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MEMORANDUM

TO: Cities Served by TNMP

FROM: Christopher L. Brewster and Thomas Brocato ^{CLB}

DATE: November 10, 2010

RE: Denial Resolution for Texas-New Mexico Power Company's Pending Rate Case;
Update on Status of Case

As you are aware, on or about August 26, 2010, Texas-New Mexico Power Company ("TNMP" or "Company") filed a Statement of Intent to increase rates with all cities in its service area that retain original jurisdiction. The Company is seeking a \$20.1 million rate increase. If approved, the \$20.1 million increase would raise rates for the average residential customer by \$10.94 per month. The Company's rate case is simultaneously proceeding at the Public Utility Commission ("PUC") in Docket No. 38480.

On September 1, 2010, Cities Served by TNMP ("Cities") intervened in the PUC matter and supplemented its intervention in the subsequent weeks as additional cities joined the coalition. The group consists of the Cities of Alvin, Barstow, Blue Ridge, Blum, Coppell, Dickinson, Emory, Farmersville, Fort Stockton, Friendswood, Glen Rose, La Marque, Lewisville, Rio Vista, and Texas City.

In September and October, each city in the Coalition with original jurisdiction over electric utility rates adopted a resolution suspending the effective date of TNMP's requested rate change at the cities level. That suspension permits cities until December 30, 2010 to take final action on the Company's request. We have attached a recommended resolution that denies the Company's request for the reasons detailed below, as well as a Model Staff Report addressing the resolution. **The city must take action on the rate request by December 30, 2010. If your city is unable to take final action on the application by that date, please contact me as soon as possible.**

Cities' Recommendation on Requested Rate Increase

Cities, along with other Intervenors, filed their direct testimony at the PUC on Monday, November 8. In order to avoid duplication of effort and minimize rate case expenses, we have coordinated our approach to the case with the other city group that has intervened, the Alliance of Texas-New Mexico Power Municipalities ("ATM"). Cities' witness Connie Cannady has provided a complete computation of the effect of both groups' proposed adjustments on the Company's proposed rates. Cities' combined recommendation would result in a \$29 million decrease to the Company's request, a request which seeks a \$20 million increase. Thus, our position in this case is that TNMP's rates should be decreased by approximately \$9 million in total. We propose that this

rate decrease, which equates to approximately 3.5%, be applied evenly to all customer classes. Cities' recommended adjustments include significant disallowances related to depreciation, taxes, and correction of the Company's proposed excessive rate of return of 10.61%.

Notably, this proposal is consistent with what Cities recommended in TNMP's last rate case, Docket No. 36025, which settled last year. In that proceeding, the parties ultimately agreed to a settlement that permitted the Company a base-rate increase of \$6.8 million, plus \$20 million in recovery for costs associated with Hurricane Ike restoration. However, Cities' initial recommendation in that proceeding was similarly for a rate reduction. Therefore, Cities' position remains essentially the same – that TNMP's ratepayers are entitled to a rate decrease.

Additionally, Cities' testimony recommends against adoption of a special storm hardening rider that would permit TNMP to recover prospective storm hardening costs on a piecemeal basis, and with little oversight by the Commission. In our view, such costs are more properly addressed through normal ratemaking mechanisms. Finally, Cities recommend that municipal franchise fees on discretionary services charges should be collected through base rates, rather than a special rider, as TNMP has proposed.

For your reference, the direct testimony of Connie Cannady, Karl Nalepa, and Steve Hill can be found at these links, respectively.

http://interchange.puc.state.tx.us/WebApp/Interchange/application/dbapps/filings/pgSearch_Results.asp?TXT_CNTR_NO=38480&TXT_ITEM_NO=259

http://interchange.puc.state.tx.us/WebApp/Interchange/application/dbapps/filings/pgSearch_Results.asp?TXT_CNTR_NO=38480&TXT_ITEM_NO=260

http://interchange.puc.state.tx.us/WebApp/Interchange/application/dbapps/filings/pgSearch_Results.asp?TXT_CNTR_NO=38480&TXT_ITEM_NO=261

For these reasons, we advise that Cities adopt a resolution denying the Company's rate increase request.

Next Steps in Case

The Hearing on the Merits in this matter is scheduled to begin on December 2 and last for one week. On a date to be determined, TNMP, PUC Staff and Intervenors will engage in settlement discussions to gauge whether settlement is a possibility in this case. We will update you if any such potential emerges and will continue to keep you updated as to the status of this case. Please feel free to call or email Chris Brewster (512-322-5831, cbrewster@lglawfirm.com) if you have any questions or concerns about the case in the meantime.