significantly larger value on demands occurring in these three months as compared to the rest of the year.

Q WHAT IS THE ISSUE WITH RESPECT TO THE ALLOCATION OF TRANSMISSION COSTS?

A PNM has allocated transmission costs using the 12 monthly coincident peaks.[7] This allocation method is inappropriate because the transmission system must be built to meet the annual system peak demand, which occurs in the summer; not the average of the 12 monthly peak demands, some of which are significantly lower (as much as 40% lower) than the summer peak demand. In this respect, the transmission system is similar to the generation system, and should be allocated in a similar fashion.

Q WHAT IS THE ISSUE WITH RESPECT TO THE CLASSIFICATION OF CERTAIN NON-FUEL GENERATION O&M EXPENSES?

A The issue involves the classification of non-labor generation costs (other than fuel and purchased power) between the "fixed" category and the "variable" category. The categories of costs, broadly speaking, are non-labor costs in the generation operations cost category and the generation maintenance category. Classification is important in cost of service studies because fixed costs are allocated on the production demand allocation factor, while variable costs are allocated on the

[7]Direct Testimony of Stella Chan at Page 33.