Price ESAs

Name	MW	Annual Payment	Estimated Lease Liability 12/31/2024
Arroyo Solar ESA	150	13,428,000	112,999,329
San Juan Solar ESA	100	11,472,000	98,586,363
Jicarilla I Solar Battery	20	2,392,800	19,815,604
Atrisco Battery	300	31,860,000	273,793,716
Skyranch Battery	50	4,716,000	40,433,458
	620	63,868,800	545,628,470
S&P 25% Debt			136,407,117
S&P 50% Debt			272,814,235

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Applicant)	
_____)	

SELF AFFIRMATION

TIM NICHOLS, Director of Strategic Financial Planning for PNMR Services Company, upon being duly sworn according to law, under oath, deposes and states: I have read the foregoing **Direct Testimony of Tim Nichols** and it is true and accurate based on my own personal knowledge and belief.

Dated this 25th of October, 202

/s/Tim Nichols
TIM NICHOLS