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(61FR15427)

Financial Assurance Requirements for Decommissioning Nuclear Power Reactors

9

61 FR 15427

COMMENTS OF PUBLIC SERVICE COMPANY OF NEW MEXICO  
IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING

Public Service Company of New Mexico ("PNM") responds to the Notice of Proposed Rulemaking ("NOPR") issued in the above captioned docket on April 8, 1996, by the Nuclear Regulatory Commission ("NRC"). In its NOPR, the NRC proposes to amend certain requirements for decommissioning funding by electric utilities. The proposed rule also would allow utility licensees to assume a positive real rate of return on decommissioning funds during the safe storage period. Finally, the rule would establish certain periodic reporting requirements.

I. The Company's Interest in Palo Verde Nuclear Generating Station

The Company is participating in the three 1,270 MW units of Palo Verde Nuclear Generating Station ("PVNGS"), also known as the Arizona Nuclear Power Project, with

Arizona Public Service ("APS") (the operating agent), Salt River Project, El Paso Electric Company, Southern California Edison, Southern California Public Power Authority, and The Department of Water and Power of the City of Los Angeles. PVNGS is located in Wintersburg, Arizona. PNM has a 10.2 % undivided interest in PVNGS, with its interest in Unit 1 held under leases and Unit 2 held partially under leases. The Company's owned and leased interests in PVNGS (390 MW) comprise nearly 26% of PNM's total net generating capacity of 1506 Mw.

PNM's interest in Units 1 and 2 has been declared "used and useful" by the New Mexico Public Utility Commission ("NMPUC") and is included in PNM's New Mexico jurisdictional rates, which allows, among other things, recovery of decommissioning costs from PNM's New Mexico jurisdictional customers. PNM's ownership interest in Unit 3 of PVNGS is not in PNM's rate base, but wholesale power sales are regulated by FERC.

## II. Responses to Specific Questions raised in the NOPR.

The following comments are provided and arranged by topic:

### A. Topic A -- Timing and Extent of Electric Utility Industry Deregulation in New Mexico

Many commentators and electric utility analysts have speculated on a likely timetable for industry-wide transition to competition. For purposes of this rulemaking, PNM's primary focus will be to provide the NRC with an update on the legislative and regulatory climate in New Mexico relating to competition in the electric industry.

In November 1995, after three years of study, the Integrated Water and Resource Planning Committee of the New Mexico State Legislature (the "IWRPC") issued a resolution reporting its findings on the advantages and disadvantages of retail wheeling and alternative restructuring schemes applicable to the electric power industry in New Mexico. The IWRPC's recommendation stated that any proposed restructuring (i) must benefit all ratepayers in the state, (ii) must maintain and possibly encourage the financial health and economic viability of each of the state's utilities, (iii) must provide for appropriate protection from unfair or advantaged competition from utilities or others from outside the state, and (iv) must share equitably any costs, including stranded asset costs, among the varied interests benefited.

The IWRPC also recommended that the NMPUC, under legislative direction and guidance, should monitor and evaluate the electric power industry and applicable market influences and factors and report its findings, conclusions and recommendations to the New Mexico State Legislature for legislative approval and action, as necessary, before any proposed restructuring may be implemented. The resolution further indicated that this continuing evaluation was necessary because of continuing changes even though restructuring and retail wheeling are not justified or in the public interest at this time. The IWRPC resolution was presented to the full Legislature as a Senate Joint Memorial. It was unanimously passed by the Senate and the House.

In November 1995, the NMPUC issued a Notice of Inquiry ("NOI") regarding the restructuring of regulation of the electric utility industry in New Mexico. The NMPUC is seeking input on a variety of questions related to competition, retail wheeling and state vs.

federal jurisdiction. The NMPUC established a timetable for comments and reply comments but has no date by which it has committed to issue a final rule.

The Company in its February 15, 1996, response stated that it believes that: (i) competition and customer choice may be beneficial to all affected interests in New Mexico if done appropriately and (ii) in order to achieve restructuring, there must be cooperative state and federal action to avoid prolonged uncertainty and litigation, as well as to avert inconsistent state actions that would inhibit the development of competitive markets and restrict the benefits that they may provide. The Company proposed a five-year period to accomplish the transition to a workable competitive market once the rules are established.

The Company also stated that it supports action by the United States Congress to clarify boundaries between state and federal jurisdiction over the electric utility industry, and to ensure that retail wheeling can be implemented in a manner that ensures fair competition and provides utilities the opportunity to recover all stranded asset costs. PNM specifically advocates a wires charge, similar to that adopted in the telecommunications industry, to cover stranded assets, which charge would include decommissioning costs. A copy of PNM's Response to the NMPUC's NOI is attached as Exhibit "A" to these Comments, in order to provide more details about industry restructuring in New Mexico.

#### B. Topic B -- Stranded Costs

While PNM has no crystal ball to predict the future, the Company does believe, based on current developments both in New Mexico and at the federal level, that a



transition to competition will include stranded cost recovery, including a mechanism for recovery of decommissioning costs. Instead of trying to formulate its own separate approach to decommissioning costs in the era of electric industry restructuring, the NRC, along with FERC, should urge Congress to adopt stranded cost legislation that will insure recovery of decommissioning costs as the most prudent solution to the uncertainties addressed in the NRC's NOPR. As PNM has asserted in its Response to the NMPUC's NOI, "many of the issues that must be resolved to provide for fair competition and customer choice can only be resolved at the federal level, if such resolution is to avoid unfair advantages to consumers and producers in some states and disadvantages to consumers and producers in other states. Moreover, restructuring must be approached comprehensively, rather than on a piecemeal basis, if it is to proceed efficiently and with a minimum of delay and litigation." PNM NOI Response at page 16, Exhibit A hereto. The NRC should avoid regulating industry-wide transition with respect to decommissioning costs based on selected developments with selected companies or selected states. Such action could have extremely negative and unintended consequences for ratepayers as well as taxpayers across the country--particularly in states such as New Mexico where legislatures have a cautious approach to any legislative or regulatory transition scheme that could dramatically increase costs or decrease reliability or availability of service for residential ratepayers.

PNM understands that the NRC cannot abdicate its responsibility to examine difficult issues relating to the electric industry's transition to competition but urges that the timing of any new rules that dramatically alter the way an electric utility funds its

decommissioning obligation be delayed to correspond with legislative or regulatory resolution of the stranded cost issue. If the NRC were to change its rules prematurely, the entire industry could suffer dramatically and without good cause. This is particularly true in New Mexico given the Legislature's recognition of the importance of recovery of stranded costs and FERC's current Open Access Rule that embraces stranded cost recovery.

### III. Summary

In summary, PNM urges the NRC to approach rule making regarding decommissioning costs in a manner that will facilitate a federal legislative solution to stranded costs. New rules should be timed to allow utilities sufficient flexibility to take advantage of stranded cost recovery, whether mandated federally or by individual states. To act otherwise would create intolerable industry-wide financial impacts that are extremely undesirable both for ratepayers and taxpayers.

Respectfully submitted,

PUBLIC SERVICE COMPANY OF NEW MEXICO

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BEFORE THE NEW MEXICO PUBLIC UTILITY COMMISSION

IN THE MATTER OF THE )  
INVESTIGATION OF )  
RESTRUCTURING OF REGULATION )  
OF THE ELECTRIC INDUSTRY )  
IN NEW MEXICO. )  
\_\_\_\_\_)

CASE NO. 2681

Public Service Company of New Mexico's  
Comments on the Notice of Inquiry

FEBRUARY 15, 1996

# INITIAL COMMENTS OF PUBLIC SERVICE COMPANY OF NEW MEXICO

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1                   BEFORE THE NEW MEXICO PUBLIC UTILITY COMMISSION

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3 IN THE MATTER OF THE )  
4 INVESTIGATION OF )  
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6 OF THE ELECTRIC INDUSTRY )  
7 IN NEW MEXICO. )

Case No. 2681

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10                   INITIAL COMMENTS OF  
11                   PUBLIC SERVICE COMPANY OF NEW MEXICO  
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13                   Pursuant to the Notice of Inquiry ("NOI") issued in the  
14 above-captioned proceeding by the New Mexico Public Utility  
15 Commission ("Commission") on November 28, 1995, Public Service  
16 Company of New Mexico ("PNM") hereby submits its initial comments  
17 on the restructuring of the electric utility industry and the  
18 steps involved that may permit benefits from competitive markets  
19 for all New Mexico consumers and utilities.

20                   PNM's comments are structured as follows: First, PNM  
21 sets forth an executive summary. Second, PNM (1) identifies some  
22 of the economic, regulatory, and legal issues presented by New  
23 Mexico Senate Joint Memorial 42 ("SJM 42"), the NOI, changes in  
24 federal statutes, and pending and rapidly emerging proposals for  
25 change in state and federal regulation and legislation, and (2)  
26 presents general recommendations based upon the New Mexico  
27 legislature's guidance to the Commission concerning restructuring  
28 matters. PNM also offers for discussion a process by which  
29 interested parties can seek, and perhaps achieve, solutions based  
30 upon a consensus with respect to at least some of these issues  
31 related to the implementation of competition.

32                   Third, PNM offers more specific recommendations  
concerning appropriate New Mexico and federal actions to



1 implement restructuring and thereby bring the possibility of  
2 benefits of competition and customer choice to New Mexico. By  
3 doing so, PNM responds both to the Commission's invitation to all  
4 commenters "to raise any and all issues relating to retail  
5 competition or otherwise relevant to restructuring issues  
6 believed important to the development of a sound regulatory  
7 policy[]" 1/ and to specific questions posed in Ordering  
8 Paragraph A of the NOI. 2/ Next, PNM responds to specific  
9 questions raised by the Commission's NOI, to the extent that  
10 those questions are not answered in the previous section. At  
11 this time, PNM does not propose changes to the existing statutory  
12 and regulatory framework governing New Mexico's electric  
13 utilities, because restructuring discussions in New Mexico are at  
14 an early stage and because the pace of change in the industry  
15 will likely ensure that any such recommendations would be  
16 premature (NOI Question 25 and Ordering Paragraph B). PNM notes  
17 that these comments reflect PNM's views based on the current  
18 state of the electric utility industry and the restructuring  
19 debate. PNM reserves the right to supplement these comments if  
20 further developments so warrant, to submit reply comments as  
21 provided in the NOI, and to submit proposed changes to the  
22 existing statutes and regulations at an appropriate time when the

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1/ NOI, at 1.

2/ Where PNM responds to a particular question posed by the Commission in the NOI, the question is noted parenthetically, by number.

1 debate has crystallized.

2

3 I. EXECUTIVE SUMMARY

4 The electric utility industry in the United States  
5 currently is undergoing a period of revolutionary change.  
6 Legislators and regulators at both the state and federal levels  
7 are considering whether, and how, to promote competition among  
8 suppliers of electricity and customer choice of suppliers. SJM  
9 42, as adopted by the 1996 Legislature, reflects the conclusion  
10 that neither retail wheeling nor restructuring is in the public  
11 interest in New Mexico at this time.

12 In the NOI, the Commission recognized the "speed and  
13 breadth of changes occurring across the country . . . ." The  
14 pace of change in the debate has accelerated since the Commission  
15 published the NOI late last year. It is clear that change is  
16 coming, and New Mexico will be affected whether it acts or stands  
17 still. PNM believes that there are many issues that must be  
18 addressed if competition is to work in the electric industry, and  
19 believes that New Mexico must be part of the transition process,  
20 in order to shape the process and ensure that the interests of  
21 New Mexico are protected.

22 Because the pace of change in the industry is so rapid,  
23 PNM's conclusions are preliminary and based upon assumptions and  
24 perceptions that may change. One conclusion that is not  
25 tentative or ambiguous is that if the anticipated benefits of  
competition are to be achieved without disruptions that harm

1 public and private interests alike, regulators must address  
2 stranded costs, and other costs associated with the transition to  
3 a competitive environment before restructuring takes place. So,  
4 too, regulators must ensure that service remains reliable. These  
5 conclusions hold whether the model desired is that of competition  
6 for wholesale markets, as envisioned by the Federal Energy  
7 Regulatory Commission ("FERC") Mega-NOPR, which includes stranded  
8 cost recovery and explicit recognition of reliability issues as  
9 mandated by the Energy Policy Act of 1992 ("EPAct"), or a more  
10 extreme model based upon disaggregation or even divestiture of  
11 the vertical functions of the industry, whose proponents may not  
12 share concerns for reliability for all consumers, or for  
13 constitutional protection of property rights, or for benefits and  
14 opportunities for all consumers and producers.

15 PNM believes that stranded cost recovery is sound  
16 policy -- to ensure that generation competes in the future  
17 without regard to past decisions or inconsistent recovery  
18 mechanisms. Further, such recovery is required under the fifth  
19 and fourteenth amendments to the U.S. Constitution, as well as  
20 Article II, Sections 18 and 20 of the New Mexico constitution. If  
21 stranded costs are not addressed in advance of restructuring,  
22 certain segments of the industry may achieve temporary and  
23 opportunistic benefits. In enlarging third-party access to the  
24 integrated transmission system, the U.S. Congress mandated that  
25 reliability be preserved. If stranded cost recovery and  
reliability are not addressed before restructuring and retail

1 access, the groundwork will not be laid to ensure that society  
2 will achieve the lasting benefits of competition.

3 PNM also believes that in order to establish a  
4 competitive regime in which customers will have effective choice  
5 of energy suppliers at the retail level in as smooth, efficient,  
6 and painless a fashion as possible, there must be cooperative  
7 state and federal action to avoid prolonged uncertainty and  
8 litigation, as well as to avert inconsistent state actions that  
9 could inhibit the development of competitive markets and restrict  
10 the benefits they may provide. Without such action, the State of  
11 New Mexico, its electric utilities, and their customers may be  
12 disadvantaged -- the concern raised by the Commission in the  
13 first sentence of the NOI.

14 To achieve deregulation in the market for electricity  
15 generation, PNM believes that a five-year transition period will  
16 be necessary, during which time state and federal regulators  
17 should take actions necessary to foster a workably competitive  
18 generation market. The Commission should use this opportunity to  
19 encourage pilot or experimental programs that will allow New  
20 Mexico to gain experience with new forms of pricing for  
21 generation, transmission, and distribution services.

22 In these comments, PNM discusses possible structures,  
23 and describes some of the regulatory issues raised by those  
24 structures. At one extreme, regulators could decline to open up  
25 the retail market to competition, relying instead on wholesale  
competition to lower prices and protect the public interest in

1 economic and reliable electric service. At the other extreme,  
2 regulators and legislators could seek to force vertically  
3 integrated companies to disaggregate the ownership of generation,  
4 transmission, and distribution assets. The markets for  
5 generation, transmission, distribution, and other services could  
6 be deregulated entirely, and the marketplace assumed to protect  
7 the public interest. There are many possible approaches rather  
8 than these two extremes; PNM suggests that a model somewhere in  
9 between holds the greatest promise to achieve the benefits of  
10 competition without adversely affecting reliability and without  
11 the disruption and uncertainty.

12 The Commission should consider performance-based  
13 regulation for pricing of any service which remains a monopoly  
14 subject to regulation, and should permit utilities to provide  
15 energy-related services in unregulated markets. Above all, the  
16 Commission should participate actively in the restructuring  
17 process at the federal level, to protect the interests of all New  
18 Mexicans.

19 PNM also supports action by the U.S. Congress to  
20 clarify the boundaries between state and federal jurisdiction  
21 over the electric utility industry, and to ensure that retail  
22 wheeling can be implemented in a manner that ensures fair  
23 competition. Federal action should also provide that utilities  
24 will have the opportunity to recover all stranded asset costs,  
25 and should implement appropriate methods for siting assets and  
pricing transmission service to encourage and facilitate the

1 competitive generation market. There should be a unified  
2 environmental review process, to protect local interests and  
3 promote efficient siting of new generation and transmission  
4 facilities. PNM believes that, PUCHA reform or repeal could help  
5 foster corporate unbundling and the formation of non-utility  
6 subsidiaries for those utilities who so desire. While PNM does  
7 not believe that corporate restructuring is universally  
8 necessary, there are benefits to such a structure.

9 PNM believes that these recommendations are necessary  
10 to bring about the anticipated benefits of competitive market  
11 forces and free customer choices with a minimum of delay and  
12 disruption, and to protect the interests of New Mexicans in  
13 reliable electric service.

## 15 II. INTRODUCTION

### 16 A. The Changing Face of Electric Utility Regulation

17 The Commission's NOI should be viewed as a response to  
18 SJM 42. SJM 42 is the result of three years of legislative study  
19 and is, grounded upon a recognition of the many changes to the  
20 structure and regulation of the electric utility industry,  
21 current and anticipated, at both the federal and state levels.  
22 As the Commission's NOI states, "the speed and breadth of changes  
23 occurring across the country make it apparent that the time is  
24 appropriate to commence consideration of changes in [Commission]



1 rules which may be required to adapt to restructuring." 3/ As  
2 will be demonstrated, however, changes in Commission rules are  
3 insufficient: New Mexico and federal statutory changes are also  
4 required.

5 At the federal level, the United States Congress has  
6 enacted several regulatory changes since the mid-1970s, many of  
7 which have been designed to promote competition in certain  
8 sectors of the electric industry. The National Energy Act of  
9 1978 included the Public Utility Regulatory Policies Act  
10 ("PURPA"), 4/ which freed some wholesale generation from  
11 regulation based upon accounting costs, required purchases from  
12 some facilities at avoided costs, and provided a relatively  
13 ineffective wholesale wheeling program. The National Energy Act  
14 also included the Powerplant and Industrial Fuel Use Act ("FUA"),  
15 5/ which limited the use of natural gas for electric generation  
16 and thereby promoted utility investment in nuclear plants and  
17 coal-fired generators.

18 More recently, EPAct 6/ revised the rules governing  
19 wholesale markets and access to transmission for wholesale  
20 customers. EPAct also amended the Public Utility Holding Company  
21 Act of 1935 ("PUHCA") 7/ to permit the formation of exempt

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3/ NOI, at 1.

4/ Pub. L. 95-617, 92 Stat. 3117 (1978).

5/ 42 U.S.C. §§ 8301 et seq. (1988).

6/ Pub. L. 102-486, 106 Stat. 2776 (1992).

wholesale generators ("EWGs"), thereby promoting the creation of additional generation by utility affiliates and other entities. Today, Congress is considering changes to, or repeal of, PURPA and PUHCA, as well as comprehensive proposals for the overhaul of the electric utility industry. <sup>8/</sup> These federal initiatives developed after the Electricity Consumers Resource Council ("ELCON") and others called for federal action to address competition issues. <sup>9/</sup>

Federal regulators have not been idle. In 1994, the Federal Energy Regulatory Commission ("FERC") began to develop principles applicable to public utility open access tariff filings for wholesale markets. The most significant of these principles, often described as the "golden rule of comparability," is that a transmission provider must allow third parties access to its transmission system under comparable terms

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<sup>7/</sup> 15 U.S.C. §§ 79 et seq. (1988 & Supp.).

<sup>8/</sup> Senator J. Bennett Johnston, one of the prime movers behind EPAct, recently introduced the Electricity Competition Act of 1996, S. 1526, which would, if enacted, require states to implement competitive regimes, with proper consideration given to recovery by utilities of the stranded costs associated with the transition. Likewise, Representative Edward J. Markey has introduced a bill, the Electric Power Competition Act of 1996 (H.R. 2929), to address restructuring and competition issues. Representative Dan Schaefer, who chairs the House Energy and Power Subcommittee, also has indicated his intention to move forward on electric competition and restructuring issues on a comprehensive basis.

<sup>9/</sup> ELCON has published a "Blueprint" and a "Road Map" describing its vision for federal statutory changes. ELCON, Blueprint for Customer Choice, Discussion Draft (Sept. 13, 1995); Road Map for the Transition, Discussion Draft (Dec. 22, 1995).

and conditions to those applicable to the provider's own use of its system. <sup>10/</sup> In the spring of 1995, FERC promulgated the Mega-NOPR, <sup>11/</sup> which proposes to require utilities to functionally unbundle their generation and transmission services and to provide open access transmission, and which supplements a prior Notice of Proposed Rulemaking ("NOPR") concerning the appropriate treatment of stranded costs associated with the transition. <sup>12/</sup> The Mega-NOPR appropriately links unbundling to utility recovery of stranded costs, as do each of the comprehensive legislative reform proposals. There is robust debate concerning how unbundling should be accomplished and how to ensure that transmission-owning utilities conduct their business without favoring their own merchant generation. <sup>13/</sup> FERC is expected to issue a final rule in the Mega-NOPR proceeding in the spring of 1996.

In addition, numerous states have begun to address

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<sup>10/</sup> American Elec. Power Serv. Corp., 67 F.E.R.C. (CCH) ¶ 61,168 at p. 61,490 (1994).

<sup>11/</sup> Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, IV F.E.R.C. Stats. & Regs. (CCH) ¶ 32,514 (1995).

<sup>12/</sup> Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, IV F.E.R.C. Stats. & Regs. (CCH) ¶ 32,507 (1994).

<sup>13/</sup> FERC has issued a NOPR on real-time information networks ("RINs"), to address how information about transmission systems and markets is shared, and standards of conduct for transmitting utilities. Real-Time Information Networks and Standards of Conduct, 60 Fed. Reg. 66,182 (1995).

1 retail wheeling and restructuring issues; the California Public  
 2 Utilities Commission ("CPUC"), for example, has issued an order  
 3 providing for the restructuring of its three largest electric  
 4 utilities. 14/ The CPUC order embraces competition and customer  
 5 choice, requires utilities to engage in retail wheeling, and  
 6 provides for recovery of transition costs through a non-  
 7 bypassable charge. Other states, such as Massachusetts, also  
 8 have moved to implement competition and retail wheeling.  
 9 Massachusetts also has provided for recovery of stranded costs  
 10 associated with customers that depart utility systems for other  
 11 generation sources. 15/

12 Some states, including New Mexico, have concluded that  
 13 retail wheeling is not in their interest at this time. The  
 14 Maryland Public Service Commission ("MPSC") has rejected retail  
 15 wheeling in favor of a policy relying on progressive changes to  
 16 take advantage of wholesale competition. 16/ The MPSC cited  
 17 reliability concerns, and also noted its apprehension that it  
 18 would be unable to ensure reciprocity and thereby prevent out-of-

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14/ Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation, CPUC No. R.94-04-031, Opinion (Dec. 20, 1995) ("CPUC Order").

15/ See Cambridge Elec. Light Co., 164 P.U.R.4th 69 (Mass. D.P.U. 1995), in which Massachusetts Institute of Technology was required to pay a transition cost charge deriving from its decision to rely on self-generation and take only standby service from the utility.

16/ In the Matter of the Commission's Inquiry Regarding Electric Services, Market Competition, and Regulatory Policies, 163 P.U.R.4th 131 (Md. P.S.C. 1995).

1 state suppliers from cherry-picking Maryland industrials. The  
2 staff of the Pennsylvania Public Utility Commission ("PaPUC")  
3 recently issued a report recommending against retail wheeling,  
4 citing concerns about reliability and stranded costs and  
5 concluding that retail wheeling would benefit only certain large  
6 customers, while harming small ratepayers and utility  
7 shareholders. 17/ The PaPUC has not yet acted on the staff  
8 report.

9 The legislative and regulatory changes reflect a  
10 growing conviction that traditional return on rate base  
11 regulation of bundled services may not create appropriate  
12 economic incentives for conduct by utilities and their customers,  
13 and that the interests of producers and consumers of electricity  
14 could be served better by other regulatory approaches. As a  
15 result, some regulators have adopted performance-based rates  
16 ("PBR"), to reward utilities for efficient conduct and to ensure  
17 that the benefits of efficiency are shared with consumers. These  
18 developments have been coupled with the recognition that  
19 generation of electricity may not be a natural monopoly, and may  
20 be better left subject to the discipline of market forces.

#### 21 22 B. The New Mexico Legislative Response

23 After extensive hearings and testimony from many

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17/ See "Pa. Staff Recommends No Retail Access; Would Harm Reliability, Strand Assets," Electric Utility Week, at 10 (Aug. 21, 1995).

affected interests over the past three years, the Integrated Water and Resource Planning Committee ("IWRPC") of the New Mexico Legislature has concluded in SJM 42 that neither retail wheeling nor restructuring of the electric power industry is in the public interest at this time. The full Legislature adopted this conclusion in SJM 42 by a vote of 34-0 in the Senate and 56-0 in the House. However, the Legislature recognized that competitive influences ultimately may benefit all New Mexicans, and instructed the Commission to monitor and evaluate potential restructuring. SJM 42 specifies four primary factors to be considered:

- (1) [A]ll ratepayers in the state should benefit directly with lower rates from any proposed restructure;
- (2) any proposed restructure must maintain and possibly encourage the financial health and economic viability of each of the state's utilities;
- (3) any proposed restructure must provide for appropriate protection of the state's interests, including in-state utilities, from unfair or advantaged competition from utilities or others from outside the state; and
- (4) the costs, including stranded asset costs, of any proposed restructure must be shared and apportioned equitably among the varied interests benefitted by the proposed restructure[.]

These factors are to be given equal weight in the Commission's evaluation.

In addition, SJM 42 specifies five additional factors to be considered by the Commission:



- (1) [T]he avoidance, if possible, of initiating or instigating litigation over any proposed restructure;
- (2) the merits of transitional, phased-in, experimental or pilot projects to further determine the potential advisability of the restructure of the electric power industry;
- (3) the experience of other states whose market influences may be better suited at this time for either retail wheeling or industry restructure;
- (4) the benefit of wholesale competition, in the long run, in lieu of retail competition; and
- (5) the measures by which an evaluation of any proposed industry restructure can be made[.]

SJM 42 also states that the Commission should seek legislative guidance prior to undertaking any restructuring.

PNM agrees that the factors identified by SJM 42 are critical in determining the benefits associated with any proposal to restructure the electric utility industry in New Mexico. PNM believes that implicit in SJM 42 is a recognition that the benefits of any proposed restructuring should be considered over the long term. Proposals should not be adopted in order to produce short-term benefits if, over the long term, they may produce significant costs, particularly if the short-term benefits accrue solely to narrow interests rather than the broad interests identified by SJM 42. Likewise, significant long-term benefits should not be sacrificed because of relatively minor short-term burdens. Finally, PNM recognizes that the

Legislature, having established the regulatory structure followed in New Mexico since 1941, has reserved for itself the public policy decision making authority over major changes to that structure.

### C. PNM's Perspective

PNM believes that the Commission and the New Mexico legislature have vital roles to play in ensuring that New Mexico utilities and consumers of electricity are prepared to participate in and benefit from the restructured industry, and in regulating New Mexico's utilities after restructuring has occurred where the services provided are not subject to competitive forces, or where oversight may be needed to ensure reliability of service. New Mexico's interests will be affected, regardless of whether the state acts, but failure to act appropriately will only serve to ensure that New Mexico's interests are adversely affected. Moreover, New Mexico should not attempt to act in isolation, because national and regional concerns are also implicated.

#### 1. The Need for State and Federal Cooperation

PNM believes that New Mexico must act in tandem with federal authorities to bring about restructuring. PNM believes that New Mexico must take legislative and regulatory actions that ensure that New Mexico consumers and utilities benefit from competitive market forces and have fair access to markets and to

1 supplies located in other areas. However, New Mexico should  
2 recognize that many of the issues that must be resolved to  
3 provide for fair competition and customer choice can only be  
4 resolved at the federal level, if such resolution is to avoid  
5 unfair advantages to consumers and producers in some states and  
6 disadvantages to consumers and producers in other states.  
7 Moreover, restructuring must be approached comprehensively,  
8 rather than on a piecemeal basis, if it is to proceed efficiently  
9 and with a minimum of delay and litigation. That is not to say,  
10 however, that transitional steps should not be implemented as  
11 part of the comprehensive plan.

12 The need for a comprehensive approach, for cooperation  
13 between state and federal authorities, and for uniform federal  
14 solutions to certain issues, is clearly illustrated by the  
15 experience of restructuring in the natural gas and  
16 telecommunications industries. Piecemeal restructuring has been  
17 a prolonged process in both industries, and after more than two  
18 decades, neither industry has completed the transition. Although  
19 consumers and regulated entities have benefitted under more  
20 competitive regimes, delay and uncertainty over the final outcome  
21 have muted the benefits that competitive markets might otherwise  
22 produce.

23 In the natural gas industry, FERC began addressing the  
24 consequences of the developing gas surplus in interstate markets

1 in the mid 1980s. 18/ After programs to allow pipelines to  
 2 transport gas solely for industrial customers, but not for  
 3 residential and commercial customers, were rejected as unlawfully  
 4 discriminatory, 19/ FERC promulgated Order No. 436, 20/ which  
 5 encouraged pipelines to provide open access transportation for  
 6 all customers. Order No. 436 was struck down because it failed  
 7 to address the increased take-or-pay burdens that pipelines would  
 8 incur as a result of reduced sales of gas. 21/ Order No. 500,  
 9 22/ which established a mechanism for addressing this issue, was  
 10 itself struck down. 23/ Finally, in 1992, FERC issued Order No.

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18/ These surpluses came after a decade of shortages that many believe to have been caused by cost-of-service regulation of the competitive production function. Debate over that law and policy raged from the Supreme Court's 1954 decision in Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954), until Congress passed the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. 101-60, 103 Stat. 157 (1989).

19/ Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985); Maryland People's Counsel v. FERC, 761 F.2d 780 (D.C. Cir. 1985)

20/ Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, F.E.R.C. Stats. & Regs. [Regs. Preambles 1982-1985] (CCH) ¶ 30,665 (1985).

21/ Associated Gas Distribs. v. FERC, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988).

22/ Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, F.E.R.C. Stats. & Regs. [Regs. Preambles 1986-1990] (CCH) ¶ 30,761 (1987).

23/ American Gas Ass'n v. FERC, 888 F.2d 136 (D.C. Cir. 1989); American Gas Ass'n v. FERC, 912 F.2d 1496 (D.C. Cir. 1990). In addition, the Commission's methodology for resolving transition costs was struck down as violative of the filed rate doctrine. Associated Gas Distribs. v. FERC, 893 F.2d 349 (D.C. Cir. 1989), cert. denied, 498 U.S. 907 (1990).

636, 24/ which required all interstate pipelines to unbundle fully their merchant services from their transmission services and to provide open access transportation, and provided correspondingly for full recovery of resulting transition costs. 25/ However, over twenty years after FERC's initial response to competitive forces in the production function, and over forty years after Phillips, Order No. 636 (as well as the Commission orders implementing restructuring for individual pipelines) are still pending judicial review; among the more significant issues to be resolved is whether FERC has jurisdiction over use of interstate pipeline capacity by local distribution companies. 26/

Moreover, the tangled saga of federal action, and the expenditure of valuable time, money, and the loss of opportunities for producers and consumers alike associated with the restructuring of the pipeline industry, is only part of the story. In New Mexico, PNM Gas Services ("PNMGS") was not immune to the changes taking place at the national level. It experienced transitional problems and costs similar to those faced by pipelines nationwide. In 1987, in response to the

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24/ Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,939 (1992), order on reh'g, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,950 (1992), order on reh'g, 61 F.E.R.C. (CCH) ¶ 61,272 (1992).

25/ These costs included stranded production function costs -- gas purchase contracts -- and the costs associated with creating the new marketplace for gas transactions.

26/ United Distrib. Cos. v. FERC, No. 92-1485 (D.C. Cir.).

1 enactment of NMSA § 62-6-4.1, 27/ the Commission issued General  
2 Order 44 (now Commission Rule 660) to allow customers to seek  
3 lower-priced gas supplies and to have that gas transported  
4 through the facilities of New Mexico utilities, such as PNMGS.  
5 The Commission's open access transportation requirement  
6 exacerbated the quantity deficiency liabilities faced by PNMGS,  
7 as system supply customers became transportation customers and  
8 purchased gas from third parties. As a result, PNMGS faced  
9 significant take-or-pay litigation. In total, PNMGS and Sunterra  
10 Gas Gathering Company incurred over \$150 million in costs to  
11 realign their gas purchase obligations -- a significant portion  
12 of which, under the Commission's order in Case No. 2183, have  
13 been recovered from PNMGS' customers. In many other states,  
14 efforts are underway to bring about unbundling of local  
15 distribution companies, as well as to provide residential  
16 consumers of gas with a menu of choices similar to that enjoyed  
17 by many industrial and large commercial users of gas today.  
18 These efforts will likely lead to further litigation and further  
19 expense.

20 The introduction of competition into the  
21 telecommunications industry has presented even more difficulty.  
22 Just this month the President signed the Telecommunications Act  
23 of 1996 (S. 652), an omnibus telecommunications bill that would,  
24 theoretically, resolve many of the issues that still confront

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27/ N.M. Stat. Ann. 1978 § 62-6-4.1 (Repl. Pamp. 1993).



1 that industry in its continuing transition to a market-oriented  
2 regulatory scheme. The protracted efforts to bring competition  
3 to the telecommunications industry can be traced as far back as  
4 the late 1950s, to the landmark "Hush-a-Phone" decision on the  
5 equipment side 28/ and the 1960s on the network side when  
6 Microwave Communication Inc. requested and was granted authority  
7 to build a private line network connecting St. Louis and Chicago,  
8 a proceeding which lasted about six years.29/ Any attempt to  
9 present a detailed discussion of the legislative, regulatory, and  
10 judicial efforts to bring about competitive conditions in the  
11 telecommunications field would require far more space than is  
12 available here. 30/ Nevertheless, it is worth noting that the  
13 process has been costly, both in terms of time, money, and lost  
14 opportunities; it has featured an abundance of court litigation,  
15 including private and government antitrust cases and appeals from  
16 regulatory action by the Federal Communications Commission and  
17 the states. Failure to anticipate potential problems rendered

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28/ Hush-a-Phone v. United States, 238 F.2d 266 (D.C. Cir. 1956).

29/ Microwave Communications Inc., 18 FCC 2d 953 (1969).

30/ Moreover, the term "telecommunications" covers a broad spectrum, including wire-based telephone service, cellular telephone service, and cable television, each of which has been the subject of extensive regulatory activity in recent decades, and which can be more broadly considered as part of the "information services" industry as technological advances blur the distinctions among previously discrete industries.

1 restructuring orders obsolete almost immediately. 31/

2         The long and costly battles attendant upon  
3 restructuring in the natural gas and telecommunications  
4 industries clearly demonstrate that in an industry regulated at  
5 both the state and federal levels, the transition to competition  
6 and customer choice must involve cooperation between the state  
7 and federal authorities, both legislative and regulatory, if  
8 uncertainty and litigation are to be avoided. They also show  
9 that jurisdictional issues need to be resolved and that a  
10 piecemeal approach is likely to cause more problems, not fewer.

11         Restructuring of the electric utility industry presents  
12 even more problems than restructuring of other industries. The  
13 magnitude of the stranded cost problem is one complicating  
14 factor. The laws of physics, which cannot be repealed by  
15 legislative or regulatory fiat, impose their own rigorous  
16 obligations upon the vertical network involved in serving the  
17 diversity of loads on any utility's system; reliability of  
18 service does not occur by accident. The system for efficient and  
19 reliable production and delivery of electric energy is essential  
20 to New Mexico and the nation's economy. 32/ It is therefore

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31/ See Michael K. Kellogg, John Thorne, and Peter W. Huber, Federal Telecommunications Law, at 541-64 (1992) (describing the Federal Communications Commission's attempts in the 1970s and 1980s to address the relationship between computers and communications).

32/ As Senator Johnston has noted, approximately 90% of the United States gross domestic product is produced by entities that consume 99.9% of the nation's electricity. 142 Cong. Rec. S379-80 (daily ed. Jan. 25, 1996) (statement of Sen.

1 imperative that restructuring be undertaken in as smooth and  
2 efficient a fashion as possible, to minimize disruption to the  
3 nation.

4  
5 **2. General Recommendations**

6 As noted above, PNM believes that SJM 42 appropriately  
7 sets forth the considerations that should be viewed as paramount  
8 in assessing the benefits of restructuring to New Mexico. As a  
9 declaration of the Legislature's views on this matter of vital  
10 public policy, it cannot be ignored. PNM offers the following  
11 general comments concerning the benefits of competition and  
12 customer choice and the considerations that the Commission must  
13 address if they are to be introduced into the electric utility  
14 industry:

15 a. PNM supports the promotion of customer choice  
16 among energy merchants, and believes that choice must be  
17 available to all customers, not merely larger entities. All  
18 consumers, including residential consumers, should be entitled to  
19 choose from a wide menu of energy services and providers (NOI  
20 Questions 1, 2). This menu should include a fully bundled  
21 service, as well as other services for which there is a consumer  
22 demand, based upon consumer choices and appetite for, or aversion  
23 to, risk. If a customer wants PNM, or some other supplier, to  
24 provide "one-stop shopping" for its electric or other energy

1 needs, that option should be available.

2 b. PNM supports the promotion of competition if the  
3 competitive market outcome will be better for the public interest  
4 than the results of regulation. This may be the case in markets  
5 for the generation of electricity and the provision of other  
6 services that are the subject of consumer choice. It is very  
7 unlikely to be the case in many -- if not all -- markets for the  
8 transmission and distribution of electricity, which will need to  
9 remain subject to some form of economic regulation (although  
10 preferably not traditional return on rate base regulation).

11 c. For regulated transmission and distribution  
12 services, PBR should replace return on rate base regulation.  
13 Regulators should abandon the command and control model of  
14 regulation for the services they regulate, and permit  
15 transmission and distribution utilities to operate within a band  
16 of freedom. PBR mechanisms can promote efficiency and reduce  
17 transaction costs associated with traditional return on rate base  
18 regulation, and development of such mechanisms should be  
19 encouraged.

20 d. If competition is to be introduced into the  
21 electric utility industry, regulators must honor prior  
22 commitments by allowing utilities full recovery of their stranded  
23 costs. If utilities are to compete with non-utility generation  
24 for the energy component of retail and wholesale sales, it is  
25 imperative that their ability to compete not be throttled by the  
costs of investment and purchase or other contractually fixed

1 obligations that, although reasonable under the regulatory scheme  
2 in effect at the time, would become uneconomic. As discussed  
3 more fully below in response to NOI Question 24, PNM submits that  
4 stranded cost recovery is required by the U.S. Constitution, as  
5 well as New Mexico law.

6 Furthermore, it is clear that stranded cost issues must  
7 be addressed in conjunction with restructuring, not at some  
8 future date. <sup>33/</sup> The recovery mechanism must cover stranded  
9 costs over the expected commercial life of the stranded assets  
10 which, in some instances for PNM, extends through 2022 (with  
11 decommissioning costs extending even further). If necessary,  
12 costs should be amortized over a reasonable time frame to avoid  
13 rate shock, with carrying costs to be recovered by the utility in  
14 accordance with applicable accounting rules (NOI Question 16).

15 e. Competition must not be allowed to affect  
16 adversely the availability of reliable service to customers who  
17 do not choose to seek alternate suppliers. To ensure open access  
18 transmission and distribution, the transmission system could be  
19 operated by an independent system operator ("ISO"). At present,  
20 public utilities are responsible for ensuring that customers  
21 receive reliable electric service. No matter what restructuring

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<sup>33/</sup> See Duquesne Light Co. v. Barasch, 488 U.S. 299, 315 (1989) (noting that "serious constitutional questions" arise when regulatory regimes change and deny opportunities for cost recovery); Associated Gas Distribs. v. FERC, 824 F.2d F.2d 981, 1030 (D.C. Cir. 1987) (rejecting FERC open access program because of failure adequately to address producer-pipeline contract issues arising out of open access), cert. denied, 485 U.S. 1006 (1988).

1 model is adopted, there must be assurance that reliability will  
2 not be compromised. If there is to be a continuing obligation to  
3 serve, that obligation must be defined and assigned to the  
4 appropriate entity. If consumers are permitted to choose among  
5 suppliers, however, they will bear the responsibility for  
6 ensuring that their supplier is able to deliver the power when it  
7 is needed. Nor should some competitors be permitted to shift  
8 costs to other customers, or to the utility whose former  
9 customers they serve. In these cases, the price of reliability  
10 will be driven by the market. To the extent that utilities are  
11 expected to provide backup service to ensure reliability, there  
12 must be compensation (NOI Question 13).

13 f. Proper utilization of scarce resources should be  
14 encouraged via proper price signals. Scarcity and constraints  
15 should be recognized via higher prices for utilization of scarce  
16 or constrained resources. PNM supports some form of transmission  
17 congestion pricing to promote more efficient customer choices and  
18 load patterns.

19 g. As a transitional mechanism, pilot programs of  
20 real-time pricing ("RTP") should be allowed. Real-time pricing  
21 can provide customers and utilities with experience in pricing  
22 and operations that will be of great use in moving towards a  
23 competitive generation market. It also enables customers to  
24 receive appropriate price signals concerning the cost of  
25 generation at peak times, enabling them to alter their load  
3 patterns. RTP also helps promote industrial growth by



1 encouraging increased electricity usage during off-peak hours.

2

3 **3. Proposed Process for Action**

4 PNM believes that the restructuring inquiry in New  
5 Mexico should be undertaken collaboratively, so that all affected  
6 interests will be heard and there will be the opportunity to  
7 achieve a consensus with respect to some, if not all, issues  
8 involved. To make this process work, PNM suggests that the  
9 Commission use the NOI comment process to define the issues, and  
10 schedule roundtable discussions with respect to these issues,  
11 each of which would be led by a "facilitator". Each discussion  
12 group would attempt to produce a workable plan for addressing its  
13 issue, supported by as many interests as possible.

14 PNM suggests that the Commission begin immediately the  
15 process of selecting facilitators of the roundtable discussions.  
16 After reply comments have been filed on April 1, 1996, the  
17 Commission should identify basic principles and develop subtopics  
18 for discussion purposes. Parties interested in participating in  
19 discussions would sign up for each subtopic. Each roundtable  
20 discussion group would then meet regularly with its facilitator,  
21 in order to try to achieve a workable plan to address its  
22 assigned issue that is supported by as near to a consensus as  
23 possible. The Commission would hold periodic sessions with  
24 discussion group facilitators to consolidate separate work  
25 products and assess results on a total system basis. The  
Commission should also hold regularly scheduled public discussion

1 sessions with regard to each subtopic. Finally, in time for  
2 introduction in the 1997 session of the New Mexico legislature,  
3 the Commission should be in a position to propose draft  
4 legislation to the IWRPC, consistent with the requirements of  
5 SJM42.

6 PNM believes that this would be a viable framework for  
7 ensuring that all interests are taken into account and a  
8 consensus is gained that would decrease the likelihood of  
9 extensive litigation.  
10

### 11 III. COMMENTS

12 PNM believes that if competition and customer choice  
13 are to be introduced into the electric power industry in a manner  
14 that will avoid unnecessary litigation over state and federal  
15 jurisdiction, cooperation between state and federal authorities  
16 will be necessary. In the comments that follow, PNM will set  
17 forth its recommendations for restructuring action by New Mexico  
18 and by the federal government. Below, in its response to NOI  
19 Question 24, PNM develops certain issues relating to state and  
20 federal jurisdiction over utility regulation and restructuring in  
21 order to explain more fully the jurisdictional basis for certain  
22 of its recommendations, including its conclusion that recovery of  
23 stranded costs is required by the U.S. Constitution and by New  
24 Mexico law. 34/

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34/ Throughout this response, PNM points out areas of  
uncertainty in the law, and conflicting views of policy

1           The comments that follow reflect PNM's preliminary  
2 recommendations, as well as questions that PNM believes are  
3 raised by the prospect of restructuring. These issues need to be  
4 worked out among all affected constituencies, and the Commission  
5 needs to consider the possible unanticipated consequences of  
6 actions taken now which, if not reversible, may produce harm  
7 where benefits were intended. For example, if competition for  
8 retail markets is to be brought into being, the Commission needs  
9 to consider who bears the risk of reliable energy supply --  
10 utilities, new generators, new marketers, or consumers? -- and  
11 what sectors remain subject to regulation. The Commission also  
12 should consider how consumers are to be shielded from or pay for  
13 risks associated with failure to perform by new generators,  
14 without shifting that risk, and the costs associated therewith,  
15 to the utility or its remaining customers.

16  
17           **A.   Proposals for New Mexico Action**

18           PNM believes that there are a number of actions that  
19 should be taken, by the Commission and by the New Mexico  
20 legislature, to restructure the New Mexico utility industry in  
21 order to bring the benefits of competition and customer choice to

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          matters. In so doing, PNM does not compromise the positions  
that it has advocated in the past or may advocate in the  
future, where these issues are squarely joined; instead, PNM  
suggests that these conflicts and uncertainties make more  
compelling the need for a comprehensive and cooperative  
state and federal solution to achieve the transition and  
capture the benefits of competition and customer choice with  
a minimum of confrontation, litigation, and delay.

1 consumers, New Mexico utilities, and other electricity suppliers.  
2 These recommendations are, in PNM's view, critical in order to  
3 achieve the goals specified in SJM 42, thereby ensuring that all  
4 New Mexicans benefit from the change that is taking place in the  
5 industry today.

6  
7 1. As an Interim Measure, the Commission Should  
8 Solicit and Encourage Pilot and/or Experimental  
9 Programs for Competitive Pricing.

10  
11 a. Pricing Proposal

12 Pursuant to SJM 42, the Commission is to consider  
13 whether establishing "transitional, phased-in, experimental or  
14 pilot projects" will assist in determining whether restructuring  
15 is advisable. PNM believes that the Commission should solicit  
16 and encourage pilot programs which, among other things, would  
17 begin to separate generation costs from integrated rates and  
18 apply competitive pricing techniques (NOI Question 4 and 20).  
19 Such a program could prepare utilities and consumers for the  
20 emerging competitive generation market. While this proposal is  
21 by no means the only measure that should be taken in order to  
22 make the transition to competition, it is an important step.

23  
24 A key component of pilot programs could be the testing  
25 of real-time pricing rates. RTP rates can be designed to reflect  
26 the market price of purchased power or the marginal cost of a  
27 utility's own generation on a nearly real-time basis. In one  
28 version of RTP, a utility would send customers 24 prices, one for  
each hour of the following day. In a more simple version, the

1 utility would send the customer three prices, reflecting on-peak,  
2 mid-peak, and off-peak periods. The prices for each period would  
3 likely be the same on most days of the year, but would increase  
4 on critical capacity days.

5 The primary advantage of RTP is that it sends customers  
6 a better price signal by showing the costs of providing power at  
7 particular times during the day. For example, the marginal (or  
8 peak) cost of generating capacity for some utilities exceeds  
9 \$1.00/kWh produced during a few critical hours during the year.  
10 Under conventional time-of-use rates, however, these high needle-  
11 peak costs are averaged with other lower cost hours, producing an  
12 energy cost to the customer of only \$.05-.10/kWh. This averaging  
13 of costs mutes the price signal to the customer, and does not  
14 encourage adjustment of electricity usage in a manner that will  
15 most reduce the cost of service for the utility and the customer.

16 PNM believes that RTP can produce several important  
17 benefits. First, RTP gives customers a greater opportunity to  
18 manage their electricity costs by recognizing those hours when  
19 their costs are highest and enabling them to focus their energy  
20 management efforts. This, in turn, can reduce the need for new  
21 generation and transmission capacity. As customers gain  
22 experience with RTP and pay the true cost of critical hour  
23 capacity, they become more likely to adjust their usage during  
24 those critical hours to avoid those higher costs. Utilities can  
25 reduce their costs still further under demand-side management  
programs.

1           Additionally, RTP can aid in encouraging economic  
2 development. When high-cost hours are no longer averaged with  
3 lower cost hours, the price of lower cost hours becomes very  
4 attractive, encouraging existing businesses to expand operations  
5 during low load hours and enticing new businesses. Georgia  
6 Power, for example, has used RTP successfully to attract new  
7 business and promote expansion of existing business in its  
8 service area, without significantly increasing peak capacity  
9 requirements.

10           Finally, as recognized in the recently restructured  
11 United Kingdom electric industry, as well as by the CPUC, RTP can  
12 help provide competitive pricing, as utilities can sell power  
13 that more nearly reflects the price of power in the competitive  
14 wholesale market. Hourly (or half-hourly) varying RTP prices are  
15 the currency by which power is bought and sold. Under an RTP  
16 scheme, the price for generation can be competitively  
17 determined, 35/ and the market price for regulated transmission  
18 and distribution services can be derived from the marginal (or

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35/ The United Kingdom, and the CPUC's proposed Power Exchange, follow a "Poolco" restructuring model in which generators sell into a wholesale pool from which all customers buy. PNM does not necessarily advocate the Poolco approach, and notes that the CPUC and others also offer the option of bilateral transactions in which generators contract directly with customers, often with simpler versions of RTP that do not involve hourly prices. PNM believes that it is prudent to prepare for both Poolco and bilateral contract approaches.



1 congestion) cost 36/ of serving a customer using the system at  
2 that time. Thus, RTP can provide for market-influenced pricing  
3 now, as well as in a restructured marketplace.

4 PNM believes, therefore, that New Mexico utilities  
5 should be allowed to pursue experimental programs such as the RTP  
6 pilot program at this time. RTP will provide another tool for  
7 addressing peak generation and transmission capacity constraints.  
8 Pilot programs will allow New Mexico to gain experience with RTP,  
9 thereby capturing many of the benefits associated with  
10 restructuring before restructuring takes place, experiencing  
11 competition under Commission supervision, and encouraging a  
12 smoother transition when the time is deemed right for broader  
13 restructuring.

14 Pilot programs can also benefit New Mexico's utilities  
15 by giving them an opportunity to gain experience in planning,  
16 billing, and metering, in preparation for the restructured  
17 industry. Furthermore, it will allow customers to gain  
18 experience in managing the risks and opportunities associated

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36/ The approach to marginal cost pricing for transmission and distribution under the pilot program may be an extension of the current approach to calculating marginal costs followed by PNM and the Commission. PNM notes that FERC contemplates embedded cost pricing under its comparable transmission tariffs, see Mega-NOPR, at p. 33,147; however, FERC has expressed a willingness to examine marginal cost or congestion pricing, see Inquiry Concerning the Commission's Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act, III F.E.R.C. Stats. & Regs. (CCH) ¶ 31,005 at p. 31,146 (1994). California utilities and others, including PNM, look to transmission congestion pricing as an appropriate solution. See infra § III.B.5.

1 with a competitive environment, and the opportunity for utilities  
2 to work closely with customers in this regard.

3 Pilot programs should help to develop criteria for  
4 determining who is eligible for real-time pricing, as well as to  
5 define scheduling criteria and other relevant considerations.  
6 Moreover, a pilot program will permit utilities to develop  
7 safeguards to ensure that reliability of service is not adversely  
8 affected by the transition and permit the market to develop to  
9 provide assets and players willing and able to supply reliability  
10 functions in various geographical markets and to various classes  
11 of customers. It should be recognized that the costs of such  
12 programs will not be trivial, and should be recoverable by  
13 utilities as part of the cost of the transition to competition.

14  
15 **b. Implementation**

16 PNM submits that the timing is perfect for its own RTP  
17 pilot program. Because of PNM's changing resource situation, and  
18 because the Commission staff expressed interest, PNM has begun  
19 internal development of interruptible and RTP rates that could be  
20 made available to a broader base of customers than those who can  
21 currently benefit from PNM's existing interruptible rate. PNM is  
22 investigating the possibility of submitting the revised  
23 interruptible and RTP rates this year. Prior to such a filing,  
24 PNM will offer to review its plans with interested parties for  
25 feedback in developing the proposal. Thus, PNM and the  
Commission may be able to commence a pilot program quickly, and

1 at the same time help to address issues relating to PNM's  
2 existing generation and transmission capacity constraints.

3 Although the details of implementing a pilot program  
4 have not been determined, PNM has considered certain factors that  
5 it believes are appropriate. First, there should be a choice  
6 between average cost and real-time rates driven by merit order  
7 dispatch, reliability, and transmission system constraints. 37/  
8 Customers who so desire would be able to experience the benefits  
9 of real-time pricing on an immediate basis. At the same time,  
10 customers who do not desire real-time pricing would be permitted  
11 to choose average cost rates, as at present. Those customers  
12 choosing to use real-time rates should of course bear the cost of  
13 installing the necessary meters, as well as any other costs  
14 necessary to implement real-time pricing.

15 Another aspect of a properly designed pilot program  
16 should be the gradual elimination of cross-subsidies (NOI  
17 Question 2). Elimination of cross-subsidies may offset  
18 reductions in rates associated with competition, at least in the  
19 short run (NOI Question 18).  
20

21 2. The Commission Should Consider Innovative Methods  
22 of Regulating Transmission, Distribution, and Some  
23 Generation Services.

- 24 a. Utilities Should Be Permitted to Package  
25 Their Services to Compete in the Marketplace.  
26  
27

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37/ The CPUC order adopts a similar approach. CPUC Order, at  
76.

1           Unbundling of generation pricing will promote customer  
2 choice, as will the opportunity to benefit from real-time  
3 pricing. Utilities should be permitted further to enhance  
4 customer choice by packaging their service offerings to meet the  
5 desires and needs of individual customers (NOI Question 4).  
6 Service offerings could include competitive service options and  
7 enhancements at market based prices.

8           Non-utilities, to the extent that they can create  
9 marketable packages of services, should be permitted to compete  
10 as well, subject only to those limitations that are placed on  
11 utilities in offering these services. Consumers would receive  
12 more appropriate price signals and could affect markets for  
13 products and services by casting their dollar votes.

14  
15                   **b.   Appropriate Performance-Based Rate Mechanisms**  
16                   **Should Be Permitted.**  
17

18           PNM believes that the Commission should consider  
19 proposals to implement performance-based rate mechanisms with  
20 respect to rates for services that are not subject to  
21 competition, to the extent that they will provide benefits to  
22 consumers and utilities (NOI Questions 12, 26). A properly  
23 designed PBR mechanism can ensure that consumers and utilities  
24 share in the cost savings resulting from more efficient utility  
25 conduct.

26           Performance-based rates are not a novel concept. FERC  
27 has promulgated a policy statement setting forth general

standards to govern PBR proposals by entities subject to its jurisdiction. 38/ Price caps, such as those based on changes in a consumer price index minus X percent, have been implemented in the United States and abroad in electricity and telecommunications industries. Several states have experimented with some form of PBR mechanism for certain utilities. 39/

The New Mexico Supreme Court has recognized that regulation is a surrogate for competition. 40/ PNM submits that a properly constructed PBR can better imitate competition than traditional return on rate base regulation. Performance-based rates can benefit consumers by promoting more efficient and innovative utility management for services that remain subject to rate regulation. Further, traditional regulation can provide disincentives for utilities to improve operations by constantly questioning if improvements reflect past inefficiencies and should therefore lead to disallowances.

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38/ Incentive Ratemaking for Interstate Natural Gas Pipelines, Oil Pipelines, and Electric Utilities, 61 F.E.R.C. (CCH) ¶ 61,168 (1992). In its January 31, 1996 policy statement concerning non-cost-based rates for natural gas pipelines, Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, 74 F.E.R.C. (CCH) ¶ 61,076 (1996), FERC revised its criteria for judging incentive rate proposals to permit rates that may be higher than cost-of-service results, if efficiency gains are shared with customers. FERC reiterated its interest in incentive rates.

39/ See, e.g., Central Maine Power Co., 159 P.U.R.4th 209 (Me. P.U.C. 1995); San Diego Gas & Elec. Co., 154 P.U.R.4th 313 (Cal. P.U.C. 1994).

40/ See City of Albuquerque v. New Mexico Pub. Serv. Comm'n, 115 N.M. 521, 534 (1993).

1 Performance-based rate mechanisms will, if properly  
2 designed, promote improved economic efficiency and environmental  
3 performance. Additionally, PBRs can reduce the transaction costs  
4 associated with return on rate base regulation, by increasing the  
5 time between rate cases and limiting the issues to be litigated.

6 There are many types of PBR mechanisms, and the  
7 Commission should consider the various types and determine which  
8 are appropriate for New Mexico utilities. A PBR system could be  
9 developed that provides the incentives and disincentives deemed  
10 appropriate in furtherance of the public interest of New Mexico.  
11 In PNM's view, the best approach would be to consider PBR  
12 proposals on their merits as presented in individual cases,  
13 rather than to establish rigid guidelines in advance.

14  
15 **3. The Commission Should Regulate Only Those Aspects**  
16 **of the Utility Business That Require Regulation.**  
17

18 There are many ways of addressing retail competition in  
19 the electric utility industry. At one extreme, regulators could  
20 reject the introduction of competition into the retail  
21 electricity market, on the theory that wholesale competition will  
22 be sufficient to promote the public interest in inexpensive and  
23 reliable electric service. At the other extreme, the industry  
24 could be fully disaggregated and deregulated; under such a  
25 regime, the whole issue of reliable integrated service is turned  
26 over to competitive suppliers.

27 PNM does not believe that either extreme model is



1 appropriate. Some form of retail competition may be needed to  
2 ensure that all customers have the ability to benefit from  
3 competition and choice. But reliability is likely to suffer in a  
4 deregulated market where ownership of assets is suddenly  
5 disaggregated by an attempt to force divestiture, and thus there  
6 will be no assurance that customers will receive the service they  
7 need. Most scenarios for industry transition envision the  
8 unbundling of the various elements of the integrated service  
9 (generation, transmission, distribution and customer services)  
10 provided today. How and when each element is unbundled is  
11 critical to a successful transition. PNM believes that it is  
12 appropriate to follow a middle course. PNM offers one  
13 possibility, among many that exist.

14 PNM believes that, if competition for energy sales or  
15 other services is to be introduced into retail markets in the  
16 electric utility industry, those functions of a utility's  
17 business, or services provided by the utility, that are subject  
18 to competitive forces should not be regulated. There are four  
19 basic functions in PNM's business, each with its own  
20 characteristics, and the need for regulation should be tied to  
21 these separate characteristics. **Generation** may, in time, become  
22 largely a commodity, and at that time could be subject to  
23 competitive forces. However, stranded cost recovery must be  
24 addressed initially, to ensure that utility generation can  
25 compete fairly with other generation. **Transmission** will remain a  
natural monopoly, at least for the foreseeable future and, to

1 that extent, should be regulated to ensure reliability and  
2 economy. **Distribution** will also be a natural monopoly for the  
3 foreseeable future and, as such, should be regulated to provide  
4 for reliability and deliverability. Market power based upon  
5 ownership of transmission and distribution assets can be  
6 mitigated by non-discriminatory access and customer choice, and  
7 should not be used to favor a utility or an affiliate's  
8 generation or services offerings. Finally, PNM also provides  
9 **other services** which it should be allowed to provide on an  
10 unregulated basis in competition with other entities. To sell  
11 these services successfully in a competitive market, PNM must  
12 differentiate its services from those provided by others as to  
13 price and quality, and package them to serve customer needs.

14 Utilities should be able to sell closely related  
15 utility and energy services, either through separate subsidiaries  
16 or as part of the utility's business. This will allow utilities  
17 to employ their knowledge and expertise to the maximum, thereby  
18 enabling potential consumers of these services to benefit (**NOI**  
19 **Question 15**).

20 There are a variety of areas where PNM and other New  
21 Mexico utilities may be able to, and should be permitted to,  
22 provide valuable services, such as power brokering, load  
23 management, energy efficiency services, real-time energy  
24 information, total energy services, reliability, and other  
25 energy-related services. New Mexico utilities should be  
permitted to engage in these activities on a completely

1 unregulated basis. Unlike transmission and distribution  
2 services, these are not natural monopoly functions, and thus  
3 utilities should be allowed to compete to provide these services,  
4 subject only to the laws of competition and to any necessary  
5 scrutiny to ensure that regulated functions do not unfairly  
6 advantage unregulated functions over third-party suppliers.

7  
8 **4. Distribution Utilities Should Be Required to**  
9 **Source New Generation Facilities and Power**  
10 **Supplies Competitively.**

11  
12 The first consideration that SJM 42 requires the  
13 Commission to take into account is, not surprisingly, lower rates  
14 to ratepayers. PNM believes that in order to lower costs to  
15 consumers, distribution utilities should be required to source  
16 new generation facilities and power supplies (or demand-side  
17 management, where that alternative competes with physical  
18 generation facilities) competitively.

19 One question that the Commission must address is  
20 whether, and to what extent, there is a continuing obligation to  
21 serve. PNM believes that the obligations of generation suppliers  
22 to serve should be determined solely by contract, and, once  
23 undertaken, should not be shifted to other customers or to the  
24 residual utility (NOI Question 9). It may be appropriate to  
25 require marketers or other out-of-state entities to post a  
26 performance bond, or impose some other requirement to ensure  
27 performance or ensure that the out-of-state entity can satisfy  
8 liabilities if it fails to perform without shifting risks and

1 costs to other consumers or producers.

2           However, a utility should have the obligation to  
3 continue providing transmission and distribution services to  
4 customers, given the natural monopoly nature of transmission  
5 assets, and to connect to new customers for those same services  
6 (NOI Question 5). 41/ The utility should not necessarily be  
7 required to operate the system itself, but if it does not, it  
8 should be responsible for finding another entity, such as an  
9 independent system operator, to operate the system. As discussed  
10 more fully below, 42/ this may be done on a broader basis than  
11 merely one utility system, as is to be the case in California,  
12 with its ISO proposal. 43/ Once the ISO is approved by the  
13 appropriate regulatory authority, however, the ISO should bear  
14 the responsibility for operating the system; the obligation to  
15 serve would remain with the distribution utility.

16  
17           5.    The Commission Should Develop Legislative  
18                Recommendations to Aid in Implementing  
19                Restructuring.  
20

21           SJM 42 envisions clearly an ongoing dialogue between  
22 the legislature and the Commission concerning restructuring, and  
23 states that the Commission is not to act on restructuring without  
24 first consulting the Legislature for guidance. PNM recognizes

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41/ New transmission services are discussed infra, § III.B.3.b.

42/ See infra § III.B.7.

43/ CPUC Order, at 28.

1 that many of the actions that the Commission will need to take in  
2 order to implement restructuring of New Mexico's utility industry  
3 will require additional legislation. Accordingly, the Commission  
4 should develop legislative recommendations that will aid in  
5 implementing restructuring. The Commission should serve as an  
6 expert agency making recommendations to the Legislature with  
7 regard to restructuring, and, together with the New Mexico  
8 Energy, Minerals, and Natural Resources Department, should lobby  
9 Congress as directed by the Legislature.

11           **6. The Commission Should Participate Actively in the**  
12           **Federal Restructuring Debate.**

13           The introduction of competition and customer choice  
14  
15 into the American electric utility industry will require action  
16 at both the state and federal levels. Many proposals that have  
17 been raised, and will be raised in the future, may have  
18 significant adverse effects on New Mexico utilities and  
19 consumers. The Commission should participate actively in the  
20 federal debate, both at FERC and before the Congress, to protect  
21 the New Mexico public interest.

22           In addition, the Commission should contribute to  
23 resolving federal-state jurisdictional questions. As discussed  
24 in response to NOI Question 24 below, the lines between state and  
25 federal jurisdiction under the Federal Power Act ("FPA") are not  
26 always clear, and there is the potential for costly and time-  
27 consuming litigation in the event that competing authorities or

1   constituencies are unable to resolve their differences.   PNM  
 2   urges the Commission to work with federal authorities in a spirit  
 3   of cooperative federalism, to minimize the incidence of, and  
 4   uncertainty associated with, litigation and to ensure that New  
 5   Mexico's interests are protected. This is consistent with the  
 6   factors prescribed by SJM 42.

7           One issue that should be addressed is whether there are  
 8   limits on a state's authority to disallow costs paid to a  
 9   supplier in the event a utility purchases power or services from  
 10   an unregulated seller. This could become a significant issue and  
 11   the risks should be identified clearly, in light of judicial  
 12   precedent concerning passthrough of FERC-approved rates.

13           The Supreme Court, in Nantahala Power & Light Co. v.  
 14   Thornburg, 44/ reversed a state regulatory ruling that prevented  
 15   a utility from recovering its full costs of purchasing power at a  
 16   FERC-approved rate. 45/ The Court specifically declined to  
 17   address whether "a particular quantity of power procured by a  
 18   utility from a particular source could be deemed unreasonably  
 19   excessive if lower cost power is available elsewhere, even though  
 20   the higher cost power actually purchased is obtained at a FERC-  
 21   approved, and therefore reasonable, price." 46/ It is possible

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44/ 476 U.S. 953 (1986).

45/ 476 U.S. at 970-71. See also Narragansett Elec. Co. v. Burke, 381 A.2d 1358 (R.I. 1977), cert. denied, 435 U.S. 972 (1978).

46/ Nantahala, 476 U.S. at 972 (emphasis in original). The question has answered in the affirmative by state courts.



1 that absent a FERC-approved rate, such as would be the case in  
2 the event of a utility purchase from an unregulated supplier,  
3 Nantahala would not operate to protect the utility. This could  
4 discourage utilities from purchasing from unregulated entities,  
5 and thereby inhibit competition simply through risk-averse  
6 behavior by utilities.

7 With respect to this issue, competitive sourcing by the  
8 distribution company should ensure that generation is purchased  
9 at the market price, and such purchases should be deemed to be  
10 prudent and recoverable. Competitive markets cannot operate  
11 correctly if regulators second guess competitive outcomes, or  
12 attempt to replace direct regulation with indirect regulation.

13  
14 **B. Proposals for Federal Action**

15 PNM believes that federal action is necessary to bring  
16 about the benefits of competition and customer choice throughout  
17 the country. <sup>47/</sup> Congress needs to act with regard to retail  
18 wheeling, because Congress alone has the authority under the  
19 United States Constitution to allow reciprocity among the states,  
20 thereby providing for fair competition among suppliers located in  
21 different states. PNM also believes that federal action is  
22 desirable to address the stranded cost question, in order to

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See, e.g., Pike County Light and Power Co. v. Public Serv.  
Comm'n, 465 A.2d 735 (Pa. Commw. 1983).

<sup>47/</sup> PNM's rationale for this conclusion is set forth below in  
the response to NOI Question 24.

1 ensure that competition among utilities in different states is  
2 not skewed as a result of differing regulatory treatment of  
3 stranded costs. Accordingly, PNM suggests the following areas  
4 where federal action is appropriate.

5  
6 **1. Congress Should Establish Clearly FERC's**  
7 **Jurisdiction Over the National Power Grid.**

8  
9 PNM believes that Congress should find that the  
10 electric system is a national resource, highly interconnected and  
11 interdependent, and requires an overall federal structure to  
12 promote fair competition, reliability, and economic security. At  
13 present, the FPA does not provide FERC with the full extent of  
14 potential federal jurisdiction over electricity under the  
15 commerce clause. 48/ Accordingly, the FPA should be amended to  
16 ensure that FERC has jurisdiction over the transmission of  
17 electricity, both at wholesale and retail, while the States  
18 retain authority over distribution of electricity.

19 The need for a uniform federal structure to govern fair  
20 competition is clear. The purpose of restructuring is to  
21 increase customer choice and promote the creation of new services  
22 and new technologies. All competitors must be able to compete in  
23 the marketplace unfettered by the effect of prior regulation, and  
24 this is unlikely to happen if they are subject to differing cost  
25 considerations depending upon their location and the state  
26 regulation to which they must answer. Moreover, reciprocity in

---

48/ U.S. Const. art. 1, § 8, cl. 3.

1 the retail wheeling context is also vital to fair competition,  
2 and can only be authorized at the federal level (NOI Questions 3,  
3 24) .

4 As discussed above, 49/ experience in other industries,  
5 such as natural gas and telecommunications, has revealed that  
6 restructuring of federally regulated industries should be  
7 undertaken comprehensively at the federal level. The  
8 restructuring process in those industries has gone on for many  
9 years, at both the state and federal levels, and in neither case  
10 is the transition complete. The public interest would be served  
11 better by clear federal direction at the outset, rather than a  
12 hodgepodge of federal and state actions and judicial proceedings.

13 Finally, Congress should provide a clear line between  
14 state and federal jurisdiction in order to discourage litigation  
15 and regulatory forum-shopping, eliminate uncertainty, and provide  
16 uniformity. PNM would suggest that federal authority extend to  
17 generation, which should be deregulated, and retail and wholesale  
18 transmission, which should be regulated, while states should  
19 retain regulatory authority over local distribution. In any  
20 event, the line should be a true "bright line."

21 Senator Johnston stated the issue forcefully in his  
22 remarks on introducing the Electricity Competition Act of 1996:

23 This Nation cannot afford to miss this  
24 opportunity. This legislation is needed to  
25 avoid a patchwork of state policies, to bring  
26 competition to consumers on a rational

---

49/ See supra § II.C.1.

timetable, and to standardize stranded cost recovery. It is essential that we make this commitment now, and set competition in motion. Every year, every month, every day that we lose debating the fine points of this transition means a loss of prosperity for this Nation. We are now fighting tooth and nail in a global economy where every dollar counts. Accordingly, this legislation is essential. 50/

Although PNM does not embrace each and every aspect of Senator Johnston's bill, PNM agrees with his sentiment concerning the need for prompt federal action (NOI Questions 3, 24).

2. **Consideration Should Be Given to Permitting Utilities to Unbundle by Creating Separate Subsidiaries Under a Holding Company Structure.**

In the Mega-NOPR, FERC has proposed to require utilities to unbundle generation functionally from transmission, 51/ and has required utilities to adhere to the "golden rule of comparability" in providing transmission service to third parties under open access tariffs. 52/ In the NOI, the Commission inquires whether corporate restructuring will be necessary (NOI Question 22). PNM believes that corporate restructuring is not necessary, but that it should be permitted for those entities who so choose.

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50/ 142 Cong. Rec. S379 (daily ed. Jan. 25, 1996) (statement of Sen. Johnston).

51/ Mega-NOPR, at p. 33,080.

52/ American Elec. Power Serv. Corp., 67 F.E.R.C. (CCH) ¶ 61,168 at p. 61,490 (1994).

1           As discussed above, 53/ regulators should recognize  
2 which functions of the vertically integrated utility should be  
3 regulated, and which need not be. Some functions, such as  
4 distribution, need more flexible regulation as described below.  
5 Disaggregation of these functions should be permitted in any  
6 manner selected by the utilities to meet their business needs,  
7 including as separate operating subsidiaries of a holding  
8 company. 54/ There are several potential advantages to a holding  
9 company structure: it may facilitate financing, facilitate spin-  
10 off, improve the company's ability to dispose of assets, and  
11 provide for a more efficient capital structure. It would also  
12 isolate risk and reward, shielding ratepayers from risk, while  
13 preserving benefits for shareholders and other investors. In  
14 addition, managers of these separate entities would have  
15 incentives to improve performance and profitability, in rivalry  
16 with other sellers of goods and services and with other entities  
17 within the holding company, and the invisible hand of competition  
18 would be permitted to promote consumer welfare.

19           Under this structure, the holding company could own  
20 four (or more) subsidiaries. The generation subsidiary would not  
21 be regulated and would have no service obligation other than that

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53/ See supra § III.A.3.

54/ The question of forced disaggregation and separation of ownership of vertically integrated assets is beyond the scope of these comments. Suffice it to say, the legality of such a course is subject to grave doubt, and the wisdom of proceeding in that fashion is not apparent.

1 defined by contract. The transmission subsidiary would be  
2 regulated by FERC, and its assets potentially operated by a  
3 regional ISO. The transmission subsidiary would retain the  
4 obligation to connect with wholesale customers desiring service  
5 but would retain no obligation to procure power and serve. As  
6 discussed below, some form of federal or regional siting  
7 procedure would be necessary to ensure that the transmission  
8 subsidiary is able to construct the transmission facilities  
9 necessary to serve the system.

10 The distribution subsidiary would be regulated by the  
11 state. It would be the entity that would collect stranded costs  
12 and should be allowed significant regulatory flexibility to  
13 provide competitive energy related services and enhance and  
14 customize its total service package. In selling such services,  
15 the distribution subsidiary should be allowed to retain all  
16 profits for its shareholders, if shareholders incur the costs and  
17 risks of providing those services. If those costs are allocated  
18 to the ratepayer, then the ratepayer should enjoy the resulting  
19 profit. The distribution subsidiary would retain an obligation  
20 to serve existing core customers and connect to new ones, as well  
21 as to connect to customers served by another generation supplier.  
22 However, the distribution subsidiary must also be provided the  
23 ability to protect any investments or generation commitments it  
24 must make in this regard for this potentially highly volatile and  
25 unpredictable customer base. Finally, a fourth subsidiary could  
be created to sell unregulated services, such as efficiency and



1 utility services in broader markets outside the utility structure  
2 at market prices (or this function could be undertaken by one of  
3 the other subsidiaries).

4 This structure, which PNM offers merely as an example,  
5 raises numerous issues and more study would be necessary to  
6 determine whether such a structure would be appropriate and how  
7 it would operate, as well as how to avoid unintended  
8 consequences. Nevertheless, PNM believes that it could be a  
9 viable way of approaching the various functions of the vertically  
10 integrated utility once competition is introduced into the retail  
11 section of the industry.

12  
13 3. **Generation Should Be Deregulated and Transmission  
14 and Distribution Should Be Regulated as Common  
15 Carriers.**

16  
17 a. **The Generation Market Should Be Deemed  
18 Workably Competitive And Deregulated.**  
19

20 PNM supports deregulation of the generation market,  
21 based on the competitive conditions prevalent in the regional  
22 generation market and assuming regulation is relatively equal in  
23 the relative market area. 55/ At present, there is an abundance  
24 of generation, including utility generation and non-utility  
25 generators, in the regional generation market, and PNM submits  
26 that this market is workably competitive, both as to existing  
27 assets and new assets; with open access, barriers to entry should

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55/ With the development of open access transmission, PNM believes that the market for generation is becoming regional, and in many cases national, in scope.

1 be minimized. PNM believes that, under these circumstances, the  
 2 market can discipline the price for generation, and the only need  
 3 for federal regulatory oversight is to determine whether market  
 4 power becomes a problem (NOI Question 3, 23). 56/

5 Market power is not an insignificant issue, but  
 6 mechanisms currently exist, such as the Hart-Scott-Rodino  
 7 premerger notification law 57/ and the Department of Justice  
 8 ("DOJ") and Federal Trade Commission ("FTC") merger guidelines 58/  
 9 to address the attainment of market power through acquisition.  
 10 Oligopolistic behavior by generators is a potential problem,  
 11 given the existence of certain barriers to market entry, such as  
 12 high capital requirements, transmission bottlenecks, and  
 13 environmental regulations. However, PNM believes that  
 14 governmental and private enforcement of the antitrust laws should

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56/ In addition, deregulation of the generation market would be consistent with Congressional deregulation of the wellhead price of natural gas. See Natural Gas Wellhead Decontrol Act of 1989, Pub. L. 101-60, 103 Stat. 157 (1989) (deregulating all wellhead gas prices effective January 1, 1993). However, provision must be made for recovery of stranded costs incurred prior to the introduction of competition. Moreover, Congress should not distinguish between "old" and "new" generation, as it previously distinguished between "old" and "new" gas production, with consequent artificial and unintended adverse results.

57/ 15 U.S.C. § 18a (1988 & Supp.).

58/ Department of Justice and Federal Trade Commission Horizontal Merger Guidelines (1992); Department of Justice Merger Guidelines (1984). Note that the 1992 DOJ/FTC Guidelines specifically address only horizontal mergers (mergers between competitors in the same market); the 1984 DOJ Guidelines still govern DOJ analysis of non-horizontal mergers, although the 1992 Guidelines are not irrelevant.

1 be sufficient to address these concerns.

2           Market power is a legitimate concern as the generation  
3 function is deregulated. Since the airline industry was  
4 deregulated in the late 1970s, one of the most striking  
5 developments has been the significant decrease in the number of  
6 competing national airlines, coupled, however, with the emergence  
7 of niche carriers where barriers to entry permit. Many factors  
8 combined to bring about this result, but the airline experience  
9 demonstrates that deregulation can result in shrinking the number  
10 of competitors. If that occurs in the electric industry, it  
11 should be the result of activity that enhances efficiency, and  
12 not destructive competition.

13           Destructive competition is undesirable because it would  
14 lead to achievement of undue market power, leaving consumers ripe  
15 for price gouging which likely be by out-of-state entities with  
16 no interest in the welfare of New Mexico. The DOJ/FTC definition  
17 of seller market power is "the ability profitably to maintain  
18 prices above competitive levels for a significant period of  
19 time." 59/ Thus, prevention of destructive competition is  
20 necessary to preserve true competition, not simply to preserve  
21 competitors. 60/ In any discussion of market power, it is  
22 necessary to define the relevant market. In the case of

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59/ DOJ/FTC Merger Guidelines § 0.1 (1992).

60/ Cf. Brown Shoe Co. v. United States, 370 U.S. 294, 320  
(1962) (antitrust laws designed "for the protection of  
competition, not competitors") (emphasis in original).

1 generation, the relevant market is at least the Western region,  
2 and possibly the entire continental United States.

3  
4 **b. The Transmission Function Should Be Regulated**  
5 **by FERC, and the Distribution Function Should**  
6 **Be Regulated by the States.**  
7

8 Unlike the generation market, which may be workably  
9 competitive, the transmission and distribution markets remain as  
10 natural monopoly functions, at least in many markets. PNM  
11 believes that these functions should be treated as common  
12 carriers, with transmission subject to federal regulation and  
13 distribution subject to state regulation. PNM further believes  
14 that the relationship between state and federal regulators should  
15 be one of cooperative federalism. Thus, regulators should  
16 cooperate to develop compatible roles for pricing, planning, and  
17 siting.

18 Siting of transmission facilities is a particularly  
19 critical issue, because of its effect on generation markets.  
20 Generation has to be transmitted to loads. Transmission  
21 constraints keep needed generation from markets, and if  
22 competition in the generation market is to function  
23 appropriately, it will be necessary to ensure that transmission  
24 constraints can be eliminated (NOI Question 3). Given the  
25 existence of environmental and federal/tribal land and resource  
26 concerns in the western United States, it is often a lengthy and  
27 costly process to obtain approval to construct transmission  
facilities. When individual states superimpose additional or

1 contradictory environmental planning or compliance requirements  
2 for certain types of projects or applicable to certain types of  
3 entities only, the result may increase costs, inhibit  
4 competition, and unfairly discriminate against those projects or  
5 entities. A good recent example is the lengthy history of PNM's  
6 efforts to build the OLE transmission facilities. PNM spent 15  
7 years and \$17 million; it obtained all requisite federal and  
8 state environmental regulatory and cultural approvals other than  
9 from the Commission; these approvals withstood judicial scrutiny;  
10 yet the Commission rejected PNM's application. PNM is now  
11 determining how it can proceed with regard to planning in order  
12 to ensure that it can provide reliability on its transmission  
13 system.

14 It may be necessary to establish some federal or at  
15 least regional certification authority to ensure that needed  
16 transmission facilities are constructed and that all interests  
17 are considered and appropriately balanced. One possible approach  
18 is provided by Title I of the FPA. Section 21 of the FPA  
19 provides for a right of eminent domain to condemn private  
20 property; 61/ section 4(e) permits FERC to license facilities on  
21 tribal lands, 62/ and section 10(e) provides for payment for such  
22 use. 63/ This federal authority, if expanded to cover all

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61/ 16 U.S.C. § 814 (1988 & Supp.).

62/ 16 U.S.C. § 797(e) (1988).

63/ 16 U.S.C. § 803(e) (1988 & Supp.). See also Escondido Mutual Water Co. v. FERC, 701 F.2d 826, 828 (9th Cir. 1983)

1 transmission certification issues, could provide an appropriate  
2 mechanism for promoting the public interest in the construction  
3 of additional transmission facilities.

4 EPAct and FERC's Mega-NOPR address the costs of  
5 constructing new facilities to provide transmission services, 64/  
6 but do not address pricing for constrained facilities. 65/ Nor  
7 has FERC addressed -- yet -- issues related to costs of abandoned  
8 projects, although customers may desire investment to increase  
9 transmission capability. These matters must be addressed to  
10 avoid inhibiting competition in generation because of  
11 transmission constraints.

12  
13 **4. Stranded Costs Should Be Addressed at the Federal**  
14 **Level, and Utilities Should Be Allowed 100 Percent**  
15 **Recovery.**

16  
17 Stranded costs are a major threat to the continued  
18 health of the electric utility industry. Due in large measure to  
19 federal policies that, in retrospect, were mistaken, some  
20 utilities invested in nuclear facilities, signed up for long-term  
21 obligations to buy PURPA power, and entered into long-term coal  
22 contracts due to the FUA. By contrast, some utilities have  
23 benefitted from certain federal energy policies. For example,

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(Anderson, J., concurring).

64/ See 16 U.S.C. § 824k(a) (1988 & Supp.) (costs of transmission service to be recovered from the applicant for such service); Mega-NOPR, at p. 33,091.

65/ See infra § III.B.5.



1 hydroelectric projects, particularly in the West, generate cheap  
2 energy for statutorily preferred customers. No viable plan for  
3 restructuring the industry -- whatever its form -- can avoid  
4 dealing with the stranded costs or benefits associated with these  
5 federal mandates. PNM submits that stranded costs should be  
6 addressed at the federal level, and that utilities should be  
7 allowed full recovery of all stranded costs (NOI Questions 16,  
8 17). 66/ PNM further submits that in light of the national  
9 nature of the problem, all customers across the nation should be  
10 allocated a portion of the national stranded costs, which would  
11 be collected by means of a national wires charge; divided by a  
12 large number of terawatt-hours, 67/ even a large cost of stranded  
13 assets becomes small. It should be noted that, in the  
14 telecommunications industry, use of a subscriber line charge  
15 imposed on a national basis provided recovery of local loop costs  
16 potentially stranded with the growth of competition in the long  
17 distance market.68/

18       Upon introducing his retail wheeling bill, Senator  
19 Johnston stated that "[r]ecovery of all stranded costs is  
20 imperative," 69/ and his bill intends to provide for full

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66/ PNM addresses the legal justification for addressing stranded cost recovery in advance of restructuring in its response to NOI Question 24.

67/ A terawatt is 1,000 gigawatts.

68/ See, NARUC v. FCC, 737 F.2d 1095 (D.C. Cir. 1984).

69/ 142 Cong. Rec. S379 (daily ed. Jan. 25, 1996) (statement of Sen. Johnston).

recovery of stranded costs by utilities. 70/ Representative Markey's bill also contemplates full stranded cost recovery, 71/ and Representative Schaefer has indicated his support for full stranded cost recovery. 72/ The Mega-NOPR recognizes that full stranded cost recovery is tied to the introduction of wholesale open access. 73/

PNM agrees. Full recovery is essential in order to bring about the transition to a competitive market:

In short, if we do not enact legislation ensuring stranded cost recovery, most utilities will be reluctant to embrace competition. If we do not enact legislation, the transition to competition and lower electricity prices will be slower. If we do not enact legislation, corporate risk becomes unmanageable, and bankruptcies may occur. This is not in the public interest. 74/

Moreover, permitting utilities to recover all stranded costs is necessary to ensure that utilities and non-utility generators can compete on a level playing field (NOI Question 3).

Full recovery of stranded costs is equally important in

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70/ S. 1526, 104th Cong., 2d Sess. § 11(b) (1996).

71/ H.R. 2929, 104th Cong., 2d Sess. § 201 (1996).

72/ See "Policymakers Push ELCON to Compromise on Stranded Costs; Group May Cede 50%," Electric Utility Week, at 3 (Oct. 30, 1995).

73/ "The recovery of legitimate and verifiable stranded costs is critical to the successful transition of the electric utility industry from a tightly regulated, cost-of-service industry to an open transmission access, competitively priced industry." Mega-NOPR, at p. 33,095.

74/ 142 Cong. Rec. S379 (daily ed. Jan. 25, 1996) (statement of Sen. Johnston).

1 order to assure that a competitive generation sector can attract  
2 capital in the future. In a market economy, capital cannot be  
3 conscripted -- it must be attracted. An industry where capital  
4 is written off based upon changes in regulatory policy will face  
5 higher costs of capital and thus higher costs to consumers, even  
6 where markets are workably competitive. It would be unfair to  
7 impose stranded costs on the utility's secured and unsecured  
8 creditors, who provide the debt financing that makes capital  
9 acquisitions possible. Full recovery of stranded costs is  
10 particularly fair for PNM, because the Commission already has  
11 determined that PNM's nuclear facilities are prudent and,  
12 furthermore, PNM already has written off and written down its  
13 assets by approximately \$525 million, \$179.1 million of which  
14 were entirely voluntary in order to produce \$30 million in annual  
15 rate reductions in association with NMPUC Case 2567. These  
16 write-offs also included \$116 million associated with Inventory  
17 AFUDC and the Inventory methodology, \$189.9 million associated  
18 with the Palo Verde Nuclear Generating Station Unit 3 and \$40  
19 million associated with the 105 megawatt Contingent Power  
20 Purchase Agreement with Modesto, Santa Clara and Redding (M-S-R).

21 A federal solution is particularly vital because many  
22 of the stranded assets are the result of federal policies, such  
23 as the promotion of nuclear generation, the QF purchase  
24 requirement, and the FUA prohibition against using natural gas to  
25 fuel electric generation. Moreover a federal solution will also  
reduce uncertainty and delay, and provide uniformity -- it will

1 provide the fastest path to competition. At a minimum, Congress  
2 must allow full recovery of stranded costs, and either Congress  
3 or FERC must state which costs are to be considered stranded.

4 a. Measurement of stranded costs. The Commission  
5 should establish procedures now to identify the extent of the  
6 stranded cost problem for New Mexico utilities. The recent New  
7 Mexico State University study is a starting point, but PNM has  
8 serious doubts about the results of that study, and believes that  
9 a forum should be created in which all stakeholders can  
10 participate. The forum should consider all possible stranded  
11 costs and benefits.

12 Stranded costs should include the costs associated with  
13 assets that have become uneconomic due to regulatory changes and  
14 market changes induced by regulatory changes, such as nuclear  
15 facilities, high-priced contracts for purchases from qualifying  
16 facilities, or long-term coal contracts entered into in the era  
17 of the FUA. They should include both capital and operating  
18 costs. Costs associated with nuclear decommissioning should be  
19 recoverable by the utility, whether as stranded costs or through  
20 some other mechanism.

21 PNM believes that Congress should establish the  
22 appropriate standard for stranded cost recovery, which states  
23 could then implement. PNM suggests two ways of approaching the  
24 issue at this time. The first, which PNM favors, is to  
25 establish, as of some point in time, the market value of a  
utility's generation, and subtract that market value from book

1 value at that same point in time. Stranded costs are the  
2 difference. Deferred taxes associated with an asset should  
3 follow the asset; if the utility is entitled to full recovery, as  
4 PNM supports, the deferred taxes should be credited as an offset  
5 against stranded costs. A major benefit of this approach is that  
6 the utility has an incentive to compete at market prices in the  
7 future. A second approach is to take the difference, measured at  
8 periodic intervals, between the cost of electricity and its  
9 market price. This approach would reduce the incentive to  
10 mitigate, however.

11       b. Transition costs other than stranded costs. The  
12 Commission also should address recovery of costs of restructuring  
13 other than stranded costs. These would include costs that will  
14 be incurred in developing the mechanisms for all classes of  
15 customers to benefit from a restructured industry, such as the  
16 cost of computer software and hardware, administrative and  
17 general costs, direct labor costs, and others.

18       c. Mechanisms for recovery of stranded costs. PNM  
19 believes that all customers should share in stranded cost  
20 responsibility. PNM sees three alternatives. PNM believes that  
21 the best approach would be a non-bypassable surcharge, allocated  
22 evenly over each unit of transmission and distribution service.  
23 This would ensure that all customers pay, and that no customer  
24 can escape payment by leaving the system (NOI Question 6).  
25 Ideally, this surcharge would be imposed nationwide, on all  
customers that use the system, in a manner similar to the

1 Department of Energy's spent fuel charge for nuclear utilities or  
2 FERC's annual assessment for investor-owned utilities. The  
3 charge, however, should be spread over all utilities to minimize  
4 the effect on any one region and to allocate the recovery across  
5 all utility customers -- who should share in the costs of failed  
6 policies and the benefits of future competition equally.  
7 Imposing the surcharge nationwide would reflect the national  
8 nature of the problem, as well as the federal policy origins of  
9 many stranded costs and the federal initiatives to achieve  
10 competitive markets. Alternatively, the costs could be recovered  
11 on a regional basis, to reflect the benefits that all regional  
12 customers receive from the various transmission systems in the  
13 region, or a variation to the solution would be to impose the  
14 costs solely on a state-by-state or utility-by-utility basis.  
15 However, stranded costs must be recovered, regardless of the  
16 means of recovery.

17 Another way to recover the costs would be to revalue  
18 the assets and establish incremental rates for transmission and  
19 distribution. 75/ A third approach would be to charge customers  
20 an exit fee. In theory, this could ensure that the costs are  
21 allocated to those customers who "cause" the assets to become  
22 stranded. But it does not guarantee that the cost of the  
23 stranded asset will be removed from rates within a specified  
24 period of time. Until one of these approaches is selected,

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75/ See South Carolina Elec. & Gas Corp., Docket No. 95-1000-E,  
Order No. 96-15 (S.C.P.S.C. Jan. 9, 1996).



1 customers departing the system should be charged an exit fee, an  
2 approach which has been followed in Massachusetts.<sup>76/</sup>

3 To prevent "rate shock," and to ensure that competitive  
4 pricing signals are allowed to function in the new electric  
5 market, stranded costs should be amortized over a reasonable  
6 period and utilities should earn a fair return on these costs  
7 during the amortization. Likewise, previous write-downs and  
8 write-offs must be considered if authorities establish any  
9 mitigation requirements or seek to impose stranded costs on  
10 stockholders or creditors. <sup>77/</sup> If utilities are required to  
11 absorb any stranded costs, previous write-downs and write-offs  
12 should be used as an offset.

13  
14 **5. Congress Should Require Pricing That Will Provide**  
15 **Incentives to Proper System Utilization and**  
16 **Construction of New Transmission Facilities.**  
17

18 Transmission pricing is critical to ensuring market  
19 efficiency. Failure to provide for correct transmission pricing  
20 will provide improper market signals in terms of the need to  
21 build additional generation and transmission facilities. PNM  
22 believes that the proper solution may be "transmission congestion  
23 pricing," which can provide the correct incentives for  
24 appropriate system utilization and the construction of new

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<sup>76/</sup> Re Cambridge Electric Light Company, 164 PUR 4th 69, 1995 WL 634599 (Mass. DPU 1995).

<sup>77/</sup> As discussed below in response to NOI Question 24, PNM believes that imposition of stranded costs on stockholders or creditors is unlawful.

1 facilities.

2           Transmission congestion pricing is a means of pricing  
3 transmission capacity based upon its scarcity or constraints of  
4 its use. The price of capacity is higher where there are  
5 constraints, or where the system is heavily subscribed, and lower  
6 where there is available capacity. This is consistent with basic  
7 economic principles, and does not implicate concerns over  
8 monopoly rents. Allocative efficiency requires that scarce  
9 capacity go to those who value it most and are willing to pay for  
10 it. This proposition has been recognized by FERC in its  
11 regulations governing rate design for natural gas transportation.  
12 78/ Logically, if capacity is scarce in certain locations, and  
13 additional capacity is needed, a higher price for the scarce  
14 capacity will send the appropriate signal to construct additional  
15 facilities.

16  
17           **6. PUHCA Should Be Reformed or Repealed.**

18           PUHCA reform or repeal is desirable to facilitate  
19 corporate unbundling and the formation of non-utility  
20 subsidiaries, if utilities so desire. At present, PUHCA's  
21 restrictions on holding company structures may tend to discourage  
22 the formation of subsidiaries to perform separate businesses.

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78/ See 18 C.F.R. § 284.7(c)(1). But see Pricing Policy for New and Existing Facilities Constructed by Interstate Natural Gas Pipelines, 71 F.E.R.C. (CCH) ¶ 61,241 at p. 61,916 (1995) (providing for presumption of rolled-in pricing for new facilities unless the rate impact on existing customers is greater than 5%).

PNM believes that state and federal regulatory authority over utility operations will be sufficient to protect the public interest, without regulation of registered or exempt holding companies by the Securities and Exchange Commission under PUHCA.

7. The Transition to a Restructured Environment  
Should Be Phased in Over Five Years, or Sooner  
Where Possible.

The end result of restructuring should be that all classes of customers should have access to competitive generation sources. To achieve this goal, significant physical changes will need to be made to the control, billing, and metering systems of utilities like PNM, and such changes will take time. <sup>79/</sup> Businesses will need to decide upon the appropriate corporate structure to adopt and how to divide their assets among the components adopted to ensure both efficient and reliable service and a competitive posture in deregulated markets. There should be a five-year transition period to permit all participants to become ready, physically and otherwise, for the new industry structure.

Physical system changes also will have to be paid for, and utilities should be able to recover the costs in their rates. FERC provided for recovery of new facilities costs incurred by

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<sup>79/</sup> FERC currently is examining some aspects of this matter in its proceeding concerning real-time information networks. Other hardware and software will be required, as well, as discussed above with regard to the proposed New Mexico pilot program.

1 natural gas pipelines in restructuring under Order No. 636. 80/  
2 A similar provision for recovery of costs by electric utilities  
3 should also be adopted.

4 It may be that restructuring will have to be  
5 accomplished via a combination of bilateral contracts and  
6 "Poolco" methods, as the CPUC currently intends to proceed in  
7 California. 81/ FERC, the various regional systems, the states,  
8 utilities, and consumers should arrive at some sort of consensus  
9 as to the best way to proceed in this area.

10 Federal and state authorities must consider the need  
11 for regional independent system operators. 82/ Jurisdiction over  
12 ISOs would logically, and by statute, fall to FERC, as recognized  
13 in the recent California restructuring order. 83/ However, the  
14 impact of ISOs on local regulatory concerns suggests that FERC  
15 should consult closely with state officials in addressing the  
16 formation and regulation of the ISOs.

17  
18 **IV. ADDITIONAL RESPONSES TO QUESTIONS IN NOI**

19 In this section, PNM will address questions raised by

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80/ Order No. 636, at p. 30,460. Recovery of such costs is also contemplated by the Telecommunications Act of 1996. See 47 U.S.C. § 254(e) (providing for federal support for "provision, maintenance, and upgrading of facilities" to ensure universal service).

81/ CPUC Order, at 29.

82/ On January 24, 1996, FERC conducted a technical conference on ISOs and power pools.

83/ CPUC Order, at 43.

1 the Commission in the NOI to which PNM has not responded in the  
2 foregoing discussion.

3  
4 3. What actions should be taken to ensure full and fair  
5 competition in generation markets? What may be the  
6 impact of competition on rural electric cooperatives  
7 and their customers?

8  
9 PNM believes that if competition is deemed appropriate  
10 for investor-owned utilities, all providers of electric services  
11 should also be subject to competition; the industry should not be  
12 Balkanized so that some providers are subject to competition and  
13 others are protected. Full stranded cost recovery should be  
14 permitted for all entities subjected to competition. Customers  
15 should not be denied choice simply because they now receive  
16 service from a rural cooperative or a municipal utility. If, for  
17 public policy reasons, any utility is exempted from competition,  
18 it should be prohibited from competing for customers of other  
19 utilities for as long as it is protected from competition. A  
20 wholesale supplier, owned by retail entities, should not be  
21 allowed to compete on a retail basis if its owners are not  
22 subject to competition on a retail basis.

23  
24 5. How should the Commission address issues related to  
25 universal service?

26  
27 Through a collaborative process, the Commission should  
28 develop and enumerate the elements of universal service. PNM  
29 believes that the currently existing obligation to procure power  
and serve should continue with respect to core customers -- those

1 customers that prefer to continue receiving generation service  
2 from the utility. For those customers that choose to seek  
3 competitive supplies, the obligation to procure and serve should  
4 be replaced with an obligation to connect and deliver. 84/ That  
5 is, the utility should no longer be required to supply generation  
6 service to those customers, because generation will be  
7 competitive and the customer will have access to other suppliers.

8 Because the transmission and distribution functions  
9 remain natural monopolies, however, and are often necessary for  
10 access to generation, the utility should be obliged to remain  
11 connected with all customers who so desire, and to stand ready to  
12 provide transmission for all supplies. However, there are  
13 limitations on the utility's ability to connect to customers,  
14 including the inability to obtain siting authorization for needed  
15 transmission facilities, the need to recover the costs of  
16 construction, and the difficulty of reaching remote locations.  
17 If a utility is required to supply backup reliability, it should  
18 receive appropriate compensation for the market value of the  
19 service.

20  
21 6. What should Commission policy be with respect to a  
22 customer who changes generation suppliers?  
23

24 First, customers who change generation suppliers should  
25 not be permitted to evade liability for stranded costs. The

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84/ During the transition to competition, utilities may need to retain some obligation to provide generation for backup.



1 transition cost charge should be non-bypassable; otherwise,  
2 customers will have a clear incentive to abandon utilities and  
3 shift costs to those customers that cannot switch. The  
4 Commission should not permit the customer that changes generation  
5 suppliers to impose costs on the displaced utility or its other  
6 customers. Second, as stated above, the utility should have no  
7 obligation to continue to provide electricity to (as opposed to  
8 the obligation to be connected with) customers who depart the  
9 system. They must be responsible for their own energy needs.  
10 The utility may agree to resume service, either in an emergency  
11 or on a long-term basis, but it should have no obligation to do  
12 so. If the utility does resume service, it should be compensated  
13 fairly.

14  
15 7. How should the Commission address issues related to  
16 alternative energy supplies, including renewable  
17 resources?  
18

19 Generally, PNM believes that the Commission should not  
20 require customers to purchase power that is generated from  
21 alternative energy technologies and/or renewable resources. Such  
22 a requirement would be inefficient, and it is inconsistent with  
23 customer choice. Certainly if a customer wishes to purchase  
24 electricity from such sources, it should have the opportunity to  
25 do so; however, the customer should be responsible for paying any  
26 higher costs associated with such electricity. Market forces  
27 should determine the cost and availability of these resources.

- 1           8.    To what extent should or would competitive power  
2               suppliers be required to obtain a certificate of public  
3               convenience and necessity?  
4

5               Certificates of public convenience and necessity should  
6               only be required for competitive power suppliers to the extent  
7               necessary to maintain a level playing field. If utilities must  
8               undergo any sort of certificate process in connection with their  
9               generation, so should competitors.  
10

- 11           9.   What obligations, if any, should competitive generation  
12               suppliers have to participate in system reliability  
13               requirements and to continue service in the markets  
14               they serve? Conversely, under what conditions may  
15               competitive generation suppliers abandon markets they  
16               serve?  
17

18               Competitive generation suppliers must contribute to  
              maintaining the reliability of the system. If a supplier fails  
20               to perform, it should be required to purchase the necessary power  
21               or other resources at market prices, and it must be penalized by  
22               the system operator for its failure to perform. The penalties  
23               should be designed to ensure that suppliers are deterred from  
24               harmful conduct. Generation suppliers should be required to post  
25               a bond or provide some other means to guarantee that they will be  
26               able to perform, or will be able to satisfy liabilities for  
27               failure to perform.  
28

- 29           10.   What role should "aggregators" and "remarketers" or  
30               other free market players have in a restructured  
31               market? What certification requirements would apply to  
32               such entities?  
33

              Aggregators and remarketers should be permitted to

1 compete to provide repackaged service to customers, as long as  
2 PNM and other utilities are permitted to do the same. This will  
3 increase competition and customer choice, to the benefit of the  
4 public interest. These entities should not be subject to  
5 certification requirements, as long as utilities who seek to  
6 provide these services are not. These entities should also be  
7 required to guarantee performance, in the same fashion as a  
8 generation supplier.  
9

10 11. In what respect should environmental concerns impact  
11 the restructuring of the industry, especially in the  
12 generation and transmission areas?  
13

14 Environmental regulation of generation and transmission  
15 must be coordinated with siting and transmission planning. In  
16 industry restructuring, environmental concerns should be  
17 integrated in such a way that artificial incentives or  
18 disincentives, based on the level of environmental requirements  
19 that are applied in a given instance, are not created. For  
20 example, if generation projects constructed by state-regulated  
21 entities are subject to an additional layer of environmental  
22 planning and compliance requirements that are not applicable to  
23 entities who are not so regulated, additional obstacles, in terms  
24 of cost and time, are raised that affect the competitive stance  
25 of regulated entities and the competitive choices available to  
26 customers. In many cases, this results in elevated costs to  
27 consumers with no discernible progress toward protecting the  
environment. The goal should be a level playing field,

1 environmentally speaking. Uniform planning and compliance  
2 criteria should be applied to all entities who wish to build  
3 certain types of projects or offer certain types of services.

4           Currently, entities that wish to build generation or  
5 transmission projects are subject to a myriad of federal, state,  
6 local, and tribal resource and environmental management and  
7 protection requirements. These requirements often are  
8 duplicative, confusing, or outright contradictory. It would be  
9 counterproductive to superimpose yet another layer of  
10 requirements on certain segments of the industry or certain types  
11 of projects. Instead, a more fruitful method of obtaining an  
12 adequate level of environmental protection would be to promote  
13 cooperation and coordination among federal, state, and tribal  
14 authorities to ensure that these requirements are adequately  
15 enforced by the agencies having principal jurisdiction, rather  
16 than developing another set of requirements. The Commission  
17 should then rely upon, and defer to, the findings of other  
18 federal, state, local, and tribal agencies that have expertise in  
19 given areas of environmental compliance, rather than developing  
20 its own set of criteria or requirements.

21           As an example, differing environmental requirements for  
22 transmission, as opposed to distributed generation, promotes  
23 inefficiency by inhibiting the ability of market incentives to  
24 determine the best alternative. The ideal solution would be to  
25 transform environmental requirements from "command and control"  
regulations imposed by a patchwork of authorities into a unified

1 system of environmental incentives that utilize market principles  
2 applied to all providers of goods and services in order to obtain  
3 optimum levels of environmental compliance. Such a solution most  
4 likely would require that a federal, or at least regional,  
5 planning and siting authority be established to ensure that  
6 needed facilities are constructed and that all interests are  
7 considered and appropriately balanced.  
8

9 13. How should the Commission address issues related to  
10 long-term supply availability and reliability? Who  
11 should be responsible for these issues?  
12

13 If competition is to be introduced, the answer to this  
14 question must be that long-term supply availability will be left  
15 to the market to decide. If there are incentives to generate  
16 electricity, it will be generated -- provided that capital can be  
17 attracted to finance the required assets. The Commission should  
18 not introduce competition and then require some entity to ensure  
19 that there will be supplies available, although it may be  
20 appropriate to have the appropriate governmental entities perform  
21 periodic studies to ensure that the market is working and that  
22 there is sufficient supply to meet the demand for electricity.  
23 However, if competition works in the industry, as anticipated,  
24 the law of supply and demand will work over the long term to  
25 ensure sufficient supply, given appropriate pricing signals.  
26 Government must be willing to allow the market to work over time,  
27 and not reimpose command and control regulation precipitously  
because the market outcome may appear temporarily unpopular.

1 Competitive markets do not always run smoothly, but have self-  
2 correcting mechanisms that work, and must be permitted to work,  
3 over time.

4 Operational reliability can be addressed by an ISO. It  
5 may also be appropriate to establish regional compacts among  
6 state regulators to attempt to ensure reliability on a given  
7 regional system. The obligation to ensure reliability should not  
8 be imposed on the utility, however, although utilities may be  
9 prepared to provide backup services at a market price.

10 Maintenance of NERC and WSCC planning and operating criteria are  
11 vital to ensuring continued reliability of the interconnected  
12 grid, and any entity operating transmission facilities in the  
13 grid must be obliged to abide by these criteria and rules.

14  
15 14. How should the Commission address issues related to  
16 generation, transmission and distribution system  
17 planning?  
18

19 As discussed above, PNM believes that it may be  
20 appropriate for utilities to reorganize into holding company  
21 structures, with the generation, transmission, distribution, and  
22 other services provided by separate subsidiaries of the holding  
23 company. The generation company would be deregulated, and there  
24 would therefore be no formal generation planning; rather, the law  
25 of supply and demand would be relied upon to ensure sufficient  
26 supplies. States could play a useful role, however, in ensuring  
27 the availability of public information concerning anticipated  
system demands and constraints. The transmission company would



1 be regulated by FERC, and the distribution company by the state,  
2 with planning undertaken on a federal or regional basis.  
3

4 19. What impact would restructuring of the electric  
5 industry have on integrated resource planning, demand-  
6 side management, renewable resources and other least  
7 cost planning tools, and plant decommissioning costs?  
8

9 As indicated previously, command and control type,  
10 government regulation based planning is inconsistent with the  
11 operation of a competitive market. Generally the market should  
12 be allowed to function. Demand-side management could be offered  
13 as a service by utilities and other providers, if the market  
14 demonstrates demand for it, but should not be regulated by the  
15 Commission. As noted in the previous section, plant  
16 decommissioning costs, as well as remediation costs, should be  
17 treated as stranded costs, and should be recoverable through  
18 utility rates. If the regulated distribution company is to have  
19 the obligation to serve customers, it must also have the  
20 responsibility for planning for those customers, and the ability  
21 to protect any future investments which may be required.  
22

23 24. What Federal-State jurisdictional issues exist with  
24 respect to restructuring and how should the Commission  
25 address those issues?  
26

27 The lines of jurisdiction between federal and state  
28 authority over electricity are not entirely clear. Congress, in  
29 enacting the FPA, clearly did not seek to extend the authority of  
30 the Federal Power Commission ("FPC"), FERC's predecessor, to the

1 full limits of possible federal authority under the commerce  
 2 clause of the U.S. Constitution. In the years since 1935,  
 3 however, there has been substantial debate over how far Congress  
 4 did go. That debate continues today, as evidenced by the  
 5 Commission's comments on the Mega-NOPR, 85/ which argue at length  
 6 against FERC's claim of jurisdiction to order open access  
 7 transmission of electricity and its further suggestion that it  
 8 may intervene with respect to stranded cost issues. In the Mega-  
 9 NOPR, FERC articulated its contrary reasoning at great length.

10 86/

11 The FPA was enacted to bridge the so-called "Attleboro  
 12 gap" 87/ and provides for federal regulation of transmission and  
 13 sale of energy at wholesale in interstate commerce. Because the  
 14 electric industry historically has been dominated by vertically  
 15 integrated utilities, the dividing line between state and federal  
 16 jurisdiction has been less clear than in other industries, such  
 17 as natural gas, where the interstate transmission and local  
 18 distribution functions generally have been vested in separate

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85/ Promoting Wholesale Competition Through Open Access Non-  
discriminatory Transmission Services by Public Utilities,  
 Docket No. RM95-8-000, Comments of the New Mexico Public  
 Utility Commission (filed Aug. 4, 1995).

86/ Mega-NOPR, at pp. 33,132-45.

87/ Public Utils. Comm'n v. Attleboro Steam & Elec. Co., 273  
 U.S. 83 (1927). In Attleboro, the Supreme Court ruled that  
 Rhode Island could not regulate the price at which a Rhode  
 Island company sold energy generated in Rhode Island to a  
 Massachusetts company, which took delivery at the state line  
 for resale to Attleboro.

1 entities subject to separate regulatory authorities. The  
2 jurisdictional question is complicated further by the free-  
3 flowing nature of electrons.

4 In addressing federal jurisdiction under the FPA, the  
5 courts have in some instances drawn a bright line, as in Colton.  
6 88/ In other instances, such as distinctions in jurisdiction  
7 over transactions involving transmission, the line is far less  
8 bright and, at least arguably, may not be clear under present  
9 statutory language. 89/ PNM believes that the debate should  
10 focus on what matters should be governed by uniform federal  
11 solutions and what are matters of purely local concern. In some  
12 instances, a federal solution may be necessary to protect the  
13 public interest in an area where FERC currently does not possess  
14 explicit jurisdiction under the FPA. In such instances, Congress  
15 should act to ensure that jurisdiction is vested in FERC.

16  
17 a. Federal Action Is Required to Establish a Retail  
18 Wheeling Program That Protects New Mexico  
19 Interests.

20  
21 i. Authority Over Retail Wheeling

22  
23 PNM believes that many of the issues surrounding the  
24 electric industry today are regional or national in character,

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88/ FPC v. Southern California Edison Co., 376 U.S. 205 (1964)  
(holding that § 201(b) of the FPA, 16 U.S.C. § 824(b),  
extends FPC jurisdiction to all sales of electric energy at  
wholesale not expressly exempted by the FPA).

89/ See, e.g., Duke Power Co. v. FPC, 401 F.2d 930 (D.C. Cir.  
1968); Wisconsin-Michigan Power Co. v. FPC, 197 F.2d 472  
(7th Cir. 1952).

1 and can only be resolved appropriately at the federal level. For  
2 example, in PNM's view, the New Mexico legislature currently may  
3 have the authority to require retail wheeling in New Mexico,  
4 although it has not acted to confer that authority on the  
5 Commission. PNM believes that the proposals for cooperative  
6 state and federal action set forth in PNM's comments will limit  
7 uncertainty, delay, and a proliferation of litigation that would  
8 result from state-by-state and case-by-case solutions, consistent  
9 with the mandate of SJM 42.

10 PNM believes that the Legislature does have the  
11 authority to mandate retail wheeling in New Mexico, although the  
12 issue is very close. Section 212(h) of the FPA, which explicitly  
13 forbids FERC to order retail wheeling, declares that "[n]othing  
14 in this subsection shall affect any authority of any State or  
15 local government under State law concerning the transmission of  
16 electric energy directly to an ultimate consumer." 90/ This  
17 language, added to the FPA by EPAct, does not constitute an  
18 affirmative grant of jurisdiction; rather, it simply reflects an  
19 intent by Congress not to disturb the jurisdictional status quo.

20 Several Supreme Court decisions recognize that Congress  
21 may enact "savings" provisions that are largely nugatory because  
22 state authority does not, in fact, exist. 91/ Savings provisions

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90/ 16 U.S.C. § 824k(h) (1988 & Supp.).

91/ See, e.g., Sporhase v. Nebraska ex rel. Douglas, 458 U.S.  
941, 959-60 (1982); New England Power Co. v. New Hampshire,  
455 U.S. 331, 343 (1982).

1 "do not indicate that Congress wished to remove federal  
2 constitutional constraints on . . . state laws. The negative  
3 implications of the Commerce Clause, like the mandates of the  
4 Fourteenth Amendment, are ingredients of the valid state law to  
5 which Congress has deferred." 92/ When Congress wishes to  
6 provide an affirmative recognition of state authority, it does so  
7 in affirmative language, as it did in the McCarran Act. 93/ The  
8 EPAct savings provision, like those addressed in New England  
9 Power and Sporhase, contains no such affirmative recognition of  
10 existing state authority.

11 PNM believes that state-mandated retail wheeling would  
12 not be preempted, and thus the New Mexico legislature does have  
13 the authority to order retail wheeling. Federal law preempts  
14 state law in six instances: (1) where federal law expresses a  
15 clear intent to preempt; (2) where there is such a pervasive  
16 scheme of federal regulation that there is no room for the states  
17 to supplement it; (3) where there is a conflict between state and  
18 federal law; (4) where compliance with both federal and state law  
19 would be physically impossible; (5) where there is an implicit  
20 barrier to state law in federal law; and (6) where state law  
21 obstructs the full accomplishment of federal objectives. 94/ PNM  
22 believes that in light of the shared regulatory roles of federal

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92/ Sporhase, 458 U.S. at 959-60 (emphasis in original).

93/ See Prudential Ins. Co. v. Benjamin, 328 U.S. 408 (1946).

94/ Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 368-69 (1986).

1 and state authorities, and the historical preeminence of the  
2 states in the regulation of electric distribution, state  
3 authority to mandate retail wheeling would not be preempted.

4 The Legislature, however, has not conferred its  
5 authority over retail wheeling upon the Commission. Nothing in  
6 the New Mexico statute governing electric utilities authorizes  
7 the Commission to order an electric utility to transmit  
8 electricity generated by a third party to a consumer. The  
9 Commission possesses only the authority given it by the New  
10 Mexico legislature, and cannot order retail wheeling in the  
11 absence of such legislative authorization.

12 Clear evidence of the Commission's lack of authority to  
13 order retail wheeling is provided in Section 62-6-25 of the New  
14 Mexico Public Utility Act. 95/ This section constitutes the only  
15 grant of wheeling authority to the Commission, and is very  
16 limited. Had the Legislature intended for the Commission to have  
17 authority to require retail wheeling, it would have said so,  
18 rather than expressly limiting the Commission's authority.  
19 Moreover, when the Legislature intended for the Commission to  
20 have authority to order open access in the natural gas industry,  
21 it expressly so provided. 96/ Finally, the New Mexico Supreme  
22 Court, in discussing the introduction of competition, including  
23 wheeling, into the New Mexico electric industry, stated:

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95/ N.M. Stat. Ann. 1978 § 62-6-25 (Repl. Pamp. 1993).

96/ N.M. Stat. Ann. 1978 § 62-6-4.1 (Repl. Pamp. 1993).



1 All of these developments, and more, may  
2 occur; we have no crystal ball and can only  
3 apply New Mexico law as it is presently  
4 written . . . .

5  
6 \* \* \*

7  
8 Perhaps the regulatory climate will change  
9 . . . . Only time, and legislatures around  
10 the country, including Congress, will tell.  
11 97/

12  
13 Moreover, PNM believes that New Mexico's authority over  
14 retail wheeling does not extend to the rates, terms, and  
15 conditions for retail wheeling transactions. The Florida Public  
16 Service Commission ("FPSC") has considered this issue, and has  
17 concluded that even where a state commission orders  
18 jurisdictional utilities to transmit electricity to one another,  
19 FERC has exclusive authority over the rates, terms, and  
20 conditions of such transactions. 98/ The FPSC recognized that  
21 although FERC has no jurisdiction over facilities used in the  
22 local distribution of electricity, retail wheeling will likely  
23 involve the use of transmission facilities, over which FERC does  
24 have jurisdiction. FERC has ruled that a wheeling transaction  
25 employing both distribution and transmission facilities is a  
26 single transaction constituting the transmission of electric  
27 energy in interstate commerce, and therefore is subject to FERC's

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97/ City of Albuquerque, 115 N.M. at, 534 (1993) (emphasis in original).

98/ Investigation into the Adequacy of the Electrical Transmission Grid in North Florida, 119 P.U.R.4th 269 (Fla. P.S.C. 1990).

jurisdiction. <sup>99/</sup> Accordingly, FERC would have authority to establish the rates, terms, and conditions of retail wheeling transactions in New Mexico if, as is likely, the transactions involve facilities employed for the transmission of energy in interstate commerce.

**ii. Authority to Require Reciprocity**

Moreover, PNM believes that an appropriate New Mexico retail wheeling program must provide for reciprocity (NOI Question 27). SJM 42 recognizes that New Mexico's interests, including the interests of its utilities, must be protected against unfair or advantaged competition from out-of-state entities. It would not be equitable to allow suppliers from other states to compete against PNM for retail sales in New Mexico, if PNM is unable to compete with those suppliers for retail sales in their home states. However, a review of Supreme Court precedent suggests that New Mexico cannot impose a reciprocity condition on competition from other states.

The commerce clause gives Congress exclusive power over interstate commerce. The commerce clause not only grants Congress the exclusive authority to regulate commerce among the states, but also directly limits the power of the states to

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<sup>99/</sup> See Consolidated Edison Co. of New York, Inc., 15 F.E.R.C. (CCH) ¶ 61,174 (1981) (exercising jurisdiction over rates for retail wheeling transactions in New York, although FERC did not mandate the transactions). See also Mega-NOPR, at pp. 33,144-45.

discriminate against interstate commerce. 100/ This "negative" aspect of the commerce clause prohibits economic protectionism -- those regulatory measures enacted by a state which are designed to benefit in-state economic interests by burdening out-of-state competitors. 101/ State statutes that clearly discriminate against interstate commerce are routinely invalidated, unless the discrimination is demonstrably justified by a valid factor which is unrelated to economic protectionism. 102/

The Supreme Court has articulated general principles concerning the extent to which a state law may burden interstate commerce legitimately without violating the commerce clause. In order for a state law which burdens interstate commerce, such as a reciprocity provision, to survive a commerce clause challenge,

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100/ New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 273 (1988). See also Hughes v. Oklahoma, 441 U.S. 322, 326 (1979); H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 534-35 (1949).

101/ New Energy Co., 486 U.S. at 273-74.

102/ See, e.g., City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978) ("[W]here simple economic protectionism is effected by state legislation, a virtual per se rule of invalidity has been erected."). See also H. P. Hood and Sons, Inc. v. Du Mond, 336 U.S. 525 (1949); Toomer v. Witsell, 334 U.S. 385 (1948); Baldwin v. G. A. F. Seelig, Inc., 294 U.S. 511 (1935). Litigation over the subject has arisen in cases involving state regulation and the imposition of taxes, particularly in the area of energy supplies. Some taxes pass constitutional muster, yet others do not. Compare Maryland v. Louisiana, 451 U.S. 725 (1981) (rejecting Louisiana "first-use" tax on imported natural gas) with Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981) (upholding Montana severance tax on coal).

1 it must be either (1) specifically authorized by Congress 103/ or  
 2 (2) based on legitimate local concerns unrelated to economic  
 3 protectionism.

4 The Supreme Court has established a balancing test to  
 5 determine whether a state statute is able to withstand scrutiny  
 6 under the commerce clause. First established in Pike v. Bruce  
 7 Church, Inc., 104/ the test provides that a state law will be  
 8 upheld under the commerce clause if it "regulates even-handedly  
 9 to effectuate a legitimate local public interest, and its effects  
 10 on interstate commerce are only incidental," unless the "burden  
 11 imposed on such commerce is clearly excessive in relation to the  
 12 putative local benefits." 105/ In Pike, the Court recognized  
 13 that a state may have a legitimate interest in protecting the  
 14 financial well-being of an industry within the state. That  
 15 legitimate state interest, however, must be balanced with the  
 16 burden imposed on interstate commerce by the means selected to  
 17 protect that interest. The extent of the burden that will be  
 18 tolerated depends upon the nature of the local interest involved  
 19 and on whether it can be promoted as well with a lesser impact on

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103/ See, e.g., Northeast Bancorp., Inc. v. Board of Governors,  
 472 U.S. 159 (1985) (upholding state statutes that permitted  
 out-of-state bank holding companies to acquire an in-state  
 bank if the domiciliary state accorded equivalent reciprocal  
 privileges); Western & S. Life Ins. Co. v. State Bd. of  
Equalization, 451 U.S. 648 (1981); White v. Massachusetts  
Council of Constr. Employers, Inc., 460 U.S. 204 (1983).

104/ 397 U.S. 137 (1970).

105/ 397 U.S. at 142.

1 interstate commerce. 106/

2 State reciprocity provisions are routinely invalidated  
3 under the commerce clause; the Supreme Court generally has  
4 determined that such provisions facially discriminate against  
5 interstate commerce. For example, in Sporhase v. Nebraska ex  
6 rel. Douglas, 107/ the court upheld a challenge to a Nebraska  
7 statute under which groundwater could not be exported out of  
8 Nebraska unless the importing state permitted the export of  
9 groundwater to Nebraska. The Court found that the statute was  
10 not narrowly tailored to Nebraska's stated interest in conserving  
11 its water resources, and invalidated the statute. Likewise, in  
12 Great Atlantic & Pacific Tea Co. v. Cottrell, 108/ the Court  
13 struck down a Mississippi regulation which permitted out-of-state  
14 milk to be sold in Mississippi only if the state of origin  
15 accepted Mississippi milk on a reciprocal basis. Mississippi  
16 argued that the regulation promoted free trade among the states,  
17 but the Court concluded that Mississippi could not "use the  
18 threat of economic isolation as a weapon to force sister States

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106/ 397 U.S. at 142. In Pike, the Court invalidated an Arizona law, enacted to protect and enhance the reputation of Arizona fruit growers, that served to prohibit a commercial farm from transporting uncrated cantaloupes to a nearby California city. The court found the burden on the farm to be excessive in light of the state's interest, which the court found to be minimal.

107/ 458 U.S. 941 (1982).

108/ 424 U.S. 366 (1976).

to enter even a desirable reciprocity agreement." 109/

The Court's opposition to reciprocity provisions is clearly evidenced in New Energy Co. of Indiana v. Limbach. 110/ Ohio enacted a tax credit for ethanol sales, but allowed out-of-state producers to claim the statute only if the domicile state of the producer provided a reciprocal tax credit for Ohio producers. The Court concluded that the actual purpose of the statute was favoritism to Ohio ethanol producers, and struck it down. It is significant to note that the Court struck down the provision even though it did not result in a total prohibition of interstate transport of the subject product. The Court noted that the state law imposed "an economic disadvantage upon out-of-state sellers; and the promise to remove that if reciprocity is accepted no more justifies disparity of treatment than it would justify categorical exclusion." 111/

Based on the foregoing discussion, it is clear that New Mexico could not impose a reciprocity condition on access to retail wheeling by out-of-state entities -- at least not without litigation and delay that would very likely occur. Such a condition would be viewed by the federal courts as economic protectionism -- New Mexico seeking to protect the economic interests of its utilities at the expense of out-of-state

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109/ 424 U.S. at 379.

110/ 486 U.S. 269 (1988).

111/ 486 U.S. at 275.



competitors -- and would be struck down. New Mexico's interest in protecting the financial well-being of New Mexico utilities would likely be viewed as legitimate, but the courts could conclude that a reciprocity provision is an unduly burdensome means of protecting that interest. Absent federal legislation authorizing a reciprocity condition, New Mexico could not implement such a condition, with the consequence that retail wheeling in New Mexico could disadvantage New Mexico's utilities and prefer out-of-state utilities, whether located in the Western Systems Coordinating Council or in other reliability councils, such as the Southwest Power Pool -- to which PNM is directly connected -- or the Electric Reliability Council of Texas, to which PNM is indirectly interconnected.

Accordingly, since federal action is necessary to guarantee reciprocity in connection with retail wheeling, it is critical that the federal government have the responsibility for establishing a retail wheeling regime, if retail wheeling is desirable. 112/ Clearly the FPA does not currently give FERC the authority to order retail wheeling; 113/ thus, action by Congress would be necessary.

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112/ Alternatively, New Mexico could seek an amendment to the FPA permitting states to condition out-of-state entities seeking to obtain retail wheeling from New Mexico utilities on the provision by the domiciliary state of reciprocal privileges for New Mexico utilities.

113/ "No order issued under this Act shall be conditioned on or require the transmission of electric energy: (1) directly to an ultimate consumer . . . ." 16 U.S.C. § 824k(h) (1988 & Supp.).

b. Federal Action Is Desirable to Establish Uniform Standards for Recovery of Stranded Costs.

In addition to the reciprocity issue, the prospect of competition among entities in different states raises the possibility that utilities may be advantaged (or disadvantaged) by differing state approaches to the determination and recovery of stranded costs. If utilities are to compete with suppliers in other states, it is desirable that there should be a level playing field with respect to stranded costs and other service parameters. But only federal action can ensure that utilities are not advantaged or disadvantaged by their states' position on stranded costs.

PNM strongly believes, as set forth in its comments, 114/ that utilities should be allowed to recover 100 percent of their stranded costs. In addition to the policy rationales discussed elsewhere, PNM believes that full recovery of stranded costs is required by the U.S. Constitution. The Commission, in previous decisions concerning PNM's rates, has not addressed the consequences of open access or retail competition. This is clearly evidenced by PNM's decision to write off approximately \$525 million of its assets because of a need to remain competitive.

In FPC v. Hope Natural Gas Co., 115/ the Supreme Court noted that one element in determining whether a rate is

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114/ See supra § III.B.4.

115/ 320 U.S. 591 (1944).

1   confiscatory, in violation of the fifth and fourteenth amendments  
2   to the U.S. Constitution, is the so-called "comparable earnings"  
3   test: "[R]eturn to the equity owner should be commensurate with  
4   returns on investments in other enterprises having corresponding  
5   risks." 116/ Regulation makes the utility industry a special  
6   case, in that public utilities are immune to the usual market  
7   risks, but also unable to gain the benefits of free competition.  
8   The utility industry is capital intensive, and because the  
9   ability to profit is limited by regulation, investment in capital  
10   assets will only be made if there is some reasonable assurance  
11   that the utility will achieve some opportunity to earn a return  
12   on those assets.

13           If the electric utility industry is opened to  
14   competition, and the utility's ability to recover the costs of  
15   capital assets purchased under regulation is made to depend upon  
16   market forces, the assumptions under which the investment in  
17   those assets was made -- the assumptions comprising the  
18   "regulatory compact" -- are retroactively invalidated. As the  
19   Supreme Court has recognized, regulators cannot simply shift  
20   gears in a way that requires investors to bear the risks and  
21   receive none of the benefits: "[A] State's decision to  
22   arbitrarily switch back and forth between methodologies in a way  
23   which required investors to bear the risk of bad investments at  
24   some times while denying them the benefit of good investments at

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116/ 320 U.S. at 603.

1 others would raise serious constitutional questions." 117/  
2 Denial of full stranded cost recovery would produce precisely  
3 this objectionable result. Utilities would be forced to bear the  
4 burden associated with investments that have proven to be  
5 uneconomic, although they have never been able to benefit with  
6 increased profits from investments that proved to be very  
7 successful.

8 Nor have decisions of this Commission fairly  
9 compensated PNM, or any other utility, for the risks of a radical  
10 change in industry structure. The New Mexico Supreme Court has  
11 recently recognized that the returns allowed in utility rate  
12 cases are lower than reasonable returns for otherwise similarly  
13 situated competitive businesses. 118/ Even the comparable  
14 earnings standard, if applied using returns available to  
15 unregulated companies -- which it has not been -- is an  
16 inappropriate basis for compensating equity investors for the  
17 risk of losing the great part of their investment to unregulated  
18 competition in an industry with, as Senator Johnston has noted,  
19 more than twice the capital investment per dollar of sales of the  
20 next most capital intensive industry. 119/ Debt and equity  
21 capital to support the investment in assets subject to the

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117/ Duquesne Light Co. v. Barasch, 488 U.S. 299, 315 (1989).

118/ Attorney General v. New Mexico State Corporation Commission,  
1996 WL 781168, 35 SBB 13, 14 (1/18/96).

119/ 142 Cong. Rec. S378-79 (daily ed. Jan. 25, 1996) (statement  
of Sen. Johnston).

1 regulatory compact was attracted, not conscripted. The risk of  
2 loss of billions of dollars in capital investment simply was not  
3 part of the compensation for risk in electric utility ratemaking,  
4 and imposing those capital costs on debt and equity investors  
5 would cause disruption in capital markets and would also thwart  
6 societal welfare tests, rather than permit the opportunity for  
7 the benefits of competition. 120/

8 The opportunity for full stranded cost recovery is  
9 required by New Mexico law, as well. Article II, Sections 18 and  
10 20 of the New Mexico Constitution 121/ provide due process and  
11 just compensation protections similar to those accorded by the  
12 fifth and fourteenth amendments to the U.S. Constitution. In  
13 determining whether regulators have acted in a confiscatory  
14 fashion, the New Mexico Supreme Court has long since adopted the  
15 Hope Gas "end result" test. 122/ The end result of failure to  
16 permit utilities the opportunity for full stranded cost recovery  
17 would be to deny recovery of costs resulting from a fundamental  
18 change in regulatory approach. Given the magnitude of the costs  
19 at issue, this clearly would be confiscatory. Furthermore, by

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120/ As Senator Johnston also noted, Moody's Investors Service has estimated that 87 of the nation's largest investor-owned utilities could lose \$135 billion in stranded investment in the next decade, a figure which is greater than 80% of their combined total equity. 142 Cong. Rec. S379 (daily ed. Jan. 25, 1996) (statement of Sen. Johnston).

121/ N.M. Const. art. II, §§ 18, 20.

122/ See State v. Mountain States Tel. & Tel. Co., 54 N.M. 315, 335-37 (1950).

1 statute, the Commission is obligated to balance the interests of  
2 ratepayers and shareholders. 123/ As the New Mexico Supreme  
3 Court has recognized, it is appropriate for the Commission to  
4 deny ratepayers additional savings if the savings come from  
5 drastically increased exposure for shareholders. 124/

6 The CPUC's restructuring order provides for 100 percent  
7 recovery of stranded costs; 125/ this is the position espoused by  
8 Senator Johnston in his retail wheeling bill, and has received  
9 support from Congressman Schaefer as well. Regardless of how  
10 this issue is resolved, however, it is important that the  
11 resolution be uniform, so that competition is not harmed by  
12 varying states' treatment of stranded costs. In PNM's view, the  
13 best resolution would be for Congress to set forth standards for  
14 stranded cost recovery providing for full recovery, or give the  
15 authority to establish such standards to FERC, but to permit the  
16 states to implement stranded cost recovery through some form of  
17 universal, non-bypassable wires charge.

## 18 19 V. CONCLUSION

20 The electric utility industry is vital to New Mexico  
21 and the United States as a whole. If competition and customer  
22 choice are to be introduced into this industry, it is critical

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123/ N.M. Stat. Ann. 1978 § 62-3-1 (Repl. Pamp. 1993).

124/ New Mexico Indus. Energy Consumers v. New Mexico Pub. Serv.  
Comm'n, 104 N.M. 565, 571 (1986).

125/ CPUC Order, at 110.



1 that the transition to a restructured environment is handled  
2 comprehensively and carefully -- a lengthy period of uncertainty  
3 and instability would be disastrous. Moreover, to avoid  
4 litigation over jurisdictional issues that would cause  
5 uncertainty and delay, it is crucial that federal and state  
6 regulators work together to ensure a smooth transition.  
7 Cooperative federalism is consistent with the request by ELCON  
8 for federal legislation and, moreover, Congressional action could  
9 address the NMPUC's arguments that FERC currently has no  
10 jurisdiction to compel open access at the wholesale level.

11 PNM appreciates the Commission's concern that the  
12 interests of New Mexico not be disadvantaged by efforts in other  
13 jurisdictions to restructure the electric energy marketplace.  
14 PNM looks forward to working with the Commission and all  
15 interests to ensure that the New Mexico electric utility industry  
16 is restructured for the benefit of the people of New Mexico.

BEFORE THE NEW MEXICO PUBLIC UTILITY COMMISSION

IN THE MATTER OF THE INVESTIGATION  
OF RESTRUCTURING OF REGULATION OF  
THE ELECTRIC INDUSTRY IN NEW MEXICO

CASE NO. 2681

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY that true and correct copies of Public Service Company of New Mexico's Comments on the New Mexico Public Utility Commissions Notice of Inquiry on the Investigation of Restructuring of Regulation of the Electric Industry in New Mexico, were mailed First Class, postage prepaid or hand delivered to each of the following individuals on February 15, 1996:

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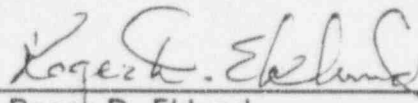
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