

**The following letter was sent to each of PNM's network integration transmission service customers on July 30, 2007. Those customers are the following:**

**Tri-State Generation and Transmission Association, Inc.  
Incorporate County of Los Alamos, New Mexico  
PNM Merchant for City of Aztec, New Mexico  
PNM Merchant for City of Gallup, New Mexico  
Western Area Power Administration for Kirtland Air Force Base  
Navopache Electric Cooperative  
Navajo Tribal Utility Authority**

July 30, 2007

Subject: Compliance with Federal Energy Regulatory Commission ("FERC")  
Order No. 890

As you are aware, the FERC issued Order No. 890 on February 16, 2007, with a compliance date of July 16, 2007 for certain actions. Of particular relevance to this communication is the filing of a compliance Open Access Transmission Tariff ("OATT") and implementation of certain provisions of FERC's modified pro-forma OATT.

PNM has posted its compliance OATT on its Open Access Same-Time Information System ("OASIS") site and has established a folder specifically for documents related to compliance with Order No. 890. Certain actions were required to be completed within sixty days (later increased to one hundred twenty) and additional compliance activities related to direction provided to the North American Electric Standards Board ("NAESB") and North American Electric Reliability Council ("NERC") will take up to a full year to complete.

PNM brings the following specific items to your attention, as we believe they merit special mention in the context of the relationship with our network integration transmission service ("NITS") customers. This notice is not intended to address all the issues addressed in Order No. 890 and we would strongly urge that you review the Order to better understand the NITS customer and Transmission Provider responsibilities.

PNM brings your attention to these items:

**Undesignation of Network Resources for Firm Generation Sales**

As you are aware, each NITS customer is required to designate network resources per the provisions of OATT Section 29.2. PNM plans and operates the transmission system in a

manner that will accommodate delivery of all network resources to both retail native load and wholesale native load served by NITS agreements.

In Order No. 890, FERC has clarified that customers who wish to use designated network resources (“DNRs”) to make firm wholesale sales must “undesignate” those DNRs for the time period over which such sales are intended to be made. Please see paragraphs 1539 through 1559 of Order No. 890 in particular regarding FERC’s determination on this subject.

Further, FERC has directed NAESB to develop the required OASIS templates to provide for online designation and undesignation of network resources for purposes of making firm off-system sales.

During the interim period while awaiting the development by NAESB of the templates and process as directed by FERC, PNM has implemented a business practice requiring undesignation to be made on a day-ahead basis, following the scheduling provisions of Section 13.8 of the OATT. At such time as the NAESB work in this area is completed and PNM can accommodate hourly undesignation on an automated basis, PNM will so advise. Any undesignation of DNRs must be received by fax or e-mail no later than 10 a.m. of the day ahead of the intended firm power sale. The undesignation should state that redesignation will occur at the termination of the undesignation period, unless indefinite termination of the DNR is sought (see Order No. 890 at paragraph 1541).

To comply with the transparency requirements in interim prior to having the proper OASIS functionality, PNM will post the undesignation notifications in a folder on its OASIS site under Order No. 890 compliance. Further, during the interim period, PNM has posted a listing of each NITS customer’s DNRs. To the extent a NITS customer procures its DNRs via a power purchase agreement (“PPA”) with PNM’s merchant function, we have indicated that resource and an estimate of the total network load served under the NITS using the PNM merchant PPA.

### **Sales from Designated and Undesignated Network Resources**

As described in paragraph 1692 of Order No. 890, NITS customers are allowed to make non-firm sales from DNRs without using the undesignation process.

However, any firm power and energy sale transactions that a NITS customer makes using one or a combination of DNR(s), regardless of the duration, must be preceded by undesignating the DNR(s) as described above. Such a transaction requires multiple steps including undesignation, transmission reservation and tagging. A NERC tag for a transaction that fails to comply with FERC's designation/undesignation rules for firm off-system sale of a DNR is subject to denial. PNM will make reasonable efforts to correct and/or resolve such situations to the extent PNM is aware they exist, but PNM does not accept any burden to do so. The responsibility for undesignating, reserving and tagging transactions in a manner that complies with Order No. 890 falls on the NITS

customer, and repeated failures to comply with designation/undesignation rules may be reported to the FERC in accordance with paragraph 1580 of Order No. 890.

### **Energy Imbalance Service**

FERC has made several changes to the pricing mechanism for Ancillary Service Schedule 4 – Energy Imbalance Service. Energy imbalance services that occur within a deviation band of +/- 1.5 percent (with a minimum of 2 MW) are reimbursed in kind. That portion of the pricing of the Energy Imbalance Service will not change under the Order No. 890 OATT.

Under the pre-Order No. 890 OATT, PNM provided Energy Imbalance Service under two pricing options for a NITS customer that either under or over generated. These prices were the higher of \$100/MWh or PNM's incremental cost plus 10 percent when the customer undergenerated its supplied energy or 90 percent of decremental cost if the customer oversupplied the energy.

Under the Order No. 890 OATT, PNM is required to change both the deviation band parameters and the pricing. The pricing bands are now the following:

1. Band 1 is for deviations within the +/- 1.5% band with a 2 MW minimum and these will continue to be repaid in kind.
2. Band 2 is for deviations between 1.5 percent and 7.5 percent (or 2 MW to 10 MW, whichever is larger). Compensation for deviations in Band 2 will be 110 percent of incremental cost or 90 percent of decremental cost.
3. Band 3 is for deviations greater than 7.5 percent or 10 MW, whichever is larger. Compensation for deviations in Band 3 will be 125 percent of incremental cost or 75 percent of decremental cost.

In addition, to the extent PNM collects penalty revenues (representing costs in excess of incremental costs) due to customer payments from undergeneration in Bands 2 or 3, PNM is obligated to distribute those penalty costs to non-offending transmission service customers, including its own retail native load. PNM has posted a mechanism on the OASIS in the Order No. 890 compliance folder with its proposal to FERC as to how it will accomplish the distribution of such penalty revenues.

### **Creditworthiness Policy**

Order No. 890 directed transmission providers to post their creditworthiness policy on the OASIS and incorporate provisions within the OATT. PNM has posted such a policy. For purposes of NITS customers, PNM's position is that initially each existing NITS customer meets creditworthiness standards and will not require any form of financial security. Going forward, PNM will review annually (or as circumstances dictate otherwise) each transmission service customer to ascertain whether they meet creditworthiness standards and will so advise. PNM will send letters to each NITS customer advising that each meet our posted creditworthiness criteria.

Should you have any questions about the items described above, please contact me at (505) 241-2850.

Sincerely,

Mike Edwards

Cc: Greg Miller  
Jeff Mechenbier  
Dave Eubank  
Keith Nix  
Don Lacen  
Richard Krajewski