

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. PA18-1-000
July 7, 2020

Mark Fenton
Executive Director, Regulatory Policy & Case Management
PNM Resources, Inc.
414 Silver Ave. SW, MS 1105
Albuquerque, NM 87102

Dear Mr. Fenton:

1. The Division of Audits and Accounting (DAA) within the Office of Enforcement of the Federal Energy Regulatory Commission (the Commission) has completed an audit of Public Service Company of New Mexico (PNM). The audit covered the period from January 1, 2015 to December 31, 2019.
2. The audit evaluated PNM's compliance with: (1) the terms, conditions, and rates of its Open Access Transmission Tariff (OATT), including its transmission formula rate mechanism as provided in Attachment H of its OATT and other jurisdictional rates on file with the Commission; (2) the accounting requirements of the Uniform System of Accounts for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; (4) the regulations regarding Open Access Same-time Information Systems prescribed in 18 C.F.R. Part 37; (5) the requirements of its market-based rate (MBR) authorizations, including the Commission's MBR regulations under 18 C.F.R. Part 35, Subpart H and Electric Quarterly Report filing regulations under 18 C.F.R. § 35.10b; and (6) the regulations governing nuclear plant decommissioning trust funds prescribed in 18 C.F.R. Part 35, Subpart E. The enclosed audit report contains 11 findings, 35 recommendations, and two other matters that require PNM to take corrective action.
3. On June 24, 2020, you notified DAA that PNM accepts all 11 findings, 35 recommendations, and two other matters in the draft audit report and will submit within 30 days of the issuance of the final audit report a plan for implementing the audit

recommendations. A copy of your verbatim response is included as an appendix to this report. I hereby approve the audit report.

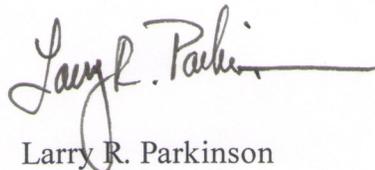
4. PNM should submit its implementation plan to comply with the recommendations within 30 days of this letter order. PNM should make quarterly submissions to DAA describing the progress made to comply with the recommendations, including the completion date for each corrective action. As directed by the audit report, these submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

5. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.311. This letter order constitutes final agency action. PNM may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713.

6. This letter order is without prejudice to the Commission's right to require hereafter any adjustments it may consider proper from additional information that may come to its attention. In addition, any instance of non-compliance not addressed herein or that may occur in the future may also be subject to investigation and appropriate remedies.

7. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Steven D. Hunt, Director and Chief Accountant, Division of Audits and Accounting at (202) 502-6084.

Sincerely,



Larry R. Parkinson
Director
Office of Enforcement

Enclosure



Federal Energy Regulatory Commission
Office of Enforcement
Division of Audits and Accounting

AUDIT REPORT

**Audit of Public Service
Company of New Mexico's
Compliance with:
Open Access Transmission
Tariff, Open Access Same-
time Information System
Requirements, Transmission
Formula Rates, Uniform
System of Accounts, FERC
Forms No. 1 & 3-Q, Market-
Based Rate Authorizations,
and Nuclear Plant
Decommissioning Trust Fund
Requirements.**

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TABLE OF CONTENTS

I. Executive Summary	1
A. Overview.....	1
B. Public Service Company of New Mexico	1
C. Summary of Compliance Findings and Other Matters	2
D. Summary of Recommendations.....	4
E. Compliance and Implementation of Recommendations.....	8
II. Background	9
A. Open Access Transmission Tariff	9
B. Market-Based and Cost-Based Rate Tariffs	9
C. Transmission Planning Process	10
D. Generation Interconnection Procedures.....	10
E. Power Supply and Trading Activities.....	11
G. Transmission Formula Rates	12
III. Introduction.....	13
A. Objectives	13
B. Scope and Methodology	13
IV. Findings and Recommendations.....	19
1. Independent Functioning of PNM’s Transmission Function	19
2. Cost-Based Sales.....	21
3. Use of Secondary Network Transmission Service	24
4. Termination of Network Resources.....	27
5. Asset Retirement Obligations	30
6. Allowance for Funds Used During Construction	34
7. Accounting for Commitment Fees.....	39

8.	Production-Related Remediation Expenses.....	43
9.	OASIS Posting of Transmission Schedules.....	45
10.	Short-Term Transmission Capacity Reassignments.....	47
11.	EQR Filing Requirements.....	49
V.	Other Matters.....	53
1.	Use of Transmission Service Numbers.....	53
2.	After-the-Fact Reservation and Scheduling Practice.....	55
	Attachment A – Company Response	56

I. Executive Summary

A. Overview

The Division of Audits and Accounting (DAA) within the Office of Enforcement of the Federal Energy Regulatory Commission (the Commission or FERC) has completed an audit of Public Service Company of New Mexico (PNM). The audit evaluated PNM's compliance with: (1) the terms, conditions, and rates of its Open Access Transmission Tariff (OATT), including its transmission formula rate mechanism as provided in Attachment H of its OATT and other jurisdictional rates on file with the Commission; (2) the accounting requirements of the Uniform System of Accounts for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; (4) the regulations regarding Open Access Same-time Information Systems (OASIS) prescribed in 18 C.F.R. Part 37; (5) the requirements of PNM's market-based rate (MBR) authorizations, including the Commission's MBR regulations under 18 C.F.R. Part 35, Subpart H and Electric Quarterly Report filing regulations under 18 C.F.R. § 35.10b; and (6) the regulations governing nuclear plant decommissioning trust funds prescribed in 18 C.F.R. Part 35, Subpart E. The audit covered the period from January 1, 2015 to December 31, 2019.

B. Public Service Company of New Mexico

PNM is a wholly owned subsidiary of PNM Resources, Inc. (PNMR), a publicly traded company. PNMR was originally founded in 1917 as the Albuquerque Gas and Electric Company, and is headquartered in Albuquerque, New Mexico. PNM is primarily involved in the generation, transmission, and distribution of electricity. It generates electricity using coal, natural gas, oil, nuclear fuel, solar power, wind, and geothermal energy sources. PNM owns 3,189 miles of electric transmission lines, which deliver energy from power plants to areas of electric demand, and 11,149 miles of distribution lines which carry power from 276 substations to customers.

PNM's electric system is located in the Southwest electric market that encompasses the Arizona, New Mexico, southern Nevada and Rocky Mountain Power Area sub-regions of the Western Electric Coordinating Council. In New Mexico, the utility's retail electric service territory covers a large area of north central New Mexico, including the cities of Albuquerque, Rio Rancho, and Santa Fe, and certain areas of southern New Mexico. PNM also provides electricity to firm-requirements wholesale customers in New Mexico.

C. Summary of Compliance Findings and Other Matters

Audit staff's compliance findings and other matters are summarized below. A detailed discussion of audit staff's findings is reflected in sections IV and V.

1. *Independent Functioning of PNM's Transmission Function* – During the audit period, upon its Wholesale Power Merchant (WPM) function's request, PNM's transmission function employees procured Point-to-Point (PTP) transmission service on certain paths for WPM function employees, contrary to the Commission's Independent Functioning Rule. As a result, PNM's transmission function employees conducted a marketing function and did not function independently of its marketing function employees.
2. *Cost-Based Sales* – PNM incorrectly used estimated transmission costs to price certain cost-based energy sales. These estimated costs did not reflect the actual transmission costs and resulted in PNM overcharging a transmission customer by approximately \$121,500.
3. *Use of Secondary Network Transmission Service* – During the audit period, PNM's transmission function improperly allowed its WPM function to use secondary network transmission service to deliver energy outside of PNM's control area. For most of these instances, WPM used secondary network transmission service to deliver energy to two generation plants located outside of PNM's control area in order to facilitate station service at those locations. As a result, PNM did not follow the requirements of its OATT associated with the use of secondary network transmission service.
4. *Termination of Network Resources* – PNM did not fully implement Commission-approved North American Energy Standards Board standards that require network customers to submit terminations (temporary and indefinite) of network resources through OASIS in a timely manner. Instead, PNM continued to allow its network customers to submit terminations of network resources outside of OASIS for more than two years after the Order No. 676-H deadline of March 1, 2017.
5. *Asset Retirement Obligations (ARO)* – PNM did not obtain Commission approval in advance of recovering asset retirement obligation costs in its transmission formula rate calculations. Also, PNM did not file its accounting entries with the Commission to reclassify approximately \$37 million from Account 108, Accumulated Provision for Depreciation of Electric Utility Plant (Major Only) to Account 435, Extraordinary Deductions.

6. *Allowance for Funds Used During Construction (AFUDC)* – PNM’s methods for calculating and accounting for its AFUDC rate were deficient and caused PNM’s AFUDC to exceed the maximum AFUDC permitted by the Commission’s regulations, as follows:
- PNM improperly included in its short-term debt rate an amount labeled “other interest,” which represented the interest recorded against transmission and interconnection study advances paid to PNM.
 - PNM incorrectly included Account 216.1, Unappropriated Undistributed Subsidiary Earnings, as part of the equity component for the purpose of computing its AFUDC rate.
 - PNM combined the costs of all debt issuances, rather than individually computing the costs of each debt issuance, to determine the weighted cost of long-term debt.

As a result of these methods, PNM overstated AFUDC by approximately \$443,000 for 2015 and approximately \$1,151,000 for 2016.

7. *Accounting for Commitment Fees* – PNM improperly accounted for upfront and quarterly commitment fees that it paid for a credit facility, in Accounts 428, Amortization of Debt Discount and Expense, and 431, Other Interest Expense, respectively, and included these items in its calculation of short-term debt interest expense used to compute its AFUDC rate.
8. *Production-Related Remediation Expenses* – PNM improperly accounted for remediation expenses related to its Santa Fe and Person Generating Stations in Account 930.2, Miscellaneous General Expenses. Since these expenses are *production-related* expenses, they should have been recorded in Account 506, Miscellaneous Steam Power Expenses (Major Only).
9. *OASIS Posting of Transmission Schedules* – PNM improperly posted certain transmission schedules associated with its transmission function and WPM as non-affiliated transactions on OASIS rather than affiliated transactions.
10. *Short-Term Transmission Capacity Reassignments* – PNM did not execute transmission service agreements governing 15 non-affiliated transmission capacity reassignments prior to commencing the reassigned transmission service. Also, PNM did not report these reassignments in its Electric Quarterly Report (EQR) filings.

11. *EQR Filing Requirements* – PNM’s EQR filings contained numerous reporting errors including the improper reporting of cost-based power sales and unreported capacity reassignments.

Other Matters

1. *Use of non-OASIS Reservations* – PNM’s transmission function created Transmission Service Numbers (TSN), a subset of non-OASIS reservations, and assigned TSNs to WPM in order to facilitate scheduling of transmission service. Since TSNs are created outside of OASIS, PNM’s scheduling of transmission service using the TSNs was less transparent than typical Transmission Service Requests (TSR) created in OASIS.
2. *After-the-Fact Reservation and Scheduling Practice* – PNM performs an “after-the-fact” (ATF) review to determine overuse of transmission service by its transmission customers. However, this ATF review is not documented as a formal business practice and posted on OASIS. Audit staff encourages PNM to document this ATF review as a formal business practice and post the business practice document on OASIS in order to enhance transparency of the ATF review. The formal business practice should include PNM’s ATF evaluation process, the approval/denial process, and information on the related transmission and ancillary service charges.

D. Summary of Recommendations

Audit staff’s recommendations are summarized below. Detailed recommendations are included in sections IV and V. Audit staff recommends that PNM:

Independent Functioning of PNM’s Transmission Functions

1. Enhance Standards of Conduct training for all applicable employees.
2. Develop and implement controls to limit, monitor and document non-OASIS communications between PNM’s transmission and WPM functions.
3. Perform quarterly reviews using controls, monitoring, and documentation developed in response to Recommendation 2 listed above.
4. Provide to DAA a summary of the above-described review in a quarterly compliance report for two consecutive quarters after this audit report is issued.

Cost-Based Sales

5. Refund the overcharged amount of \$121,500 to the affected customer in a timely manner.
6. Develop and implement procedures for validating cost-based sale prices to ensure that these prices reflect the actual cost of incremental resources including transmission cost.
7. After the new process is adopted, provide validation results in a quarterly compliance report to DAA for two consecutive quarters after this audit report is issued to demonstrate the new process works consistently.

Use of Secondary Network Transmission Service

8. Enhance controls to ensure that WPM employees only use secondary network transmission service to serve PNM native load.
9. Develop and implement processes and procedures to validate secondary network transmission service requests for delivering power to any intermediate points of delivery outside the PNM control area and ensure the requests are ultimately to serve the designated network load prior to confirming the request.
10. Develop and implement processes and procedures to review e-tags that have a transmission segment(s) associated with a Network Integration Transmission Service (NITS) request to ensure the proper use of transmission service.

Termination of Network Resources

11. Develop and implement processes and procedures to ensure use of NITS on OASIS template requirements adopted in Order 676-H.
12. Provide training with respect to the processes and procedures developed in response to Recommendation 11.

Asset Retirement Obligations

13. Develop and implement processes and procedures to prevent ARO costs from being included in PNM's annual revenue requirement and being passed on through PNM's formula rate mechanism to customers without the Commission's approval.

Allowance for Funds Used During Construction

14. Revise its procedures to ensure that its AFUDC rate calculation is consistent with Electric Plant Instruction No. 3(17), Order Nos. 561 and 561-A, and other applicable Commission accounting regulations.
15. Revise its procedures to exclude the underlying “other interest” from the short-term debt rate determination used when calculating its AFUDC rate.
16. Revise procedures to ensure that Account 216.1, Unappropriated Undistributed Subsidiary Earnings, is excluded from equity components used to derive its AFUDC rate.
17. Revise procedures to ensure that the long-term debt data reported by PNM on its FERC Form No. 1 submissions are used to compute the long-term debt rate used by PNM for calculating PNM’s AFUDC rate.
18. Provide training to PNM’s staff on the revised AFUDC accounting and rate calculation method. Also, develop a training program that supports the provision of periodic training in this area, as needed.
19. Make adjustments within 60 days of receiving the final audit report to all impacted accounts, for the period January 1, 2015 to December 31, 2019, including Account 101, Electric Plant in Service, and the accounts for accumulated depreciation, ADIT, and retained earnings, and submit these adjustments to DAA for review and approval. Also, include in this submission to DAA the impact to PNM’s Annual Transmission Revenue Requirement produced by PNM’s formula rate as a result of changes to these accounts.
20. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds to PNM’s wholesale customers since January 1, 2015, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) for which refunds will be made.
21. File a refund report with the Commission after receiving DAA’s assessment of the refund analysis.
22. Refund the amounts disclosed in the refund report to wholesale customers, with interest calculated in accordance with section 35.19a of the Commission’s regulations.

Accounting for Commitment Fees

23. Revise its procedures so as to exclude upfront and quarterly commitment fees from the cost of short-term debt when calculating its AFUDC rate.
24. Revise its procedures to record the upfront and quarterly commitment fees excluded from AFUDC rate calculations in Account 930.2, Miscellaneous General Expenses.

Production-Related Remediation Expenses

25. Revise its accounting policies to ensure that production-related remediation expenses are accounted for in production expense accounts, consistent with the Commission's accounting regulations.

OASIS Posting of Transmission Schedules

26. Develop and implement processes and procedures to verify schedules against non-OASIS reservations as part of its e-tag validation process to ensure the accuracy of all attributes, including the "Affiliate" flag.

Short-Term Transmission Capacity Reassignments

27. Develop and implement processes and procedures to ensure that transmission service agreements are executed prior to confirming reassignments of transmission capacity.
28. Refile the affected EQR filings in coordination with the refilings to be undertaken pursuant to Recommendation 31 in Finding 10 of this audit report.

EQR Filing Requirements

29. Enhance EQR filing procedures to ensure PNM reports data accurately and completely, and consistently complies with Commission EQR filing guidance.
30. Provide training on preparing and submitting EQR filings in accordance with Commission EQR filing guidance to personnel responsible for performing and overseeing these functions.
31. Begin an internal review process to examine all EQR filings made by PNM during the audit period.

32. Correct all the errors identified during the audit as well as those discovered in its subsequent internal review process and refile the amended EQR data in a timely manner.

Other Matter – Use of Transmission Service Numbers

33. Continue to evaluate and take actions to reduce the use of TSNs.
34. Post its TSN practices on OASIS and a list of TSNs (active and inactive) along with the intended business purpose.

Other Matter – After-the-Fact (ATF) Reservation and Scheduling Practice

35. Document its ATF review as a formal business practice and post the business practice document on OASIS in order to enhance transparency of the ATF review, including PNM's ATF evaluation process, the approval/denial process, and information on the related transmission and ancillary service charges.

E. Compliance and Implementation of Recommendations

PNM should also submit for audit staff's review:

- PNM's plans for implementing audit staff's recommendations. PNM should provide these plans to audit staff within 30 days after this report is issued.
- Quarterly reports describing PNM's progress in completing each corrective action recommended in this report. PNM should make these nonpublic quarterly reports no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this report is issued, and continuing until PNM completes all recommended corrective actions.
- Copies of any written policies and procedures developed in response to recommendations in this report. They should be submitted for audit staff's review in the first quarterly filing after PNM completes these products.

II. Background

A. Open Access Transmission Tariff

PNM maintains a Commission-approved OATT that provides terms, conditions, and rates under which PNM provides transmission services. Under its OATT, PNM offers two types of transmission service: PTP transmission service and NITS. PTP transmission service allows PNM customers to deliver capacity and energy at designated point(s) of receipt and transfer such capacity and energy to designated point(s) of delivery on either a firm or non-firm basis. NITS allows PNM network customers to deliver capacity and energy, either from designated network resources to service designated network load on a firm basis or from a non-designated resource to serve designated network load on a non-firm basis. The latter form of NITS is termed secondary network transmission service and has a higher curtailment priority than any non-firm PTP transmission service.

PNM provides, or allows its customers to furnish, ancillary services to support the integration of capacity and transmission of energy from resources to load while maintaining reliable operation of PNM's transmission system. All PNM transmission customers (including PTP transmission service customers and NITS customers) are required to purchase ancillary services from PNM including: (1) scheduling, system control, and dispatch; and (2) reactive supply and voltage control from generation or other sources. However, only NITS customers are required to supply additional ancillary services, whether obtained from PNM, from a third-party, or by self-supply. Specifically, if the NITS customer's load is located within PNM's control area, such customer needs to supply: (1) regulation and frequency response; (2) energy imbalance; (3) spinning reserves; and (4) supplemental reserves. If the NITS customer delivers energy from a generator located within PNM's control area, it also needs to acquire generator imbalance service.

B. Market-Based and Cost-Based Rate Tariffs

PNM maintains a Commission-approved market-based rate (MBR) tariff that provides the terms and conditions under which PNM, as a seller, sells electric energy and capacity to purchasers under negotiated rates in all balancing authority areas where PNM has been granted MBR authority. According to PNM's MBR tariff, PNM lacks MBR authority in the PNM and El Paso Electric Company (El Paso) balancing authority areas. PNM can sell energy and capacity at the metered boundary between PNM's mitigated balancing authority area and a balancing authority area where PNM has been granted MBR authority provided: (i) legal title of the power sold transfers at the metered boundary of the balancing authority area where PNM has MBR authority; and (ii) if PNM sells at the metered boundary of a mitigated balancing authority area at market-based

rates, then neither it nor its affiliates can sell into that mitigated balancing authority area from the outside.

PNM also maintains a Commission-approved cost-based rate tariff that defines the ceiling rate that PNM can charge for any cost-based sale for resale of electric energy or capacity occurring in the PNM and El Paso balancing authority areas. The ceiling rate is 110 percent of the incremental cost of the incremental resource dispatched by PNM and/or a purchase of energy by PNM supporting the sale during the period of such sale. The cost-based rate tariff governs PNM's sales of capacity or energy in the PNM and El Paso balancing authority areas due to PNM's lack of MBR authority in these two areas.

C. Transmission Planning Process

With respect to its transmission planning obligations under Attachment K of its OATT, PNM engages in its local transmission planning process and actively participates in the WestConnect regional planning group. PNM conducts its local transmission planning on a calendar year cycle for a ten-year planning horizon. PNM opens its local planning process to all affected stakeholders, including PTP and NITS transmission customers. PNM holds biannual stakeholder meetings and posts on its OASIS, with annual updates, a proposed ten-year study plan including study scope, planning methodology/criteria, and assumptions to be used in determining local transmission plans. Also, PNM has a dispute resolution process for its customers to address any matters related to its local transmission planning process. According to PNM, no customers utilized the dispute resolution process during the audit period.

In addition to its local transmission planning process, PNM also actively participates in the WestConnect regional and subregional transmission planning processes. WestConnect is a regional planning entity that facilitates and coordinates regional transmission planning in the Western Interconnection. Its members include transmission owners and transmission providers in the region. PNM planning staff participate in WestConnect's process by providing PNM's planning data based on its local transmission planning process to support the development of regional planning study cases. PNM also reviews regional study scopes and proposed projects to be considered in the regional study.

D. Generation Interconnection Procedures

Attachments M and N of PNM's OATT apply to PNM's processing of generation interconnection requests. Attachment M provides for interconnection requests for facilities no larger than 20 megawatts, and Attachment N enumerates the large generation interconnection procedures. Large generators can request interconnection service to operate as either an energy resource or network resource. Energy Resource interconnection allows generators to connect to the transmission system and deliver the

generator's output using existing firm or non-firm transmission capacity on an "as available" basis. Network Resource interconnection service requires PNM to construct transmission upgrades as necessary to integrate the generation resource in a manner comparable to that in which PNM serves its own native load customers with its own fleet of generation resources. Either type of interconnection requires PNM to identify the network upgrades, if any, and the interconnection facilities needed to accommodate the requested type of interconnection service.

PNM posts and maintains on its OASIS the status of generation interconnection requests and of the studies associated with pending requests. PNM clusters pending large generation interconnection requests for the purpose of conducting a system impact study and may cluster small generation interconnection requests in conducting such a study.

Generation interconnection requests are submitted to PNM by two divisions within PNM, Strategic Energy Planning and Development and Technical Services, as well as another subsidiary of PNMR, PNMR Development and Management Corporation (PNMR Development). PNMR Development, which does not directly own generation, is a joint-venture partner in New Mexico Renewable Development LCC, which develops and owns renewable generation assets.

E. Power Supply and Trading Activities

PNM's power supply portfolio includes a mixture of coal, nuclear, natural gas, oil and renewable generation assets, as well as purchased power. PNM's renewable generation assets include wind, solar, and geothermal facilities. PNM's non-renewable resources include two coal-fired generating stations (San Juan and Four Corners), seven natural gas-fired generating stations (Afton, Luna, Reeves, Valencia, Rio Bravo, Lordsburg, and La Luz), and Palo Verde Nuclear Generating Station (PVNGS).¹ PNM owns 100 percent of Reeves, Afton, Rio Bravo, Lordsburg, and La Luz and one-third of Luna. The remaining interests in Luna are owned equally by Tucson Electric Power (TEP) and Samchully Power & Utilities 1, LLC. PNM is entitled to the energy and capacity of Rio Bravo under a power purchase agreement (PPA). PNM is entitled to the entire output of Valencia under a PPA. PNM uses Reeves, Lordsburg, Rio Bravo, La Luz, and Valencia primarily for peaking power and transmission support. Also, PNM owns 13 percent of Four Corners Units 4 and 5. These units are jointly owned with APS (also the operator of Four Corners), Salt River Project (SRP), TEP, and El Paso.

¹ PNM is entitled to 10.2% of the power and energy generated by PVNGS, including portions that are leased to PNM. Other owners are Arizona Public Service Company (APS), the operating agent for PVNGS, Salt River Project (SRP), El Paso, Southern California Edison Company, Southern California Public Power Authority, and the Department of Water and Power of the City of Los Angeles.

PNM participates in the wholesale electricity market, and it actively trades in the desert southwest region of the Western Interconnection, through WPM, its marketing function. WPM develops its generation schedules each day by optimizing PNM's power supply portfolio, including PNM's owned generation resources, long-term PPAs, and power purchased in the forward, day-ahead, and real-time wholesale markets. The optimization of PNM's supply portfolio may result in an opportunity to sell excess generation capacity and energy, not needed to serve PNM's native load, to third parties outside of the PNM control area when market conditions warrant.

G. Transmission Formula Rates

PNM's formula rate mechanism is included in Attachment H of its OATT. Attachment H consists of Attachments H-1, H-2, and H-3. Attachment H-1 contains the formula PNM employs to calculate, annually, its charges for Transmission Service under its OATT. PNM's Annual Transmission Revenue Requirement (ATRR) is derived from a combination of PNM's permitted return on its assets or rate base and return of PNM's annual expenses. Both return on, and of, rate base and return of expenses are based on all of the accounts listed in Attachment H-1. The rates charged customers are calculated by dividing PNM's ATRR by PNM's projected load, which leads to the unit cost of a load. There are numerous accounts that flow into the formula for determining PNM's ATRR, and they are listed in PNM's yearly informational filing accompanying its formula rate annual ATRR update (Annual Update).

Attachment H-2 contains protocols that provide a process for reviewing PNM's Annual Update filing before PNM's proposed, revised ATRR and the charges resulting from it may begin to be collected by PNM. The process includes the option for customers and Commission staff to request data and other information to improve understanding and evaluation of PNM's implementation of its formula rate in the Annual Update, including evaluation of the inputs to the formula that PNM used, and any significant changes in inputs, formula application, or other related calculations from PNM's prior rate years. The process also includes an opportunity to informally challenge and resolve disagreements regarding the appropriateness of PNM's proposed inputs and any other changes, and, if needed, procedures that would govern a formal challenge before the Commission to PNM's implementation of its formula rate in the Annual Update filing.

Attachment H-3 contains the criteria for determining whether a facility is integrated into PNM's transmission system. These criteria are important because costs relating to facilities that are not integrated into the transmission system are not permitted to be included in the calculation of transmission charges using PNM's formula rate.

III. Introduction

A. Objectives

The objectives of the audit were to determine whether PNM complied with: (1) the terms, conditions, and rates of its OATT, including its transmission formula rate mechanism provided in Attachment H of its OATT and other jurisdictional rates on file with the Commission; (2) the accounting requirements of the Uniform System of Accounts for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others, and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; (4) the regulations regarding OASIS prescribed in 18 C.F.R. Part 37; (5) the requirements of its MBR authorizations, including the Commission's MBR regulations under 18 C.F.R. Part 35, Subpart H and the Electric Quarterly Report filing regulations under 18 C.F.R. § 35.10b; and (6) the regulations governing nuclear plant decommissioning trust funds prescribed in 18 C.F.R. Part 35, Subpart E.

B. Scope and Methodology

Audit staff performed these actions to facilitate testing and evaluation of PNM's compliance with Commission requirements relevant to audit objectives:

- *Reviewed Public Information* – Conducted an extensive review of public information before commencing the audit. The review provided audit staff with an understanding of PNM's operations and finances, significant contracts, prior audit issues, and other key regulatory and business activities. Examples of materials reviewed include PNM's annual reports, SEC Forms 10-K and 10-Q, FERC Form No. 1, prior FERC audit reports, company-related websites, and other relevant regulatory and media sources.
- *Identified Audit Criteria* – Identified audit criteria including Commission rules, regulations, and other requirements necessary to evaluate compliance with the audit objectives.
- *Issued Data Requests* – Issued data requests to collect audit evidence and information. The information related to internal policies; transmission operations, procedures, and controls; business practices; risk management; corporate structure; contractual agreements; financial accounting and reporting activities; corporate compliance; regulatory filings; and other pertinent information. The evidence and information were used to test and evaluate compliance with Commission requirements relevant to audit objectives.

- *Conducted Teleconferences* – Held multiple teleconferences with PNM employees to discuss audit objectives, testing, data request responses, technical and administrative matters, and compliance concerns.
- *Attended Site Visits* – Made three site visits to PNM’s headquarters in Albuquerque, NM to discuss and observe controls and procedures related to audit objectives.
- *Internal Commission Collaboration* – Conferred with other Commission staff to ensure audit staff had a complete and accurate understanding of Commission precedent and policy applicable to this audit. For example, audit staff spoke with staff from other divisions within the Office of Enforcement, and with technical and legal staff from other Commission offices, including the Office of Energy Market Regulation, the Office of Energy Policy and Innovation, and the Office of the General Counsel.
- *Audit Testing* – Audited PNM’s compliance with its OATT and relevant Commission financial accounting and reporting requirements by evaluating, on a test basis, evidence supporting the operational requirements of its OATT and amounts for select financial accounting and reporting matters.

Audit staff also performed several specific actions to evaluate PNM’s compliance with all relevant requirements of the audit’s objectives:

- *Transmission Service Requests* – Reviewed a sample of PTP and NITS transmission service requests (TSRs) obtained from PNM’s OASIS to determine whether PNM approved or denied TSRs on a nonpreferential and nondiscriminatory basis. Further, reviewed PNM’s processing of deficient TSRs to determine whether PNM followed the procedures in its OATT to communicate with customers to remedy such deficient TSRs.
- *Transmission Service Offerings* – Reviewed a sample of available transfer capacity (ATC) postings on PNM’s OASIS to determine whether PNM followed the algorithm described in the ATC calculation methodology in PNM’s OATT. Further, reviewed PNM records to determine whether PNM maintained all records needed to justify its ATC calculations.
- *Network Integrated Transmission Service* – Reviewed a sample of NITS requests to determine whether network customers used NITS only to serve designated load.

- *Network Resource Designation/Undesignation Process* – Reviewed a sample of network resource designation/undesignation records to determine whether PNM received and reviewed all the information that its OATT requires be submitted by network customers, including from its own wholesale power merchant function. Further, reviewed the controls and procedures that PNM used to process requests for designation and undesignation.
- *Generation Interconnection Requests* – Reviewed generation interconnection requests submitted to PNM during the audit period to determine whether PNM met its obligations to establish each queue position and timely communicate with customers pertaining to their requests consistent with the generation interconnection procedures contained in PNM’s OATT Attachments M and N.
- *Ancillary Services* – Reviewed PNM’s processes and procedures for obtaining ancillary services to determine whether PNM allowed its customers to make comparable arrangements themselves (self-supply) for certain ancillary services specified in the OATT.
- *Creditworthiness Procedures* – Reviewed PNM’s standards and procedures for evaluating a new transmission customer’s creditworthiness, including any instances when PNM declared a customer to be noncreditworthy.
- *Transmission Capacity Reassignments* – Examined reassignments of transmission capacity on PNM’s transmission system to determine whether PNM executed service agreements memorializing such reassignments and reported contracts/transactions pertaining to transmission capacity reassignments in its EQR filings.
- *Standards of Conduct* – Reviewed a sample of communication records, including voice recordings, between transmission and WPM employees to determine whether transmission function employees functioned independently of WPM employees or, alternatively, inappropriately shared nonpublic transmission information with WPM employees.
- *OASIS* – Audit staff reviewed information posted on PNM’s OASIS to determine whether PNM complied with Part 37 of the Commission’s regulations, including:
 - *Posted Paths* – Reviewed all applicable transmission paths posted on OASIS.
 - *Practices for Capacity Benefit Margin (CBM) Reevaluation* – Reviewed

PNM's practices for reevaluating its CBM needs.

- *Daily Load Postings* – Reviewed PNM's daily load forecast, including underlying assumptions, and actual daily peak load for the prior day.
- *Transmission Service Products and Prices* – Reviewed PNM's posted prices and a summary of the terms and conditions associated with all transmission products offered to transmission customers.
- *Ancillary Service Offerings and Prices* – Reviewed PNM's posted ancillary services provided or offered under the OATT and the prices of those services.
- *Posting and Retention of Requests for the Designation/Termination of Network Resources* – Reviewed PNM's procedures for processing customer requests to designate and terminate network resources and reviewed a sample of such requests to determine whether (1) PNM administered the requests on the OASIS platform; (2) the related information and support is retained by PNM on its OASIS; and (3) the actual designation or termination of a network resource is noted or made on the OASIS.
- *Justification for Denied Service Requests* – Reviewed posted reasons for any denied service request.
- *Notices of Transaction Curtailment* – Reviewed curtailment notices and reason(s) why the transaction could not be continued or completed.
- *Transmission Service Schedules* – Reviewed transmission service schedules to ensure PNM posted schedules no later than seven calendar days from the start of the service.
- *Notice of Transfers of Personnel between Transmission and Marketing Functions* – Reviewed notices of transfers of personnel between PNM's transmission and merchant functions.
- *Discretionary Action Log* – Reviewed instances when PNM or its agents exercised discretion under any terms of the OATT.
- *Transmission Study Performance Metrics Reports* – Reviewed reports to determine whether PNM provided accurate and complete information in its quarterly transmission study performance metrics reports.
- *TSR Metrics Reports* – Reviewed reports to determine whether PNM

provided accurate and complete information in its monthly TSR metrics reports.

- *Transmission Planning Information* – Reviewed PNM’s OASIS and other information to determine whether PNM posted its transmission planning practices consistent with OATT requirements.
- *Generation Interconnection Queue* – Reviewed PNM’s queue to determine whether PNM posted a list of all interconnection requests consistent with OATT requirements and kept the list up-to-date.
- *Transmission Planning Process* – Reviewed PNM’s transmission planning process to determine whether PNM met the planning requirements in Attachment K of its OATT requiring PNM to conduct its local transmission planning in a particular manner and coordinate its transmission planning with other transmission providers and stakeholders through its participation in the WestConnect region’s planning process.
- *Accounting and Financial Reporting* – Reviewed PNM’s accounting and financial reporting for select items included in PNM’s Annual Transmission Revenue Requirement (Attachment H of PNM’s OATT), including:
 - *ARO* – Reviewed PNM’s accounting treatment for ARO-related items recorded in select 300 series or plant-in-service accounts to determine whether PNM complied with Commission accounting regulations.
 - *Contingent Liabilities* – Reviewed the Notes to Financial Statements in PNM’s FERC Form No. 1s and gathered information about accruals for potential future obligations. Reviewed information on commitments and environmental and legal contingencies and assessed whether these amounts affected wholesale rates.
 - *AFUDC* – Reviewed PNM’s AFUDC rate calculation to determine compliance with Electric Plant Instruction No. 3. Reviewed PNM’s methodology for determining the annual AFUDC rate to determine whether it was based upon PNM’s own debt and equity book balances and to confirm the short-term debt rate variance did not exceed 25 basis points. Reviewed work orders to confirm that PNM ceased accruing AFUDC upon plant in-service dates, periods of suspension, and abandonment. Reviewed the construction base component of PNM’s AFUDC accrual calculation to determine whether it included only amounts relating to construction activities and properly allocated overheads.

- *Depreciation* – Reviewed PNM’s monthly depreciation and amortization expenses and supporting calculations to determine whether PNM used the proper accounts and recorded the correct amounts. Reviewed PNM’s depreciation expense calculation to test whether PNM derived monthly depreciation expenses using approved depreciation rates on file with the Commission.

- *Notes to Financial Statements* – Reviewed the Notes to Financial Statements in PNM’s FERC Form No. 1s for significant accounting matters and followed up on these matters to understand financial statement and wholesale formula rate implications.

IV. Findings and Recommendations

1. Independent Functioning of PNM's Transmission Function

During the audit period, upon its WPM function's request, PNM's transmission function employees procured PTP transmission service on certain paths for WPM function employees, contrary to the Commission's Independent Functioning Rule. As a result, PNM's transmission function employees conducted a marketing function and did not function independently of its marketing function employees.

Pertinent Guidance

- 18 C.F.R. § 358.5, Independent Functioning Rule, states:
 - (a) *General rule.* Except as permitted in this part or otherwise permitted by Commission order, a transmission provider's transmission function employees must function independently of its marketing function employees.
 - (b) *Separation of functions.* (1) A transmission provider is prohibited from permitting its marketing function employees to:
 - (i) Conduct transmission functions; or
 - (ii) Have access to the system control center or similar facilities used for transmission operations that differs in any way from the access available to other transmission customers.
 - (2) A transmission provider is prohibited from permitting its transmission function employees to conduct marketing functions.

Background

In its review of PNM's transmission function operations, audit staff identified 520 instances during the audit period where PNM transmission employees procured PTP transmission service for its WPM function. Specifically, WPM employees emailed PNM transmission employees to request and secure PTP transmission service on certain paths on WPM's behalf. As an example, on May 14, 2018, a WPM employee emailed a PNM transmission employee with a request for transmission service on the SJ345 to WM345 path and a request for redirect service for May 15, 2018. The PNM transmission employee later reserved and subsequently confirmed two requests on WPM's behalf.

Audit staff is concerned about this practice because it is inconsistent with the Commission's Independent Functioning Rule, which requires transmission function employees to function independently of a transmission provider's marketing function employees and prohibits transmission function employees from conducting any marketing functions. PNM's internal WPM function is a transmission customer under PNM's OATT. PNM's WPM function should have procured all transmission service itself, similarly to all other PNM transmission customers. During the audit, audit staff brought these concerns to PNM's attention, and PNM instituted new procedures whereby the WPM function should procure all transmission service itself through OASIS.

Recommendations

We recommend that PNM:

1. Enhance Standards of Conduct training for all applicable employees.
2. Develop and implement controls to be used by PNM's regulatory compliance staff to limit, monitor and document non-OASIS communications between PNM's transmission and WPM functions.
3. Perform quarterly reviews using controls, monitoring, and documentation developed in response to Recommendation 2 listed above.
4. Provide to DAA a summary of the above-described review in a quarterly compliance report for two consecutive quarters after this audit report is issued.

2. Cost-Based Sales

PNM incorrectly used estimated transmission costs to price certain cost-based energy sales. These estimated costs did not reflect the actual transmission costs and resulted in PNM overcharging a transmission customer by approximately \$121,500.

Pertinent Guidance

- 18 C.F.R. § 35.38, Mitigation, states:
 - (a) A Seller that has been found to have market power in generation or ancillary services, or that is presumed to have horizontal market power in generation or ancillary services by virtue of failing or foregoing the relevant market power screens, as described in 35.37(c), may adopt the default mitigation detailed in paragraph (b) of this section for sales of energy or capacity or paragraph (c) of this section for sales of ancillary services or may propose mitigation tailored to its own particular circumstances to eliminate its ability to exercise market power. Mitigation will apply only to the market(s) in which the Seller is found, or presumed, to have market power.
 - (b) Default mitigation for sales of energy or capacity consists of three distinct products:
 - (1) Sales of power of one week or less priced at the Seller's incremental cost plus a 10 percent adder;
 - (2) Sales of power of more than one week but less than one year priced at no higher than a cost-based ceiling reflecting the costs of the unit(s) expected to provide the service; and
 - (3) New contracts filed for review under section 205 of the Federal Power Act for sales of power for one year or more priced at a rate not to exceed embedded cost of service.
 - (c) Default mitigation for sales of ancillary services consist [sic] of: (1) A cap based on the relevant OATT ancillary service rate of the purchasing transmission operator; or (2) the results of a competitive solicitation that meets the Commission's requirements for transparency, definition, evaluation, and competitiveness.

- Section 4 of PNM's Cost-Based Power and Energy Sales Tariff, states in relevant part:

All sales shall be made at rates established by agreement between the purchaser and PNM; *provided*, however, that the rate charged by PNM shall not exceed 110 percent of the incremental cost (IC) of the incremental resource (Incremental Resource) dispatched by PNM during the period of such sale, as defined herein.²

Background

Audit staff reviewed PNM's cost-based rate sales activities in the PNM and El Paso balancing authority areas. PNM does not have MBR authority in these balancing authority areas and must sell power in these areas under its cost-based rates tariff, FERC Electric Tariff Volume No. 7. Audit staff's review of cost-based sales and price information identified multiple sales made to the El Paso balancing authority area where the sale price exceeded the cost-based price level.

In its review, audit staff determined that sales made to the El Paso balancing authority area in excess of the cost-based level were caused by overestimated transmission costs that were included in the total sale price.

Under its cost-based rate tariff, PNM is allowed to recover its incremental cost of the purchase of energy plus a 10 percent adder, as well as transmission costs to support the sale, as long as the purchaser agrees to let PNM arrange the delivery of electric energy for the sale. According to PNM, the transmission costs included in the original cost-based sale price were estimates calculated by the WPM traders responsible for execution of the transaction. However, WPM did not have a review process in place to check the accuracy of the estimated transmission costs and make necessary adjustments to the sale price to reflect the actual costs of service charged by third-party transmission providers. In reviewing these transactions in the El Paso balancing authority area, audit staff determined that PNM overestimated transmission costs for over 70 percent of sales transactions, which resulted in overcharges of approximately \$121,500. As a result, PNM agreed to refund the overcharged amount plus interest to El Paso.

² Public Service Company of New Mexico's Cost-Based Power and Energy Sales Tariff, Vol. No. 7.

Recommendations

We recommend that PNM:

5. Refund the overcharged amount of \$121,500 to the affected customer in a timely manner.
6. Develop and implement procedures for validating cost-based sale prices to ensure that these prices reflect the actual cost of incremental resource including transmission cost.
7. Provide validation results in a quarterly compliance report to DAA for two consecutive quarters after this audit report is issued to demonstrate the effectiveness of the new process.

Corrective Actions Taken

On December 11, 2018, PNM refunded the overcharged amount of \$121,500 and interest of \$10,508 to the affected customer. PNM fully completed Recommendation 5.

PNM adopted a new process that provides several levels of review, including peer review and manager review, to ensure that cost-based sales (both day-ahead and real-time) will be priced based on actual transmission costs and any sale price will be corrected in a timely manner, when necessary. Based on its review of this process, audit staff determined that PNM fully completed Recommendation 6.

3. Use of Secondary Network Transmission Service

During the audit period, PNM's transmission function improperly allowed its WPM function to use secondary network transmission service to deliver energy outside of PNM's control area. For most of these instances, WPM used secondary network transmission service to deliver energy to two generation plants located outside of PNM's control area in order to facilitate station service at those locations. As a result, PNM did not follow the requirements of its OATT associated with the use of secondary network transmission service.

Pertinent Guidance

- PNM's OATT, Part III, Network Integration Transmission Service – Preamble, states in relevant part:

Network Integration Transmission Service also may be used by the Network Customer to deliver economy energy purchases to its Network Load from non-designated resources on an as-available basis without additional charge. Transmission service for sales to non-designated loads will be provided pursuant to the applicable terms and conditions of Part II [Point-to-Point Transmission Service] of the Tariff.³

- PNM's OATT, Section 28.4, Secondary Service, states, in relevant part:

The Network Customer may use the Transmission Provider's Transmission System to deliver energy to its Network Loads from resources that have not been designated as Network Resources. Such energy shall be transmitted, on an as-available basis, at no additional charge.⁴

Background

Audit staff observed that PNM's OASIS showed that WPM reserved secondary network transmission service on a regular basis. Some of these reservations were made on transmission paths to deliver off-system purchased power to certain trading hubs (*e.g.*,

³ Public Service Company of New Mexico, PNM Open Access Transmission Tariff, Part III, Network Integration Transmission Service – Preamble, accepted in Docket No. ER14-178-000 on December 11, 2013, effective October 28, 2011.

⁴ *Id.* at Section 28.4, Secondary Service.

Four Corners and San Juan) outside of PNM's control area. When reserving transmission service, transmission customers, like WPM, are not required to specify the location where power will ultimately sink. Therefore, WPM's reservations did not indicate whether power would be delivered to PNM's native load within its control area or to locations outside of PNM's control area.

To better understand the intended business purpose of WPM's use of secondary network transmission service to deliver energy to trading hubs, audit staff interviewed a number of WPM traders and reviewed selected e-tags. Based on these interviews and the e-tag review, audit staff determined that not all of the secondary network transmission service reservations were scheduled to deliver energy to PNM's native load. PNM reviewed all secondary network transmission service schedules during the audit period and identified approximately 280 instances where WPM used secondary network transmission service to deliver energy to two generation plants (Four Corners in the Arizona Public Service Company control area and Afton in the El Paso control area) located outside of PNM's control area in order to facilitate station service at those locations. Also, PNM identified a few instances where WPM used secondary network transmission service to facilitate power exchange transactions between PNM and Tucson Electric Power Company under a long-term contract and provide reserve sharing service.

The use of secondary network transmission service to serve any purpose other than to deliver energy to designated network load or native load is contrary to the requirements set forth in PNM's OATT Part III, and PNM should have used PTP transmission service to deliver energy in the instances discussed above. PTP transmission service is the transmission of capacity and energy from the point(s) of receipt to the point(s) of delivery and can be used to deliver energy to any location while NITS and secondary network transmission service must be used to serve designated network load (*e.g.*, native load).

Audit staff did not identify any instances where non-affiliated customers' service was interrupted as a result of WPM's misuse of secondary network transmission service. In August 2018, PNM's transmission function developed and implemented a new business practice that requires its personnel responsible for processing schedules to deny any network customer's secondary network transmission service requests that do not serve that customer's designated network load.

Recommendations

We recommend that PNM:

8. Enhance controls to ensure that WPM employees only use secondary network transmission service to serve PNM native load.

9. Develop and implement processes and procedures to validate secondary network transmission service requests for delivering power to any intermediate points of delivery outside the PNM control area and ensure the requests are ultimately to serve the designated network load prior to confirming the request.
10. Develop and implement processes and procedures to review e-tags that have a transmission segment(s) associated with a NITS request to ensure the proper use of transmission service.

Corrective Actions Taken

In August 2018, PNM developed and implemented a new business practice that requires PNM's transmission function employees to deny any network customer's secondary network transmission service requests that do not serve the customer's designated network load. Based on its review of these actions, audit staff determined that PNM fully completed Recommendations 8-10.

4. Termination of Network Resources

PNM did not fully implement Commission-approved North American Energy Standards Board (NAESB) standards that require network customers to submit terminations (temporary and indefinite) of network resources through OASIS in a timely manner. As a result, PNM allowed its network customers to submit terminations of network resources outside of OASIS for more than two years after the Order No. 676-H compliance deadline of March 1, 2017.

Pertinent Guidance

- Paragraph 1541 of Order No. 890 states in relevant part:

We direct transmission providers to develop OASIS functionality and, working through NAESB, business practice standards describing the procedural requirements for submitting both temporary and indefinite terminations of network resources, to allow network customers to provide all required information for such terminations. Such OASIS functionality should allow for electronic submittal of the type of termination (temporary or indefinite), the effective date and time of the termination, and identification and capacity of resource(s) or portions thereof to be terminated. For temporary terminations, such OASIS functionality should also allow for electronic submittal of (1) effective date and time of redesignation, following the period of temporary termination; (2) information and attestation for redesignating the network resource following the temporary termination, in accordance with section 30.2 of the *pro forma* OATT; and (3) identification of any related transmission service requests to be evaluated concomitantly with the request for temporary termination.⁵

⁵ *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 118 FERC ¶ 61,119 at P 1541, *order on reh'g*, Order No. 890-A, 121 FERC ¶ 61,297 (2007), *order on reh'g*, Order No. 890-B, 123 FERC ¶ 61,299 (2008), *order on reh'g*, Order No. 890-C, 126 FERC ¶ 61,228, *order on clarification*, Order No. 890-D, 129 FERC ¶ 61,126 (2009).

- NAESB WEQ-002-101-3.3.10, Network Resource Designation, states in part:

Once designated, any modification to the DNR must be submitted via the TerminateNITSDNR NITS OASIS REQUEST Template request. Once terminated on either temporary or indefinite basis, the Network Resource may only be restored as a DNR within the period and capacity of the termination through submission of a new Add NITSDNR NITS OASIS REQUEST Template request.⁶

Background

In Order No. 890, the Commission described the OASIS function referred to as “NITS on OASIS,” which allows a network customer to make modifications to a designated network resource (e.g., temporary termination and redesignation) through OASIS, and directed public utilities, working through the North American Electric Reliability Corporation (NERC) and NAESB, to develop appropriate standards associated with this function (and others). NITS on OASIS increases the consistency and transparency of information on designated network resources across the transmission service market.⁷

In Order No. 676-H, which supported Order No. 890, the Commission approved the implementation of NITS on OASIS.⁸ Specifically, Order No. 676-H amended Commission regulations to incorporate NAESB’s Wholesale Electric Quadrant (WEQ) Version 003 - OASIS Business Practice Standards and Communication Protocol (NAESB Standards) and required all public utility transmission providers to comply with and incorporate the NAESB Standards into their tariffs.⁹ The revised NAESB Standards included the NITS on OASIS business practices from Order No. 890. Order No. 676-H required each transmission provider’s full compliance and implementation of standards related to NITS on OASIS by March 1, 2017.

⁶ https://www.naesb.org/weq/weq_standards.asp.

⁷ See Order No. 890, 118 FERC ¶ 61,119 at P 1541.

⁸ *Standards for Business Practices and Communication Protocols for Public Utilities*, Order No. 676-H, 148 FERC ¶ 61,205 (Sept. 24, 2014), (Order No. 676-H), *as modified, errata notice*, 149 FERC ¶ 61,014 (2014), *order on reh’g*, 151 FERC ¶ 61,046 (2015) (Order No. 676-H Rehearing Order).

⁹ *Id.*

On December 1, 2014, PNM submitted revisions to Attachment P of its OATT in order to comply with the requirements of Order No. 676-H.¹⁰ On February 28, 2017, PNM upgraded its OASIS to incorporate the NITS on OASIS functionality required by the NAESB standards, including network resource designations and terminations (temporary and indefinite). However, PNM did not actually let its customers use this functionality and continued letting its customers submit network resource termination requests via e-mail outside its OASIS. This manual process did not comply with Order 676-H after the March 1, 2017 compliance deadline, and PNM continued this manual process for more than two years after the deadline until audit staff identified the issue. Audit staff determined that PNM did not utilize the NITS on OASIS functionality due to a lack of training regarding these new regulatory requirements and a lack of controls to monitor compliance with these new regulatory requirements.

Recommendations

We recommend that PNM:

11. Develop and implement processes and procedures to ensure use of NITS on OASIS template requirements adopted in Order 676-H.
12. Provide training with respect to the processes and procedures developed in response to Recommendation 11.

Corrective Actions Taken

In May 2019, PNM developed a new procedure called, “NITS Customers Terminates/Redesignates NITS DNR Process on webSmartOASIS.” This procedure became effective on July 1, 2019, and PNM provided training to its NITS customers on the new procedure. On June 7, 2019, PNM submitted its new procedure to audit staff for review. Based on its review of these actions, audit staff determined that PNM fully completed Recommendations 11 and 12.

¹⁰ *Public Service Company of New Mexico*, Docket No. ER15-533-000 (Dec. 1, 2014) (submission of PNM).

5. Asset Retirement Obligations

PNM did not obtain Commission approval in advance of recovering asset retirement obligation costs in its transmission formula rate calculations. Also, PNM did not file its accounting entries with the Commission to reclassify approximately \$37 million from Account 108, Accumulated Provision for Depreciation of Electric Utility Plant (Major Only) to Account 435, Extraordinary Deductions.

Pertinent Guidance

- Order No. 631 states:

However, public utilities, licensees and natural gas companies with formula rate tariffs must not include any cost components related to asset retirement obligations in their formula rate billing tariffs for automatic recovery in their billing determinations without obtaining Commission approval.¹¹

- Order No. 631 further states:

In addition, the regulations require that all asset retirement obligations related rate base items be removed from the rate base computation through an adjustment. If the public utility, licensee or natural gas company is seeking recovery of an asset retirement obligation in rates, it must also provide a detailed study supporting the amounts proposed to be collected in rates. If the public utility, licensee, or natural gas company is not seeking recovery of the asset retirement obligation in rates, then it must remove all asset retirement obligation related cost components from its cost of service.¹²

- Order No. 631 also states that:

The Commission notes that there may be instances where adjustments to accounts 108, 110 and 253 may be required as a result of this final rule but the criteria for the recognition of a

¹¹ *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*, Order No. 631, 103 FERC ¶ 61,021, at P 60, *order on reh'g*, Order No. 631-A, 104 FERC ¶ 61,183 (2003).

¹² *Id.* P 62.

regulatory asset or liability for the net income effect is not met. While we permit jurisdictional entities to make such adjustments our actions here should not be construed as approval. Therefore, the Commission will require that jurisdictional entities to [sic] file with the Commission their journal entries along with supporting information to record any adjustment that affects net income within 60 days of the effective date of this final rule. The filing must include a description and explanation of the full particulars for including the amounts in net income.

The filing must also include a statement by the public utility, licensee or natural gas company of the facts and circumstances and the explicit determinations made by the jurisdictional entity demonstrating that the amounts credited to net income are not required to be refunded to customers or required to be recorded as a regulatory liability and must be credited to net income and not included in account 254, Other regulatory liabilities.¹³

- 18 C.F.R. § 35.18, Asset Retirement Obligations, states:
 - (a) A public utility that files a rate schedule, tariff or service agreement under §35.12 or §35.13 and has recorded an asset retirement obligation on its books must provide a schedule, as part of the supporting work papers, identifying all cost components related to the asset retirement obligations that are included in the book balances of all accounts reflected in the cost of service computation supporting the proposed rates. However, all cost components related to asset retirement obligations that would impact the calculation of rate base, such as electric plant and related accumulated depreciation and accumulated deferred income taxes, may not be reflected in rates and must be removed from the rate base calculation through a single adjustment.
 - (b) A public utility seeking to recover nonrate base costs related to asset retirement costs in rates must provide, with its filing under §35.12 or §35.13, a detailed study supporting the amounts proposed to be collected in rates.
 - (c) A public utility that has recorded asset retirement obligations on its books, but is not seeking recovery of the asset retirement costs in

¹³ *Id.* PP 31-32 (footnote omitted).

rates, must remove all asset-retirement-obligations-related cost components from the cost of service supporting its proposed rates.

Background

AROs reflect various legal obligations associated with the retirement of long-lived assets. Initially, such legal obligations associated with the retirement of long-lived assets are appropriately measured and recorded at fair value as a liability and then offset by recording a separate asset, which is depreciated over the long-lived asset's useful life. Until the legal obligation is actually settled, the liability is increased to reflect changes in the obligation due to the passage of time through the recognition of accretion expense.

General Instruction 25 of Part 101 of the Uniform System of Accounts for Public Utilities and Licensees, 18 C.F.R. Part 101, defines an ARO as "a liability for the legal obligation associated with the retirement of a tangible long-lived asset that a company is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel."

PNM initially recorded AROs by debiting Account 101, Electric Plant in Service, and crediting Account 230, Asset Retirement Obligations. These AROs were for obligations associated with production, distribution, and general plants. To record the depreciation on the ARO assets, PNM debited Account 403.1, Depreciation Expense for Asset Retirement Costs, and credited Account 108, Accumulated Provision for Depreciation of Electric Utility Plant. This depreciation is calculated on a straight line basis over a life dictated by the settlement date of the ARO liability. For accretion expense, PNM debited Account 411.10, Accretion Expense, and credited Account 230. The accretion expense recognizes the increase in the cost of removing an asset over its useful life.

During the audit, audit staff reviewed PNM's ARO accounting processes and procedures, including FERC accounts used to record ARO items and any related transmission formula rate (formula rate) impacts.

In reviewing more details about the related formula rate impacts, audit staff determined that PNM recovered ARO-related amounts in its formula rate. Specifically, PNM recovered ARO depreciation amounts recorded in Accounts 403.1 and 108 through the formula rate. Also, PNM recovered ARO general plant amounts recorded in Account 399.1, Asset Retirement Costs for General Plant, through the formula rate.

Commission regulations require approval prior to companies recovering ARO costs through their transmission formula rate mechanism. Based on Commission

requirements, no aspect of the ARO should have been included in formula rate billings to wholesale power and transmission customers, absent PNM seeking approval from the Commission to include ARO amounts in formula rate determinations. This would have afforded the Commission the opportunity to request further information regarding PNM's accounting and the impacts of including ARO amounts in determining PNM's annual revenue requirements.

Also, audit staff reviewed PNM's accounting for ARO items in Account 108 and determined that PNM reclassified, from Account 108 to Account 435, Extraordinary Deductions, excess depreciation recorded in Account 108. This excess depreciation related to accounting for prior costs of removal that exceeded accumulated depreciation, which would have been recorded under Statement of Financial Accounting Standards (SFAS) 143.¹⁴ Order No. 631 allows companies to reclassify this excess depreciation from Account 108 to Account 254, Other Regulatory Liabilities, without prior approval. However, by reclassifying to Account 435, PNM did not comply with Order No. 631 as it did not obtain the Commission's approval.

Recommendations

We recommend that PNM:

13. Develop and implement processes and procedures to prevent ARO costs from being included in PNM's annual revenue requirement and being passed on through PNM's formula rate mechanism to customers without the Commission's approval.

¹⁴ SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset, except for certain obligations of lessees. As used in SFAS 143, a legal obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel.

6. Allowance for Funds Used During Construction

PNM's methods for calculating and accounting for its AFUDC rate were deficient and caused PNM's AFUDC to exceed the maximum AFUDC permitted by the Commission's regulations, as follows:

- PNM improperly included in its short-term debt rate an amount labeled "other interest," which represented the interest recorded against transmission and interconnection study advances paid to PNM.
- PNM incorrectly included Account 216.1, Unappropriated Undistributed Subsidiary Earnings, as part of the equity component for the purpose of computing its AFUDC rate.
- PNM combined the costs of all debt issuances, rather than individually computing the costs of each debt issuance, to determine the weighted cost of long-term debt.

As a result of these methods, PNM overstated AFUDC by approximately \$443,000 for 2015 and approximately \$1,151,000 for 2016.

Pertinent Guidance

- Order No. 561, Order Adopting Amendment to Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies, states in part:

The balances of long-term debt, preferred stock, and common equity for use in the formula for the current year will be the balances in such accounts at the end of the prior year....¹⁵

- 18 C.F.R. Part 101, Electric Plant Instruction 3(A)(17), Allowance for Funds Used During Construction, states in part:

¹⁵ *Order Adopting Amendment to Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies*, Order No. 561, 57 FPC 608, at 610 (Order No. 561), order on clarification, Order No. 561-A, 59 FPC 1340 (1977) (Order No. 561-A).

Allowance for funds used during construction includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds.

The rates shall be determined annually. The balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the prior year.

- Order No. 469, Order Amending Uniform System of Accounts for Public Utilities and Licensees (Class A and Class B) and Natural Gas Companies (Class A and Class B) and FPC Annual Report Forms No. 1 and No. 2, states in part:

It will continue to be the Commission's policy that the undistributed earnings of subsidiaries are to be excluded from the common stockholder's equity in determining rate of return.¹⁶

- Order No. 561 directs that the rate for the long-term debt component of the AFUDC rate calculations shall be determined using the weighted average cost methodology:

We are modifying the proposed rule to provide that the balances of long-term debt, preferred stock, and common equity for use in the formula [calculating maximum AFUDC] for the current year will be the balances in such accounts at the end of the prior year; the cost rates for long-term debt and preferred stock will be the effective weighted average cost of such capital.¹⁷

- Accordingly, Electric Plant Instruction (EPI) No. 3(A)(17)(b) directs, in relevant part:

The cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner indicated in §35.13 of the Commission's Regulations under the Federal Power Act.¹⁸

¹⁶ Revisions in Uniform System of Accounts, and Annual Report Forms No. 1 and No. 2 to Adopt the Equity Method of Accounting for Long-Term Investments in Subsidiaries, Order No. 469, 49 FPC 326, at 327, reh'g denied, 49 FPC 1028 (1973).

¹⁷ Order No. 561, 57 FPC 608 at 610.

¹⁸ 18 C.F.R. Part 101, EPI No. 3(A)(17)(b) (2019).

- Section 35.13(h)(22)(ii)(A) states:

(ii) *Debt capital.* (A) The utility shall show the weighted cost for all issues of long-term debt capital as of the end of Period I, as expected on the date the changed rate is filed, and, if applicable, as estimated for the end of Period II. The weighted cost is calculated by: (1) Multiplying the cost of money for each issue under clause (B)(6) below by the principal amount outstanding for each issue, which yields the annualized cost for each issue; and (2) adding the annual cost of each issue to obtain the total for all issues, which is divided by the total principal amount outstanding for all issues to obtain the weighted cost for all issues.¹⁹

Background

Audit staff reviewed PNM's process and policy for computing its AFUDC rate and the application of such rates to construction projects. Through its review, audit staff identified deficiencies in PNM's methods for calculating and accounting for AFUDC in the areas described below. These deficiencies caused AFUDC calculated by PNM to exceed the maximum AFUDC permitted by the Commission's regulations.

Other Interest

During the audit period, PNM received advances on several transmission and generator interconnection studies. PNM treated the interest related to these transmission and generator interconnection study advances as "other interest" and improperly included this item in the cost of short-term debt when it calculated its AFUDC rate. PNM acknowledged that these amounts should have been excluded from the AFUDC computation since this is not interest related to short-term debt instruments.

Equity Component of AFUDC Rate Calculation

In its review of the equity component that was included in PNM's AFUDC rate calculations, audit staff determined that PNM incorrectly used balances from Account 216.1, Unappropriated Undistributed Subsidiary Earnings, in deriving the equity component of the AFUDC rate calculation. AFUDC includes the net cost of borrowed funds used for construction purposes and an allowed rate on other funds. Since amounts in Account 216.1 were undistributed by PNM's subsidiaries and, therefore, were not available to finance construction, those amounts should not have been considered as equity available to PNM for construction in deriving PNM's AFUDC rate. As noted

¹⁹ 18 C.F.R. § 35.13(h)(22)(ii)(A) (2019).

above, in Order No. 469, the Commission's predecessor, the Federal Power Commission, stated that undistributed earnings of subsidiaries are to be excluded from common stockholder equity in determining rate of return.²⁰

Long-Term Debt Rate

In its review of PNM's long-term debt rate calculation, audit staff determined that PNM calculated its long-term debt rate using the prior month long-term debt balance divided by the prior month interest expense. Order No. 561, EPI 3(a)(17)(b), and Section 35.13(h)(22)(ii)(A) of the Commission's regulations require the long-term debt rate to be calculated using the weighted average cost method, which requires that the prior year end balance of the cost of money divided by the principal amount of all outstanding bonds be used to derive the long-term debt rate.

PNM's foregoing deficiencies in calculating and accounting for its AFUDC rate caused its AFUDC to exceed the maximum AFUDC permitted by the Commission's regulations and resulted in PNM overstating AFUDC by approximately \$443,000 for 2015 and approximately \$1,151,000 for 2016.

Recommendations

We recommend that PNM:

14. Revise its procedures to ensure that its AFUDC rate calculation is consistent with Electric Plant Instruction No. 3(17), Order Nos. 561 and 561-A, and other applicable Commission accounting regulations.
15. Revise its procedures to exclude the underlying "other interest" from the short-term debt rate determination used when calculating its AFUDC rate.
16. Revise procedures to ensure that Account 216.1, Unappropriated Undistributed Subsidiary Earnings, is excluded from equity components used to derive its AFUDC rate.
17. Revise procedures to ensure that PNM uses prior year end balances to compute the long-term debt rate used by PNM for calculating PNM's AFUDC rate.
18. Provide training to PNM's staff on the revised AFUDC accounting and rate calculation method. Also, develop a training program that supports the provision of periodic training in this area, as needed.

²⁰ Order No. 469, 49 FPC 326 at 327.

19. Make adjustments within 60 days of receiving the final audit report to all impacted accounts, for the period January 1, 2015 to December 31, 2019, including Account 101, Electric Plant in Service, and the accounts for accumulated depreciation, ADIT, retained earnings, CWIP, and submit these adjustments to DAA for review and approval. Also, include in this submission to DAA the impact to PNM's Annual Transmission Revenue Requirement produced by PNM's formula rate as a result of changes to these accounts during the same period.
20. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds to PNM's wholesale customers since January 1, 2015, plus interest, relating to the adjustments made in response to the preceding recommendation; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) for which refunds will be made.
21. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
22. Refund the amounts disclosed in the refund report to wholesale customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

7. Accounting for Commitment Fees

PNM improperly accounted for upfront and quarterly commitment fees that it paid for a credit facility, in Accounts 428, Amortization of Debt Discount and Expense, and 431, Other Interest Expense, respectively, and included these items in its calculation of short-term debt interest expense used to compute its AFUDC rate.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 930.2, Miscellaneous General Expenses (Major Only), states:

This account shall include the cost of labor and expenses incurred in connection with the general management of the utility not provided for elsewhere.

- Account 181, Unamortized Debt Expense, states:

This account shall include expenses related to the issuance or assumption of debt securities. Amounts recorded in this account shall be amortized over the life of each respective issue under a plan which will distribute the amount equitably over the life of the security. The amortization shall be on a monthly basis, and the amounts thereof shall be charged to account 428, Amortization of Debt Discount and Expense. Any unamortized amounts outstanding at the time that the related debt is prematurely reacquired shall be accounted for as indicated in General Instruction 17.

- Account 428, Amortization of Debt Discount and Expense, states:

A. This account shall include the amortization of unamortized debt discount and expense on outstanding long-term debt. Amounts charged to this account shall be credited concurrently to accounts 181, Unamortized Debt Expense, and 226, Unamortized Discount on Long-Term Debt—Debit.

B. This account shall be so kept or supported as to show the debt discount and expense on each class and series of long-term debt.

- Account 431, Other Interest Expense, states:

This account shall include all interest charges not provided for elsewhere.

Items

1. Interest on notes payable on demand or maturing one year or less from date and on open accounts, except notes and accounts with associated companies.
 2. Interest on customers' deposits.
 3. Interest on claims and judgments, tax assessments, and assessments for public improvements past due.
 4. Income and other taxes levied upon bondholders of utility and assumed by it.
- Order No. 561 states in relevant part:

In regard to short-term debt, several respondents have pointed out that compensating balances and commitment fees have cost implications with respect to bank loans and as support for commercial paper and urged that recognition be given for such costs. We agree that in some instances, such items could properly be considered in determining the effective cost rate for short-term debt for use in the [AFUDC] formula. *However, primarily because of measurement problems, we do not believe that specific recognition should be given in the general rule. Instead, where an individual company has a written agreement and can support the fact that compensating balances and commitment fees are necessary in order to obtain favorable short-term financing and are not considered in its rate proceedings, we will permit an adjustment to the nominal short-term interest rates to reflect this additional cost (emphasis added).*²¹

- Order No. 561-A, states in part:

Order No. 561 neither changes the Commission's policy with respect to treatment of short-term debt in capitalization used for rate of return

²¹ Order No. 561, 57 FPC 608, at 610-611 (emphasis added).

*purposes nor does it grant blanket approval for recognition of compensating balances and commitment fees in costing short-term debt. The burden of proof is upon the companies to justify such items before they will be permitted (emphasis added).*²²

Background

PNM established a credit facility of \$400 million in 2015 that extended through 2017 to finance its utility operations. PNM's written agreement for the credit facility and credit agreement required PNM to pay upfront fees to establish the credit facility and quarterly fees on the *unused* balance. In addition, PNM paid interest on the amounts that it borrowed under this credit facility.²³ Audit staff found that the upfront fees and quarterly commitment fees were included in the costs of short-term debt when PNM calculated its AFUDC rate. PNM recorded the upfront fees in Account 181 and amortized the costs over the duration of the credit facility by debiting Account 428. PNM accounted for the quarterly commitment fees by debiting Account 431. Accordingly, PNM treated the upfront and quarterly commitment fees as interest expense and a cost of short-term debt for AFUDC purposes.

Audit staff found that the credit facility was not established in conjunction with acquisition of debt or directly associated with outstanding debt. Rather, audit staff discovered that PNM obtained the credit facility to create liquidity for the company's general-purpose needs.

PNM's recording of the upfront fees in Account 181, Unamortized Debt Expense, and PNM's amortization of these costs over the duration of the credit facility by debiting Account 428, Amortization of Debt Discount and Expense, were incorrect because Account 181 and Account 428 pertain to a public utility's issuance or assumption of long-term "debt securities," such as long-term bonds or other debt securities. Here, PNM did not issue or assume any debt securities; instead, it entered into agreements creating a credit facility upon which it drew periodically. Further, PNM's use of these accounts is also inconsistent with its treatment of the upfront fees as a cost of short-term debt and its practice of including these upfront fees in its cost of short-term debt when calculating its AFUDC rate.

²² Order No. 561-A, 59 FPC 1340 at 1342 (emphasis added).

²³ PNM's daily average use of the credit facility during 2015 through 2017 was approximately \$47.8 million, or an approximate daily average use of 12 percent of the total loan facility amount.

PNM's practice, already noted above, of recording the quarterly fees collected under the agreements establishing the credit facility in Account 431, Other Interest Expense, was not appropriate because the quarterly commitment fees were not themselves "interest charges," were not functioning here as interest, and do not fall into any of the four items specifically listed in Account 431, which are: (1) interest on notes payable on demand or maturing one year or less and on open accounts; (2) interest on customers' deposits; (3) interest on claims against the utility, judgments, tax assessments, and past due assessments for public improvements; and (4) taxes levied on bondholders and assumed by a utility.

Accordingly, we find that the upfront and quarterly commitment fees associated with this credit facility are appropriately recorded in Account 930.2, Miscellaneous General Expenses, because the credit facility with which they are associated was obtained to create liquidity for the company's general-purpose needs.²⁴ Account 930.2 includes the cost of labor and expenses incurred in connection with the general management of the utility not provided for elsewhere, and we find that the upfront and commitments fees most resemble a banking charge to support a company's utility operations as a whole when the credit facility is not required to support a specific issuance of debt or a nonoperating function. Further, PNM should exclude the upfront and quarterly commitment fees from the cost of short-term debt when calculating its AFUDC rate.

Recommendations

We recommend that PNM:

23. Revise its procedures so as to exclude upfront and quarterly commitment fees from the cost of short-term debt when calculating its AFUDC rate.
24. Revise its procedures to record the upfront and quarterly commitment fees excluded from AFUDC rate calculations in Account 930.2, Miscellaneous General Expenses.

²⁴ In contrast, upfront and quarterly commitment fees for credit facilities acquired in compliance with the provisions of specific debt agreements for specific purposes or projects should be recorded as interest expense and included as a cost of the short-term or long-term debt they support, consistent with Commission precedent. *See System Energy Resources, Inc.*, 48 FERC ¶ 61,321 at 62,063-64 (1989) (holding that bank fees for letters of credit associated with construction bonds for nuclear generating plant lowered the cost of interest on the specific issuances of long-term construction bonds, thereby functioning as interest on such bond issuances, and should be recorded in Account 427, Interest on Long-Term Debt).

8. Production-Related Remediation Expenses

PNM improperly accounted for remediation expenses related to its Santa Fe and Person Generating Stations in Account 930.2, Miscellaneous General Expenses. Since these expenses are *production-related* expenses, they should have been recorded in Account 506, Miscellaneous Steam Power Expenses (Major Only).

Pertinent Guidance

- 18 C.F.R. Part 101, Account 506, Miscellaneous Steam Power Expenses (Major Only), states:

This account shall include the cost of labor, materials used and expenses incurred which are not specifically provided for or are not readily assignable to other steam generation operation expense accounts.

Background

In its review of PNM's accounting activities, audit staff identified various remediation expenses that PNM recorded in Account 930.2, Miscellaneous General Expenses. These remediation expenses related to groundwater contamination in areas adjacent to PNM's Santa Fe Generating Station and Person Generating Station, which were steam power generating stations prior to their retirement. PNM installed water treatment facilities to remedy gasoline contamination in the groundwater in these areas after the operation of the generating stations. In an agreement with the New Mexico Environment Department (NMED), PNM agreed to operate the water treatment facilities until the groundwater meets applicable federal and state standards or until the NMED determines that additional remediation is not required, whichever is earlier.

PNM accounted for these remediation expenses by debiting Account 930.2 and crediting Account 253, Other Deferred Credits. The instructions for Account 930.2 state, in relevant part, that, "This account shall include the cost of labor and expenses incurred in connection with the general management of the utility not provided for elsewhere." Since these remediation expenses are not "incurred in connection with the general management of the utility," Account 930.2 is not the appropriate account to record this activity. Rather, these expenses were incurred to address water contamination related to the prior operations of the Santa Fe Generating Station and Person Generating Station, and should be recorded in Account 506, Miscellaneous Steam Power Expenses (Major Only). This accounting error did not result in customer overbilling because this expense was excluded from the formula rate and thus no refund is necessary.

Recommendations

We recommend that PNM:

25. Revise its accounting policies to ensure that production-related remediation expenses are accounted for in production expense accounts, consistent with the Commission's accounting regulations.

9. OASIS Posting of Transmission Schedules

PNM improperly posted certain transmission schedules associated with its transmission function and WPM as non-affiliated transactions on OASIS rather than affiliated transactions.

Pertinent Guidance

- 18 C.F.R. § 37.6(c)(4) states:

(4) For any transaction for transmission service agreed to by the Transmission Provider and a customer, the Transmission Provider (at the time when ATC must be adjusted in response to the transaction), must post on the OASIS (and make available for download) information describing the transaction (including: price; quantity; points of receipt and delivery; length and type of service; identification of whether the transaction involves the Transmission Provider's wholesale merchant function or any affiliate; identification of what, if any, ancillary service transactions are associated with this transmission service transaction; and any other relevant terms and conditions) and shall keep such information posted on the OASIS for at least 30 days. A record of the transaction must be retained and kept available as part of the audit log required in § 37.7.

Background

In its review of OASIS information, audit staff sampled transmission schedules from the period January 2015 to May 2018 and identified approximately 190,000 schedules that were incorrectly flagged as non-affiliated transactions. According to 18 C.F.R. § 37.6(c)(4), PNM must identify a transaction involving its wholesale merchant function or any affiliate. Audit staff's review of these transactions determined that these schedules were created by either PNM's transmission function or WPM personnel outside of OASIS using Transmission Service Numbers (TSN). According to PNM, in creating these schedules based on a template (specifically designed for non-OASIS reservations), PNM personnel inadvertently set the "Affiliate" column to N (No), which eventually led to this posting error on OASIS. For more information on PNM's use of TSNs, see Other Matter 1.

Recommendations

We recommend that PNM:

26. Develop and implement processes and procedures to verify schedules against non-OASIS reservations as part of its e-tag validation process to ensure the accuracy of all attributes, including the “Affiliate” flag.

10. Short-Term Transmission Capacity Reassignments

PNM did not execute transmission service agreements governing 15 non-affiliated transmission capacity reassignments prior to commencing the reassigned transmission service. Also, PNM did not report these reassignments in its EQR filings.

Pertinent Guidance

- PNM's OATT Section 23.1(b), Procedures for Assignment or Transfer of Service, states, in part:

The Assignee must execute a service agreement with the Transmission Provider governing reassignments of transmission service prior to the date on which the reassigned service commences.

- On September 18, 2008, the Commission issued a Notice Providing Guidance on the Filing of Information on Transmission Capacity Reassignments in Electric Quarterly Reports (Notice).²⁵ The Notice clarified that transmission providers must report their transmission capacity reassignment agreements in their EQR filings.²⁶ Furthermore, the Notice clarified that this reporting requirement applies equally to agreements for the temporary reassignment of transmission capacity and the full transfer of the rights and obligations of an assignor.²⁷

Background

Audit staff identified 15 non-affiliated transmission capacity reassignments on PNM's OASIS during the audit period. PNM allowed these reassignments to occur without executing the transmission service agreements with assignees governing the reassignments. Section 23.1(b) of PNM's OATT requires assignees to execute a service agreement with PNM governing reassignments of transmission service prior to the date when the reassigned service commences. PNM's practice of approving reassignments prior to executing a transmission service agreement with assignees does not comply with Section 23.1(b).

²⁵ <https://www.ferc.gov/whats-new/comm-meet/2008/091808/E-24.pdf>

²⁶ *Id.* P 6.

²⁷ *Id.* n. 9.

Audit staff also determined that PNM did not report these reassignments in its EQR filings. PNM explained that it did not do so because these transactions were temporary short-term reassignments between a transmission customer and its affiliate. However, the Commission clarified in its September 18, 2018 Notice that transmission providers must report their transmission capacity reassignment agreements in their EQR filings. Furthermore, the Notice stated that this reporting requirement applies equally to agreements for the temporary reassignment of transmission capacity as well as agreements for the full transfer of the rights and obligations of an assignor.

Recommendations

We recommend that PNM:

27. Develop and implement processes and procedures to ensure that transmission service agreements are executed prior to confirming reassignments of transmission capacity.
28. Refile the affected EQR filings in coordination with the re filings to be undertaken pursuant to Recommendation 31 in Finding 10 of this audit report.

Corrective Actions Taken

In July 2018, PNM implemented a quarterly process to review any changes, additions, and omissions to its transmission contracts prior to submitting its EQR filings.

Between June 2018 and August 2018, PNM resubmitted EQR filings to correct the contracts and transactions associated with its cost-based power sales identified in Finding 11, and the contracts associated with its short-term and partial transmission capacity reassignments identified in Findings 10 and 11, respectively.

11. EQR Filing Requirements

PNM's EQR filings contained reporting errors including the improper reporting of cost-based power sales and unreported capacity reassignments.

Pertinent Guidance

- Order No. 2001 requires companies to report EQR data that fall into two main categories: contract data and transaction data.²⁸ Contract data must include terms and conditions in agreements for all jurisdictional services (including market-based power sales, cost-based power sales, and transmission service).²⁹ Transaction data must include sales of capacity, energy, and ancillary services made under such contracts.³⁰
- 18 C.F.R. § 35.10b requires each public and nonpublic utility with more than a *de minimis* market presence to file an updated EQR with the Commission covering all services it provides under this part, for each calendar quarter. Also, EQRs “must be prepared in conformance with the Commission’s guidance posted on the FERC Web site (<http://www.ferc.gov>).”³¹
- Order No. 890 requires that public utilities must report all transmission capacity reassignments in their EQR filings.³² On September 18, 2008, the

²⁸ *Revised Public Utility Filing Requirements*, Order No. 2001, 99 FERC ¶ 61,107, at P 21, *reh’g denied*, Order No. 2001-A, 100 FERC ¶ 61,074, *reh’g denied*, Order No. 2001-B, 100 FERC ¶ 61,342, *order directing filing*, Order No. 2001-C, 101 FERC ¶ 61,314 (2002), *order directing filing*, Order No. 2001-D, 102 FERC ¶ 61,334, *order refining filing requirements*, Order No. 2001-E, 105 FERC ¶ 61,352 (2003), *order on clarification*, Order No. 2001-F, 106 FERC ¶ 61,060 (2004), *order revising filing requirements*, Order No. 2001-G, 120 FERC ¶ 61,270, *order on reh’g and clarification*, Order No. 2001-H, 121 FERC ¶ 61,289 (2007), *order revising filing requirements*, Order No. 2001-I, 125 FERC ¶ 61,103 (2008). *See also Filing Requirements for Electric Utility Service Agreements*, 155 FERC ¶ 61,280 (2016) (order clarifying reporting requirements and updating data dictionary).

²⁹ *Id.* at P 3.

³⁰ *Id.* at Attachment C.

³¹ 18 C.F.R. § 35.10b (2019).

³² Order No. 890, 118 FERC ¶ 61,119, *order on reh’g*, Order No. 890-A, 121 FERC ¶ 61,297 (2007), *order on reh’g*, Order No. 890-B, 123 FERC ¶ 61,299 (2008), *order on*

Commission issued its Notice Providing Guidance on the Filing of Information on Transmission Capacity Reassignments in Electric Quarterly Reports, thereby providing public utilities filing EQRs with guidance on reporting in their EQRs their transmission capacity reassignment agreements and the transactions they have made during the reporting period pursuant to those agreements.³³

Background

In its review of PNM's EQR filings, audit staff identified the reporting errors discussed below.

Cost-Based Power Sales

In its review of EQR information, audit staff identified contract and transaction reporting errors associated with cost-based power sales. Such reporting errors occurred in several quarters during the audit period, as identified below:

Type	Quarter	Related Contract ID / Transaction ID
Contract	Q1-2016	C4604
Transaction	Q2-2016	T2937 to T2949
Contract	Q2-2016	C4455 (24)
Transaction	Q3-2016	T1710 to T1985
Contract	Q4-2016	C4455
Contract	Q1-2017	C4611
Contract	Q2-2017	C4455
Contract	Q3-2017	C4455
Contract	Q4-2017	C4455
Contract	Q1-2018	C4455
Transaction	Q1-2018	T3679 to T3688
Transaction	Q2-2018	T1733 to T1878

Audit staff noted that all reporting errors were associated with transactions created under a standardized contract, the Western Systems Power Pool (WSPP) agreement filed

reh'g, Order No. 890-C, 126 FERC ¶ 61,228, *order on clarification*, Order No. 890-D, 129 FERC ¶ 61,126 (2009).

³³ <https://www.ferc.gov/whats-new/comm-meet/2008/091808/E-24.pdf>

as WSPP Rate Schedule FERC No. 6. According to PNM, a transaction created under a WSPP agreement can be a cost-based sale or a market-based sale depending on where power sinks. For example, if a trader sold power to an area under a Commission approved cost-based sales tariff, the trader would have to report this transaction under a cost-based tariff. However, PNM's deal capture system did not allow for traders to specify the appropriate tariff as cost-based or market-based. Instead, the traders had to flag a cost-based sale by adding a comment, such as "this is system contingent out of Afton and priced at IC (Incremental Cost) + 10%," which is a cost-based sale provision. PNM did not consistently flag the appropriate transactions and add the necessary comments, which resulted in the deal capture system automatically linking cost-based sales to a market-based tariff and resulted in those transactions being reported as market-based sales in the EQR.

To address this reporting error, PNM created a unique contract (PNM Cost Based Tariff Volume No. 7) in its deal capture system that traders can utilize when entering a cost-based sale into the system associated with a standardized contract such as the WSPP agreement. PNM has corrected erroneous EQR data files (contract and transaction) and resubmitted the revised files to the Commission.

Transmission Capacity Reassignments

Also, PNM did not report the following two partial capacity reassignments in its EQR filings (Q2-2016 and Q4-2017):

1. ID C24740 (Reassignment 474) was created to account for a partial capacity reassignment of 42 MW to Broadview Energy JN, LLC from Broadview Energy KW, LLC ID C2418 (Fourth Revised 418) of 172 MW.
2. ID C24920 (Reassignment 492) was created to account for a partial capacity reassignment of 5 MW to El Cabo Wind, LLC from Grady Wind Energy Center LLC, ID C2479 (First Revised 479) of 130 MW.

In addition, PNM did not report 15 short-term transmission capacity reassignment transactions. This issue is discussed in detail in Finding 9 – Short-Term Transmission Capacity Reassignments.

Recommendations

We recommend that PNM:

29. Enhance EQR filing procedures to ensure PNM reports data accurately and completely, and consistently complies with Commission EQR filing guidance.
30. Provide training on preparing and submitting EQR filings in accordance with Commission EQR filing guidance to personnel responsible for performing and overseeing these functions.
31. Begin an internal review process to examine all EQR filings made by PNM during the audit period.
32. Correct all the errors identified during the audit as well as those discovered its subsequent internal review process, and refile the amended EQR data for the most recent 12 quarters in a timely manner.

Corrective Actions Taken

In July 2018, PNM implemented a quarterly process to review any changes, additions, and omissions to its transmission contracts prior to submitting its EQR filings.

Between June 2018 and August 2018, PNM resubmitted EQR filings to correct the contracts and transactions associated with its cost-based power sales identified in Finding 11, and the contracts associated with its short-term and partial transmission capacity reassignments identified in Findings 10 and 11, respectively.

V. Other Matters

1. Use of Transmission Service Numbers

PNM's transmission function created Transmission Service Numbers (TSN), a subset of non-OASIS reservations, and assigned TSNs to WPM in order to facilitate scheduling of transmission service. Since TSNs are created outside of OASIS, PNM's scheduling of transmission service using the TSNs was less transparent than typical TSRs created in OASIS.

Background

In Order No. 889, the Commission stated that open access non-discriminatory transmission service requires that information about the transmission system must be made available to all transmission customers at the same time.³⁴ This means that public utilities must make available to others the same transmission information that is available to their own employees, including their own merchant function, and that is pertinent to decisions they make involving the sale or purchase of electricity.

In its review of PNM's transmission operations, audit staff learned about PNM's use of TSNs, which were created by PNM's transmission function and assigned to WPM. PNM typically used TSNs under two circumstances: 1) scheduling transmission over a transmission path that was not posted on OASIS; or 2) accommodating grandfathered agreements (pre-Order No. 888 services).

TSRs provide more transparency than TSNs in two primary ways. First, unlike TSNs, TSRs are automatically posted on OASIS. Second, while all transmission schedules are posted on OASIS, postings for schedules associated with TSRs include more information than postings for schedules associated with TSNs. PNM did not post its TSN practice on OASIS and it did not list its TSNs on its OASIS. Accordingly, by using TSNs, PNM scheduled transmission service that was not made available to all transmission customers at the same time.

PNM had 81 active TSNs during the audit period. However, in 2018 and 2019, PNM made efforts to reduce the number of active TSNs; PNM did not create any new

³⁴ *Open Access Same-time Information System and Standards of Conduct*, Order No. 889, FERC Stats. & Regs. ¶ 31,035, at III.A (1996) (cross-referenced at 75 FERC ¶ 61,078), *order on reh'g*, Order No. 889-A, FERC Stats & Regs. ¶ 31,049 (cross-referenced at 78 FERC ¶ 61,221), *reh'g denied*, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

TSNs, and PNM continues to evaluate TSN use and reduce the use of TSNs when possible with the exception of those needed for limited operational purposes.

Recommendations

We recommend that PNM:

33. Continue to evaluate and take actions to reduce the use of TSNs.
34. Post its TSN practices on OASIS and a list of TSNs (active and inactive) along with the intended business purpose.

2. After-the-Fact Reservation and Scheduling Practice

PNM performs an ATF review to determine overuse of transmission service by its transmission customers. However, this ATF review is not documented as a formal business practice and posted on OASIS. Audit staff encourages PNM to document this ATF review as a formal business practice and post the business practice document on OASIS in order to enhance transparency of the ATF review. The formal business practice should include PNM's ATF evaluation process, the approval/denial process, and information on the related transmission and ancillary service charges.

Background

PNM would consider a customer's ATF request for transmission service if ATC was available after the fact. In its review of ATF reservations, audit staff determined that PNM followed a consistent process in reviewing ATF requests for its transmission customers, including WPM. In addition, PNM charged an ATF reservation consistent with the transmission and ancillary service rates stated in its OATT. Audit staff did not identify any instance where PNM provided any preferential treatment to WPM when approving WPM's ATF requests as opposed to those of other non-affiliated customers. However, audit staff noted that PNM's ATF review is not documented as a formal business practice.

Recommendations

We recommend that PNM:

35. Document its ATF review as a formal business practice and post the business practice document on OASIS in order to enhance transparency of the ATF review, including PNM's ATF evaluation process, the approval/denial process, and information on the related transmission and ancillary service charges.

Attachment A – Company Response

Public Service Company of New Mexico
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Albuquerque, NM 87102
505-241-2498
Mark.Fenton@pnm.com



June 24, 2020

Steven D. Hunt
Director and Chief Accountant
Division of Audits and Accounting
Office of Enforcement
Federal Energy Regulatory Commission
888 First Street NE, Room 5K-13
Washington, DC 20426

Re: *Public Service Company of New Mexico,*
Docket No. PA18-1-000
Response to Draft Audit Report

Dear Mr. Hunt:

This letter is in response to the draft audit report (“Draft Report”), dated June 9, 2020, issued by the Federal Energy Regulatory Commission (the “Commission”), Office of Enforcement, Division of Audits and Accounting to Public Service Company of New Mexico (“PNM”).

The Draft Report evaluated PNM’s compliance with: (1) the terms, conditions, and rates of its Open Access Transmission Tariff (OATT), including its transmission formula rate mechanism as provided in Attachment H of its OATT and other jurisdictional rates on file with the Commission; (2) the accounting requirements of the Uniform System of Accounts for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; (4) the regulations regarding Open Access Same-time Information Systems (OASIS) prescribed in 18 C.F.R. Part 37; (5) the requirements of PNM’s market-based rate (MBR) authorizations, including the Commission’s MBR regulations under 18 C.F.R. Part 35, Subpart H and Electric Quarterly Report filing regulations under 18 C.F.R. § 35.10b; and (6) the regulations governing nuclear plant decommissioning trust funds prescribed in 18 C.F.R. Part 35, Subpart E. The audit covered the period from January 1, 2015 to December 31, 2019.

The Draft Report identifies eleven areas of noncompliance and thirty-two recommendations to remedy the noncompliance findings. PNM does not contest the Draft Report and generally agrees to the recommendations and corrective actions contained in the Draft Report to bring resolution to the audit. However, as described further in Attachment A, PNM provides comments on the Draft Report’s conclusions on several issues. These comments reflect that PNM remedied the majority of noncompliance issues during the course of the audit.

Mr. Steven D. Hunt
June 24, 2020
Page 2

Docket No. PA18-1-000

PNM takes its compliance obligations seriously and welcomes the opportunity to comment on the Draft Report in accordance with Part 41 of the Commission's regulations.¹ PNM would like to thank the Commission audit staff and notes their professionalism throughout the audit.

Sincerely,

/s/ Mark Fenton

Mark Fenton
Executive Director,
Regulatory Policy and Case Management
Public Service Company of New Mexico

¹ 18. C.F.R. 41.1(b).

Mr. Steven D. Hunt
June 24, 2020
Page 3

Docket No. PA18-1-000

Attachment A

Audit Staff Finding:

1. Independent Functioning of PNM's Transmission Function

During the audit period, upon its Wholesale Power Merchant (WPM) function's request, PNM's transmission function employees procured Point-to-Point (PTP) transmission service on certain paths for WPM function employees, contrary to the Commission's Independent Functioning Rule. As a result, PNM's transmission function employees conducted a marketing function and did not function independently of its marketing function employees.

PNM's Response:

PNM accepts this finding and the corresponding recommendations 1 through 4. As noted in the Draft Audit Report, PNM discontinued this practice upon its identification as a noncompliant activity and instituted new procedures whereby the WPM function now procures all transmission service itself through OASIS.

Audit Staff Finding:

2. Cost-Based Sales

PNM incorrectly used estimated transmission costs to price certain cost-based energy sales. These estimated costs did not reflect the actual transmission costs and resulted in PNM overcharging a transmission customer by approximately \$121,500.

PNM's Response:

PNM accepts this finding and the corresponding recommendations 5 through 7. As noted in the Draft Audit Report, PNM has fully refunded the amount and interest of the overcharges to the affected customer. As part of its corrective action, PNM also implemented a new process that provides several levels of review, including peer review and manager review, to ensure that cost-based sales (both day-ahead and real-time) are accurately priced.

Audit Staff Finding:

3. Use of Secondary Network Transmission Service

During the audit period, PNM's transmission function improperly allowed its WPM function to use secondary network transmission service to deliver energy outside of PNM's control area. For most of these instances, WPM used secondary network transmission service to deliver energy to two generation plants located outside of PNM's control area in order to facilitate station service at those locations. As a result, PNM did not follow the requirements of its OATT associated with the use of secondary network transmission service.

Mr. Steven D. Hunt
June 24, 2020
Page 4

Docket No. PA18-1-000

PNM Response:

PNM accepts this finding and the corresponding recommendations 8 through 10. As noted in the Draft Audit Report, PNM developed and implemented a new business practice that requires PNM's transmission function employees to deny any network customer's secondary network transmission service requests that do not serve the customer's designated network load.

Audit Staff Finding:

4. Termination of Network Resources

PNM did not fully implement Commission-approved North American Energy Standards Board (NAESB) standards that require network customers to submit terminations (temporary and indefinite) of network resources through OASIS in a timely manner. As a result, PNM allowed its network customers to submit terminations of network resources outside of OASIS for more than two years after the Order No. 676-H compliance deadline of March 1, 2017.

PNM Response:

PNM accepts this finding and the corresponding recommendations 11 and 12. As noted in the Draft Audit Report, PNM has fully completed audit staff's recommendation.

Audit Staff Finding:

5. Asset Retirement Obligations

PNM did not obtain Commission approval in advance of recovering asset retirement obligation costs in its transmission formula rate calculations. Also, PNM did not file its accounting entries with the Commission to reclassify approximately \$37 million from Account 108, Accumulated Provision for Depreciation of Electric Utility Plant (Major Only) to Account 435, Extraordinary Deductions.

PNM Response:

PNM accepts this finding and the corresponding recommendation 13.

Audit Staff Finding:

6. Allowance for Funds Used During Construction

PNM's methods for calculating and accounting for its AFUDC rate were deficient and caused PNM's AFUDC to exceed the maximum AFUDC permitted by the Commission's regulations.

Mr. Steven D. Hunt
June 24, 2020
Page 5

Docket No. PA18-1-000

PNM Response:

PNM accepts this finding and the corresponding recommendations 14 through 22.

Audit Staff Finding:

7. Accounting for Commitment Fees

PNM improperly accounted for upfront and quarterly commitment fees that it paid for a credit facility, in Accounts 428, Amortization of Debt Discount and Expense, and 431, Other Interest Expense, respectively, and included these items in its calculation of short-term debt interest expense used to compute its AFUDC rate.

PNM Response:

PNM accounted for upfront and quarterly commitment fees in Accounts 428 and 431 based on PNM's interpretation of the Commission's rules and regulations and past audit experience. PNM accepts this finding and the corresponding recommendations 23 and 24. PNM will revise its procedures to exclude upfront and quarterly commitment fees related to its short-term credit facility from the cost of short-term debt when calculating its AFUDC rate and record the amounts in Account 930.2 going forward and recover those costs as operating expenses in its FERC formula rates.

Audit Staff Finding:

8. Production-Related Remediation Expenses

PNM improperly accounted for remediation expenses related to its Santa Fe and Person Generating Stations in Account 930.2, Miscellaneous General Expenses. Since these expenses are production-related expenses, they should have been recorded in Account 506, Miscellaneous Steam Power Expenses (Major Only).

PNM Response:

PNM accounted for remediation expenses related to its Santa Fe and Person Generating Stations in Account 930.2 based on PNM's interpretation of the Commission's rules and regulations. PNM accepts this finding and the corresponding recommendations 25.

Audit Finding:

9. OASIS Posting of Transmission Schedules

PNM improperly posted certain transmission schedules associated with its transmission function and WPM as non-affiliated transactions on OASIS rather than affiliated transactions.

Mr. Steven D. Hunt
June 24, 2020
Page 6

Docket No. PA18-1-000

PNM Response:

PNM accepts this finding and the corresponding recommendation 26. On September 9, 2019, PNM notified audit Staff that after Site Visit #3, PNM's Transmission Function stopped securing Transmission Service Reservations on behalf of the Transmission Customer. In reference to the "Affiliate" column, this column was included in the SJWM template, which was used to create TSNs on behalf of the customer (i.e. PNMM), the SJWM template had not been used and will no longer be used due to the fact that PNM has stopped securing Transmission reservation on behalf of the customer.

Audit Finding:

10. Short-Term Transmission Capacity Reassignments

PNM did not execute transmission service agreements governing 15 non-affiliated transmission capacity reassignments prior to commencing the reassigned transmission service. Also, PNM did not report these reassignments in its EQR filings.

PNM Response:

PNM accepts this finding and the corresponding recommendations 27 and 28. As noted in the Draft Audit Report, between June 2018 and August 2018, PNM resubmitted EQR filings to correct the contracts and transactions associated with its cost-based power sales identified in Finding 11, and the contracts associated with its short-term and partial transmission capacity reassignments identified in Findings 10 and 11, respectively.

Audit Finding:

11. EQR Filing Requirements

PNM's EQR filings contained reporting errors including the improper reporting of cost-based power sales and unreported capacity reassignments.

PNM Response:

PNM accepts this finding and the corresponding recommendations 29 through 32. As noted in the Draft Audit Report, between June 2018 and August 2018, PNM resubmitted EQR filings to correct the contracts and transactions associated with its cost-based power sales identified in Finding 11, and the contracts associated with its short-term and partial transmission capacity reassignments identified in Findings 10 and 11, respectively.