

## **SECURITIES AND EXCHANGE COMMISSION**

**(Release No. 35-27979; 70-10285)**

**PNM Resources, Inc., et al.**

### **Order Authorizing Acquisition of Exempt Public Utility Holding Company by Registered Holding Company; Authorizing Amendments to Restated Articles of Incorporation**

**June 1, 2005**

PNM Resources, Inc. (“PNM Resources”), Albuquerque, NM, a registered holding company, Cascade Investment, L.L.C. (“Cascade”), Kirkland, WA, a limited liability company formed under the laws of the State of Washington, and William H. Gates III (“Mr. Gates”), Redmond, WA, Cascade’s sole member (collectively, “Applicants”), have filed with the Securities and Exchange Commission (“Commission”) an application-declaration (“Application”) under sections 6(a), 7, 9(a)(1), 9(a)(2), 10, 11, 12(e) and 13(b) of the Public Utility Holding Company Act of 1935, as amended (“Act”), and rules 51, 54, 62-65, 90 and 91 under the Act. The Commission issued a notice of proposal to amend Restated Articles of Incorporation (“Restated Articles”) and an order authorizing the solicitation of proxies in a notice-order issued on March 30, 2005 (Holding Co. Act Release No. 27954). The Commission also issued a notice of the Application on April 7, 2005 (Holding Co. Act Release No. 27957).

PNM Resources proposes to acquire all of the outstanding voting securities of TNP Enterprises, Inc. (“TNP Enterprises”), a public utility holding company claiming exemption by rule 2 under the Act (the acquisition is referred to as the “Transaction”). TNP Enterprises has subsidiary electric utility operations in Texas and New Mexico conducted by Texas-New Mexico Power Company (“TNMP”), its public utility

subsidiary. Further, as described below Cascade currently owns about 8.61% of the outstanding common stock of PNM Resources. As a result of this preexisting stock ownership, Cascade and Mr. Gates will indirectly acquire 5% or more of the outstanding voting securities of TNMP in the Transaction. Accordingly, Cascade and Mr. Gates also seek approval under sections 9(a) (2) and 10 of the Act to acquire more than 5% but less than 10% of the voting securities of TNMP. PNM Resources is also requesting authorization to amend its Restated Articles of Incorporation (“Restated Articles”) following shareholder approval of the amendments at its annual meeting held May 17, 2005.

## **I. Parties to the Transaction**

### **A. PNM Resources and its Subsidiaries**

PNM Resources became an exempt public utility holding company on December 31, 2001, and conducts its operations consistent with the order of the New Mexico Public Regulation Commission (“NMPRC”) which authorized the holding company structure. Except for certain corporate support services provided to its subsidiaries at cost pursuant to that order, PNM Resources conducts no business operations other than as a holding company. PNMR Services Company (“Services”) is a subsidiary service company, which provides services at cost to the subsidiaries of PNM Resources. PNM Resources filed a notice of registration under the Act on December 30, 2004, and transferred its service functions to Services on January 1, 2005. PNM Resources reported operating revenues of \$1,604,792,000 and operating income of \$112,898,000, for the year ended December 31, 2004; PNM Resources had assets of \$3,487,635,000 as of December 31,

2004. As of March 31, 2005, PNM Resources had total assets of \$3,776,490,000.<sup>1</sup>

PNM Resources' only public utility company subsidiary is Public Service Company of New Mexico ("PNM"), a New Mexico corporation. PNM is an electric and gas public utility company. It is engaged in the generation, transmission, and distribution of electric energy at retail in the State of New Mexico and makes sales for resale ("wholesale" sales) of electricity in interstate commerce. PNM is also engaged in the distribution of natural gas in the State of New Mexico, which includes some off-system wholesale sales of natural gas. PNM had electric revenues for 2004 of \$558,412,000, excluding wholesale sales. Its 2004 electric wholesale sales were \$554,634,000; natural gas operating revenues for 2004 were \$490,921,000.<sup>2</sup>

Through two of its subsidiaries, Luna Power Company LLC, a Delaware limited liability company, and PNMR Development & Management Corporation, a New Mexico corporation, PNM Resources owns a one-third interest in the Luna Energy power generation facility under development near Deming, New Mexico. When complete the project will consist of a 570 MW combined cycle gas-fired generating plant.

PNM Resources' current nonutility activities are conducted through Avistar, Inc. ("Avistar"), a company engaged solely in developing and marketing power system technologies. PNM Resources has the following inactive direct nonutility subsidiaries: EIP Refunding Corporation, PNM Electric & Gas Services, Inc., Sunbelt Mining Co. Inc., Sunterra Gas Gathering Company, and Sunterra Gas Processing Company. PNM

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<sup>1</sup> For the quarter closing March 31, 2005, PNM Resources had operating revenues of \$429,657,000 and operating income of \$37,818,000.

<sup>2</sup> PNM Resources' first quarter 2005 electric operating revenues were \$264,134,000; its gas operating revenues were \$165,286,000.

Resources also has the following indirect inactive nonutility subsidiaries: Gas Company of New Mexico (directly owned by Sunbelt Mining Co. Inc.), Meadows Resources, Inc. (directly owned by PNM) and its subsidiaries, Bellamah Associates, Ltd., Bellamah Community Development, Bellamah Holding Company, Bellamah Investors Ltd., MCB Financial Group and Republic Holding Company. PNM also factors its receivables through a financing subsidiary, PNM Receivables Corporation, but does not offer the service to non-affiliates.

PNM is subject to the jurisdiction of the NMPRC with respect to its retail electric and gas rates, service, accounting, issuance of securities, construction of major new generation and transmission facilities and other matters regarding retail utility services provided in New Mexico. PNM's principal business segments are wholesale operations and utility operations. Utility operations include Electric Services ("Electric"), Transmission Services ("Transmission") and Gas Services ("Gas"). In addition, PNM owns Merchant Plant (authorized power generation facilities that are not certified by the NMPRC to provide service to New Mexico retail customers and thus are not included in rate base) that is subject to a settlement agreement approved by the NMPRC, described below. PNM serves approximately 471,000 natural gas customers and 413,000 electric customers in New Mexico.

PNM's wholesale operations consist of the generation and sale of electricity into the wholesale market based on three product lines that include long-term contracts, forward sales and short-term sales. The source of these sales is supply created by selling energy not needed at the time by retail customers as well as the capacity of PNM's generating plant investment excluded from retail rates. The "regulated generation"

(generation in rate base), “unregulated generation” (certain generation excluded from rate base) and “Merchant Plant” (including certain generation excluded from rate base) are jointly dispatched.

Electric consists of the distribution and generation of electricity for retail electric customers in New Mexico. PNM provides retail electric service to a large area of north central New Mexico, including the cities of Albuquerque and Santa Fe, and certain other areas of New Mexico. PNM owns or leases generation located in the States of Arizona and New Mexico within the Western Electricity Coordinating Council (“WECC”) region, a National Electric Reliability Council region including much of the Western United States and portions of Canada and Mexico. PNM is also interconnected with the Southwest Power Pool. PNM experienced a peak electrical demand on its system of 1655 MW in 2004. PNM owns or leases 1729 MW of generating capacity. Additional capacity is purchased from third parties under certain power purchase agreements that may be accounted for as leases, for a total of 2417 MW available capacity.

Transmission consists of the transmission of electricity over transmission lines owned or leased by PNM, interconnected with other utilities in New Mexico and south and east into Texas, west into Arizona and north into Colorado and Utah. PNM owns or leases approximately 2,900 circuit miles of transmission lines. PNM owns and operates in excess of 8400 miles of distribution lines excluding street lighting in New Mexico.

The PNM Gas segment includes the transportation and distribution of natural gas to end users, including end users in most of the major communities in New Mexico, including two of New Mexico’s three largest metropolitan areas, Albuquerque and Santa

Fe. The Gas Segment operates as an integrated system and includes approximately 11,840 miles of natural gas distribution lines.

Applicants state that the Merchant Plant owned by PNM constitutes utility assets within the meaning of the Act, and will be available through joint dispatch to support service to the retail customers of PNM. PNM's Merchant Plant activities are governed by a Global Electric Settlement Agreement ("Global Settlement") that was entered into on October 10, 2002, among PNM, the NMPRC staff, the New Mexico Attorney General, and other consumer groups.

#### **B. TNP Enterprises and its Subsidiaries**

TNP Enterprises was organized as a holding company in 1983 and transacts business through its subsidiaries. On April 7, 2000, under an Agreement and Plan of Merger among TNP Enterprises, ST Acquisition Corp. ("ST Corp.") and SW Acquisition, the parent of ST Corp., ST Corp. merged with and into TNP Enterprises (the "Merger"). TNP Enterprises is the surviving corporation in the Merger, and is wholly-owned by SW Acquisition.

TNP Enterprises' principal operations are conducted through two wholly-owned subsidiaries: TNMP and First Choice Power Special Purpose, L.P. TNMP is a state regulated utility operating in Texas and New Mexico. In Texas, TNMP provides regulated transmission and distribution services under legislation that established retail competition in Texas. For the years ending December 31, 2004, TNP Enterprises reported operating revenues of \$718,880,000 and operating income of \$109,216,000; TNP Enterprises reported assets of \$1,291,937,000 as of December 31, 2004. TNP Enterprises reported a net loss for calendar year 2004 of \$75,603,000 and negative

shareholder equity of \$29,680,000. For the first quarter of 2005, TNP Enterprises had a net loss applicable to common stock holders of \$11,098,000; As of March 31, 2005, TNP Enterprises had total assets of \$1,281,692,000.

In New Mexico, TNMP provides electricity service that includes transmitting, distributing, purchasing, and selling electricity to its New Mexico customers. The TNMP utility assets located in New Mexico are connected with the PNM system and operate as a sub-area of the PNM control area. Wholesale power transactions involving the TNMP New Mexico assets are scheduled through PNM's control center.

TNMP's Texas operations lie entirely within the Electric Reliability Council of Texas ("ERCOT") region. ERCOT is the independent system operator that is responsible for maintaining reliable operations of the bulk electric power supply system in the ERCOT region, which is located entirely within Texas and serves about 85% of the electrical load in Texas. First Choice was organized in 2000 to act as TNMP's affiliated retail electric provider, as required by the Texas restructuring legislation that requires competitive access to electricity supplies.

TNMP has two inactive subsidiaries: Texas Generating Company, LP ("TGC"), a Texas limited partnership, and Texas Generating Company II, LLC ("TGC II"), a Texas limited liability company. TNMP formed TGC and TGC II as Texas corporations to finance construction of TNP One, formerly its sole generation facility. Until May 2001, TNMP owned TNP One together with TGC and TGC II. At that time, TNMP converted TGC and TGC II to their present forms and consolidated the ownership of TNP One into TGC to comply with restructuring legislation. Neither TNMP nor TNP Enterprises any

longer owns, directly or indirectly, any interest in generating plants. PNM Resources proposes to retain these subsidiaries in their present inactive status.

Effective January 1, 2002, Texas restructuring legislation established retail competition in the Texas electricity market. Prior to January 1, 2002, TNMP operated as an electric utility in Texas, generating, transmitting and distributing electricity to customers in its Texas service territory. As required by the Texas restructuring legislation, and in accordance with a plan approved by the Public Utility Commission of Texas (“PUCT”), TNMP separated its Texas utility operations into three components:

*Retail Sales Activities.* First Choice assumed the activities related to the sale of electricity to retail customers in Texas, and, on January 1, 2002, TNMP’s customers became customers of First Choice, unless they chose a different retail electric provider. First Choice and other retail electric providers now perform all activities with Texas retail customers, including acquiring new customers, setting up accounts, billing customers, acquiring power for resale to customers, handling customer inquiries and complaints, and acting as a liaison between the transmission and distribution companies and the retail customers.

*Power Transmission and Distribution.* TNMP continues to operate its regulated transmission and distribution business in Texas.

*Power Generation.* TGC became the unregulated entity performing TNMP’s generation activities in Texas. However, in October 2002, TNMP and TGC sold TNP One to Sempra Energy Resources. As a result of the sale, TGC and TGC II neither own property nor engage in any operating activities, and neither TNMP nor any of its affiliates are currently in the power generation business.

TNMP serves smaller- to medium-sized communities. TNMP provides electric service, either directly or through retail electric providers, to approximately 256,000 customers in 85 Texas and New Mexico municipalities and adjacent rural areas. Only three of the 85 communities in TNMP’s service territory have populations exceeding 50,000. TNMP’s service territory is organized into two operating areas: Texas and New



Mexico. In most areas that TNMP serves, it is the exclusive provider of transmission and distribution services. First Choice had approximately 219,000 customers in Texas as of December 31, 2004.

TNP Enterprises also wholly-owns several small subsidiaries which are inactive: TNP Technologies, LLC (a Texas limited liability company for real property acquisition in New Mexico); TNP Operating Company (inactive Texas corporation for real property acquisition in Texas and New Mexico); Facility Works, Inc. (inactive Texas corporation formerly engaged in heating, ventilating, and air conditioning service); TNP Enterprises-Magnus, L.L.C. (inactive Texas limited liability company intended for exempt business development). Applicants propose to retain these subsidiaries as inactive subsidiaries solely for winding up their affairs, absent further Commission authorization.

### **C. Cascade**

Cascade is a limited liability company formed under the laws of the State of Washington. Mr. Gates is Cascade's sole member. Cascade was formed in 1995 to make and hold certain investment securities for Mr. Gates. Cascade invests in and holds the securities of numerous publicly and privately held companies; it does not conduct any business operations of its own.

By order dated July 17, 2001 (Holding Co. Act Release No. 27427) (the "Cascade Order"), the Commission authorized Cascade and Mr. Gates to acquire 5% or more (but less than 10%) of the outstanding voting securities of three public utility or holding companies: PNM Resources, Otter Tail Corporation ("Otter Tail"), which provides electric service in portions of Minnesota, North Dakota and South Dakota, and Avista Corporation ("Avista"), which provides electric and gas service in portions of

Washington, Idaho, Oregon and California. Cascade currently holds 5,541,150 shares (or approximately 8.61%) of the outstanding common stock of PNM Resources and 2,389,299 shares (or approximately 8.2 %) of the outstanding common stock of Otter Tail. Subsequent to the issuance of the Cascade Order, Cascade reduced its ownership interest in Avista's common stock to below 5% of the total outstanding and is therefore no longer an "affiliate" of Avista.

In connection with the proposed Transaction, Cascade has agreed to purchase \$100 million in equity-linked securities of PNM Resources to enable PNM Resources to finance a portion of the redemption of high cost debt and preferred stock of TNP Enterprises. Applicants state that Cascade and Mr. Gates are joined as Applicants in this Application because they will indirectly acquire 5% or more but less than 10% of the voting securities of TNP Enterprises by virtue of Cascade's existing ownership of common stock in PNM Resources. Applicants state that in all other respects, the terms and conditions of the Cascade Order will remain in effect and undisturbed.

## **II. Requested Authority**

### **A. TNP Acquisition**

PNM Resources and SW Acquisition, L.P. ("SW Acquisition"), the holder of all of the shares of common stock (no par value per share) of TNP Enterprises, entered into a stock purchase agreement ("SPA") dated as of July 24, 2004. Pursuant to the SPA, PNM Resources agreed to purchase an aggregate of 100 shares of common stock, no par value per share, of TNP Enterprises. These shares constitute all of the issued and outstanding shares of common stock of TNP Enterprises. The closing of the Transaction will occur

on the third business day following the receipt of all regulatory approvals and the satisfaction of other conditions precedent.

The aggregate purchase price that PNM Resources is to pay to acquire the TNP Enterprises stock held by SW Acquisition, consisting of all the voting securities of TNP Enterprises, is \$189,000,000, subject to certain adjustments specified in the SPA. The purchase price that PNM Resources will pay to SW Acquisition will comprise (i) a cash amount equal to 50% of the purchase price and (ii) a number of shares of common stock, no par value, of PNM Resources by the Per Share Amount (the Per Share Amount is \$20.20, subject to certain conditions). No later than five business days prior to the closing, the chief financial officer of TNP Enterprises will deliver to PNM Resources a written statement of the estimated purchase price including all adjustments. It is estimated that the PNM Resources common stock acquired by SW Acquisition will equal 4.7 million newly issued shares, or 6% of the outstanding voting securities of PNM Resources, which will be held by SW Acquisition in a purely custodial role pending immediate distribution to its constituent partners. Pursuant to the SW Acquisition limited partnership agreement, the consideration for the sale, including the common stock received, will be divided proportionally in accordance with each partners' economic interest. The largest interests, those of Continental Casualty Company and CIBC WG Argosy Merchant Fund 2, L.L.C., account for 35% and 21.93% of the PNM Resources shares received as consideration, respectively. As a result, following the closing of the Transaction, no partner in SW Acquisition will own, with power to vote, 5% or more of the voting securities of PNM Resources.

PNM Resources will restructure much of the approximately \$835 million outstanding of TNP Enterprises debt and senior redeemable cumulative preferred stock with securities and financing that TNP Enterprises could not have issued or secured on its own. PNM Resources will reduce TNP Enterprises debt by about \$500 million and will save at least \$40 million in interest costs and preferred dividend payments. Following a mandatory thirty day notice of redemption period initiated upon the closing of the acquisition by PNM Resources, all of the debt and preferred securities issued by TNP Enterprises will be redeemed and TNP Enterprises will cease to have any debt. TNMP will continue to have debt outstanding to the public.

After the Transaction, TNP Enterprises will no longer conduct active business operations or financing and will retain no personnel or operational authority.

#### **B. Articles Amendment**

In order to finance a portion of the acquisition cost, PNM Resources will issue and sell 4,000,000 units of its 6.625% Hybrid Income Term Security Units (the "Units") to Cascade in consideration for \$100,000,000. Each Unit will have a stated amount of \$25.00. The proceeds of the sale of the Units will be used by PNM Resources to finance a portion of the cash consideration paid in the Transaction and for refinancing the debt and preferred securities of TNP Enterprises. The Units will be sold pursuant to the terms of a Unit Purchase Agreement, dated August 13, 2004, between PNM Resources and Cascade (the "UPA"). Each Unit consists of two components, (i) a forward purchase contract which obligates the holder (Cascade or an affiliate of Cascade) to purchase and PNM Resources to sell, no later than February 16, May 16, August 16 or November 16 first following the third (3rd) anniversary of the issuance of the Units, a specified number

of shares of PNM Resources common stock (“Common Shares”) (subject to anti-dilution adjustments), and (ii) a 1/40, or 2.5%, ownership interest in one of PNM Resources’ senior notes (“Senior Notes”) (A) with a principal amount of \$1,000, (B) with an initial maturity date of February 16, May 16, August 16, or November 16 next preceding the fifth (5th) anniversary date of the initial issuance of the Units, and (C) bearing interest at a rate per annum (not to exceed 6.625%) to be set at the market at or near the date of issuance.

Pursuant to Section 8.8 of the UPA, Cascade (or any Cascade affiliate holder of the Units) shall have the right to purchase PNM Resources’ Convertible Preferred Stock, Series A (the “Preferred Shares”) *in lieu* of Common Shares. Each Preferred Share is convertible at any time, at the option of the holder, into ten (10) Common Shares, subject to adjustment for stock splits, combinations, reclassifications, mergers, consolidations, sales of assets and other transactions.

Specifically, under the Restated Articles, as proposed to be amended, the Preferred Shares, voting as a single class with PNM Resources’ common stock, will be entitled to the number of votes to which the shares of common stock into which the Preferred Shares are convertible are entitled to vote on all matters required to be submitted to a vote of common stockholders (as described immediately below), other than the right to vote in the election of directors. Also, there is a limit on the aggregate amount of preferred stock outstanding with such voting rights. The limit is such that outstanding preferred stock with such voting rights may be convertible to no more than 12 million shares of common stock.

New Mexico law establishes certain class voting requirements. See, N.M. STAT. ANN. § 53-13-3 (2001). The holders of each class of shares may vote as a class upon a proposed amendment to a corporation's articles of incorporation, even if the articles of incorporation do not grant such voting rights to the class, if the amendment would: (A) effect an exchange, reclassification or cancellation of all or part of the shares or the class; (B) effect an exchange or create a right of exchange of all or any part of the shares of another class into the shares of the class; (C) change the designation, preferences, limitations or relative rights of the shares of the class; (D) change the shares of the class into the same or a different number of shares of the same class or another class; (E) create a new class of shares having rights and preferences prior and superior to the shares of the class or increase the rights and preferences or the number of authorized shares of any class having rights and preferences prior or superior to the shares of the class; (F) in the case of a preferred or special class of shares, divide the shares of the class into a series and fix and determine the designation of the series and the variations in the relative rights and preferences between the shares of the series or authorize the board of directors to do so; (G) limit or deny the existing preemptive rights of the shares of the class; or (H) cancel or otherwise affect dividends on the shares of the class which have accrued but have not been declared). In addition to these statutory voting rights, pursuant to the Rules of the New York Stock Exchange ("NYSE"), shareholders of companies listed on the exchange are entitled to vote on transactions deemed to affect their rights as shareholders, such as involving the issuance of common stock or convertible securities to related parties and equity compensation plans.

The proposed amendment to PNM Resources' Restated Articles to confer the additional (*i.e.*, non-statutory) voting rights on the Preferred Shares requires the approval of the common stockholders of PNM Resources. The proposed amendments to the Restated Articles were approved by the shareholders of PNM Resources at the annual shareholders meeting held on May 17, 2005.

As previously indicated, Cascade and Mr. Gates are joined as Applicants in this Application because they will be deemed to indirectly acquire 5% or more of the voting securities of TNP Enterprises by virtue of Cascade's existing ownership of common stock in PNM Resources. Cascade is not seeking any approval to purchase the Units, since it is Cascade and PNM Resources may, by mutual agreement, adjust the timing of the sale of the Units to coincide with the refunding of the outstanding debt and preferred securities of TNP Enterprises following a mandatory thirty day notice of redemption issued by PNM resources immediately upon closing its acquisition of the voting securities of TNP Enterprises. Applicants state that the issuance of the securities to Cascade by PNM Resources will be subject to, and is consistent with the existing authorization of PNM Resources to issue securities.<sup>3</sup>

Cascade and PNM Resources may, by mutual agreement, adjust the timing of the sale of the Units to coincide with the refunding of the outstanding debt and preferred securities of TNP Enterprises following a mandatory thirty day notice of redemption issued by PNM resources immediately upon closing its acquisition of the voting securities of TNP Enterprises. The issuance of the securities to Cascade by PNM

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<sup>3</sup> Holding Company Act Release No. 27934 (December 30, 2004).

Resources will be subject to, and is consistent with the existing authorization of PNM Resources to issue securities.<sup>4</sup>

PNM Resources proposes to utilize cash on hand and the proceeds from securities issuances (including the Unit Sale to Cascade) to reduce the leverage of the TNP Enterprises system. Based upon March 31, 2005 estimates and an anticipated May 15, 2005 closing, PNM Resources' projected debt-to-capitalization ratio as of December 31, 2005, is 53.1%. After the proposed restructuring transactions, the debt-to-capitalization ratio will increase to 62.0% on a Generally Accepted Accounting Principles ("GAAP") basis, or 53.9% on a credit ratings basis. Applicants state that the Transaction is designed to improve TNMP's credit ratings to investment grade, BBB-/Baa3, and to maintain them at that level in order to provide consistent access to the capital markets at reasonable rates, which allows TNMP to fund necessary utility system improvements.

As mentioned above, Applicants request authorization for PNM Resources to amend its Restated Articles as part of the Unit Sale to Cascade.

### **C. Post-Transaction Operations**

In the December Order, the Commission authorized PNM Resources to issue various types of equity and debt securities, including equity-linked securities in the form of stock purchase units. The financing plan that provided the basis for the authority extended by the Commission in the December Order included the acquisition of TNP Enterprises and no new financing authorizations are required.

PNM Resources plans to retain TNP Enterprises; however, TNP Enterprises will exist only as a conduit, with no active operations or financial obligations, and will retain

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<sup>4</sup> *Id.*



no personnel or operational authority. PNM Resources also proposes to include TNP Enterprises, TNMP and First Choice as client companies of PNMR Services, a subsidiary service company that provides the following support services: Accounting, Audit, Business Ethics and Compliance, Business Excellence (including Business Process Improvement), Corporate Communications, Community Affairs, Corporate Governance, Economic Development, Environmental Management, Environmental Policy, Executive Management, General Services, Governmental Regulations, Health and Safety, Human Resources, Information Technology, Investor Relations, Legal, Organization Development, Purchasing, Regulatory Affairs, Risk Management, and Treasury.

PNM Resources will integrate the support services functions that currently exist at TNMP into Services. Applicants state that the consolidation of the support services functions into Services is expected to result in reduced costs for the affiliate companies through reductions in corporate and headquarters staffing, reduced corporate and administrative programs, and purchasing savings through economies of scale. Services will also establish common processes and systems and centralized expertise.

Under the program of restructuring implemented by the State of Texas pertaining to the ERCOT System of TNP Enterprises, affiliates of TNMP are able to access certain shared services, such as billing, accounting, and payroll systems. Applicants propose to maintain these arrangements in place where such is consistent with economical operations and to comply with both state and Federal Energy Regulatory Commission (“FERC”) affiliate transaction regulation and the applicable rules of the Commission, including rules 90 and 91.

First Choice is a firm engaged in domestic energy marketing and Avistar is a firm engaged in the domestic marketing of energy technologies. Applicants maintain that First Choice qualifies as an energy-related company under rule 58 under the Act. PNM Resources proposes to retain FirstChoice. PNM Resources also proposes to retain the nonutility subsidiaries of TNP Enterprises which are currently inactive. PNM Resources also proposes to retain a limited partnership interest in National Corporate Tax Credit Fund XII, an investment qualifying for low income housing tax credits.

### **III. Discussion**

The Transaction requires prior Commission approval under sections 9(a)(2) and 10 of the Act. The Commission has reviewed the proposed transactions and finds that the requirements of the Act are satisfied. The Commission will specifically discuss the application of the integration requirements of section 11 of the Act to the Transaction as well as the financial effects, including benefits, of the Transaction.

#### **A. Integration**

Under section 10(c)(1), the Commission may not approve an acquisition that “would be detrimental to the carrying out of the provisions of section 11.” Section 11(b)(1) of the Act, with the exception discussed below, confines a registered holding company to ownership of a single integrated public utility system, as defined in section

2(a)(29) of the Act.<sup>5</sup> In view of the separate definitions and their differing criteria, the Commission has long held that gas and electric properties do not together constitute an integrated system.<sup>6</sup> Section 11(b)(1) permits a registered holding company to own one or more additional integrated public utility systems if the requirements of 11(b)(1)(A) - (C) (the “ABC clauses”) are satisfied.

Under section 2(a)(29)(A) of the Act, four standards must be met before a proposed combination of electric operations will result in an integrated system:

- the combined utility assets must be physically interconnected or capable of physical interconnection (the “interconnection requirement”);
- the combined utility assets, under normal conditions, must be economically operated as a single interconnected and coordinated system (the “economic and coordinated operation requirement”);
- the system must be confined in its operations to a single area or region (the “single area or region requirement”); and

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<sup>5</sup> Section 2(a)(29)(A) defines an integrated electric public utility system to mean:

a system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair . . . the advantages of localized management, efficient operations, and the effectiveness of regulation . . . .

<sup>6</sup> See, e.g., *SEC v. New England Electric System*, 384 U.S. 176, 178 n.7 and the cases therein cited (1966), *rev’g and remanding* 346 F.2d 399 (1<sup>st</sup> Cir. 1965), *rev’g New England Electric System*, 41 S.E.C. 888, 892-93 (1964), *on remand*, 376 F.2d 107 (1<sup>st</sup> Cir. 1967), *rev’d* 390 U.S. 207 (1968).

- the system must not be so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation (the “no impairment requirement”).

Applicants propose that the combined electric utility operations of PNM and TNMP in New Mexico (“New Mexico Electric Utility System” or the “Primary System”) will be the primary electric system for purposes of the integration analysis. The TNMP ERCOT electric utility system in Texas (“TNMP ERCOT Electric Utility System” or the “Additional Electric System”) will be an additional system and will be retainable under the ABC clauses. In addition, the gas distribution facilities of PNM are a single, integrated gas utility system and is proposed to be an additional system retainable under sections 11(b)(1) and 9(b)(1) of the Act.<sup>7</sup>

### **1. New Mexico Electric Utility System**

The initial question to be addressed regarding the New Mexico Electric Utility System is whether it constitutes an integrated public utility system under the Act. Applicants state that PNM owns or leases 2,902 circuit miles of electric transmission lines – all located within New Mexico and Arizona – over which it provides open-access service pursuant to an open-access transmission tariff on file with FERC. These

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<sup>7</sup> Section 2(a)(29)(B) defines an integrated gas public utility system to mean:

a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair . . . the advantages of localized management, efficient operations, and the effectiveness of regulation; *Provided*, [t]hat gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region.

transmission lines are interconnected with lines owned by utilities that serve customers in Arizona, Colorado, New Mexico, Utah and Texas.

TNMP owns, either solely or jointly with other utilities, 235 circuit miles of 345 kV transmission facilities, approximately 207 miles of which are located in New Mexico and approximately 28 miles of which are located in Arizona. In New Mexico, TNMP also owns, either solely or jointly with other utilities, 143 circuit miles of 115 kV transmission facilities, and 109 circuit miles of transmission facilities rated at less than 115 kV. TNMP also holds joint ownership in transmission facilities in Eddy County, New Mexico, that comprise an AC/DC/AC point of interconnection between the WECC and the Southwest Power Pool. TNMP has contracts to provide and receive transmission for and from others over its system in New Mexico. All of these facilities serve TNMP's New Mexico retail service area. TNMP has on file with FERC a tariff for open access transmission service over its New Mexico system.

PNM dispatches the generation and operates the power supply network that serves TNMP's customers in New Mexico together with its New Mexico customers on a centralized basis, the New Mexico Electric Utility System, which includes the electric utility operations of PNM and TNMP in a single electrical control area.

Applicants state that TNMP's New Mexico system and PNM's system are physically interconnected. TNMP's Central to Hildalgo lines interconnect with PNM's Luna to Greenlee line. Moreover the two systems are physically interconnected between Grant County and Luna County. Both TNMP's and PNM's New Mexico transmission systems are part of the WECC. In addition, both TNMP's and PNM's New Mexico transmission systems utilize the same OASIS system, wesTTrans.net. The OASIS

system, wesTTrans.net, is an enhanced OASIS site serving a significant portion of the Western Interconnection.

PNM dispatches the generation and operates the power supply network that serves TNMP's customers in New Mexico together with its New Mexico customers on a centralized basis. The Applicants maintain therefore that the New Mexico Electric Utility System, which includes the electric utility operations of PNM and TNMP in a single electrical control area, satisfies the coordination standard.

As stated above, PNM Resources will utilize Services to provide coordinated administrative and general services coordination for PNM and TNMP. Applicants also state that by combining operations with TNP Enterprises, PNM Resources expects to produce savings in, among other areas, support service expenses, procurement, information technology systems and other shared administrative areas. Applicants also assert that the combined operations will provide opportunities for reduced capital costs, increased efficiencies and increased purchasing power. PNM Resources anticipates approximately \$10 million of annual pre-tax cost savings in the first year after closing and expects to realize increased financial flexibility and achieve annual interest expense and preferred dividend savings of at least \$40 million at TNP Enterprises.

PNM Resources electric utility system will be confined to the State of New Mexico. Regarding the "no impairment requirement," Applicants state that PNM Resources plans to maintain local operational forces and offices. PNM Resources anticipates approximately \$10 million of annual pre-tax cost savings in the first year after closing and expects to realize increased financial flexibility and achieve annual interest expense and preferred dividend savings of at least \$40 million at TNP Enterprises.

Further, the Transaction will afford the combined companies opportunities for economies of scale as parts of PNM Resources' gas service territory overlaps with TNMP's New Mexico electric operations. Applicants also stress that the Transaction will not impair the effectiveness of regulation at either the State or Federal level. TNMP and PNM will continue to be regulated by the NMPRC with respect to retail rates, services and other matters. At the Federal level, PNM Resources will be regulated as a single registered holding company. In addition, PNM and TNMP's New Mexico assets will continue to be regulated by the FERC with respect to its wholesale interstate electric sales and transmissions services.

## **2. TNMP ERCOT Electric Utility System**

Although the corporate support of the portion of the TNMP electric utility assets located in ERCOT, *i.e.*, the TNMP ERCOT Electric Utility System, will be provided by Services, the ERCOT System is not interconnected with the rest of the TNMP system located in New Mexico or the PNM Resources system. Thus, the TNMP ERCOT Electric Utility System when combined with the New Mexico Electric Utility System will not constitute an integrated electric utility system. Applicants assert, however, that the ERCOT System is itself an integrated electric utility system and that retention of the TNMP ERCOT Electric Utility System is consistent with section 11 of the Act.

Therefore, Applicants propose that the New Mexico Electric Utility System will form the Primary System for purposes of section 11 and the TNMP ERCOT Electric Utility System will constitute an additional retainable system under section 11(b)(1). As a predicate to determining whether the TNMP ERCOT Electric Utility System is

retainable, it must first be determined whether the TNMP ERCOT Electric Utility System is itself an integrated electric utility system.

In support of that finding, Applicants state that the TNMP ERCOT Electric Utility System is primarily a distribution company in Texas but also includes 965 circuit miles of transmission facilities rated at 69 kV and above. Moreover, Applicants maintain that the TNMP ERCOT Electric Utility System will continue to operate within ERCOT.

Applicants maintain that ERCOT generation and transmission services are coordinated through a centralized generation balancing system that provides integration.<sup>8</sup> Further, the TNMP ERCOT Electric Utility System will remain in and be confined to the State of Texas.

Applicants state that the Transaction will not cause management to be more remote from operations than it is today, and will not eliminate local management. Further, Applicants argue that the acquisition will result in significant economies and efficiencies. Specifically, PNM Resources will benefit through a broader and more diverse business base within the same region as its current operators, helping it achieve economies of scale. Applicants also posit that these economies of scale, and particularly reduced financing costs, will benefit the operations presently conducted by TNP Enterprises.

Further, Applicants state that the Transaction will not impair the effectiveness of regulation at either the State or Federal level. TNMP ERCOT Electric Utility System will continue to be regulated by the PUCT with respect to retail rates, services and other

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<sup>8</sup> See, e.g., *UNITIL Corp*, Holding Co. Act Release No. 25524 (April 24, 1992).



matters in Texas, and the New Mexico utility subsidiary operations of PNM Resources will continue to be subject to the jurisdiction of the NMPRC.

In light of these facts, the Commission finds that the TNMP ERCOT Electric Utility System satisfies the integration requirements of section 2(A)(29)(A) of the Act. The retention of the TNMP ERCOT Electric Utility System is also appropriate under the ABC clauses of section 11(b)(1) of the Act. Clause A requires a showing that each additional integrated system cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by a holding company of such system. Applicants state that maintaining the ERCOT system as a separate system would require it to seek access to capital under conditions that are not favorable to investors or consumers with no offsetting enhancements of competition. Due to a regulatory impairment solely related to the TNMP ERCOT Electric Utility System, TNP Enterprises shareholder equity has been substantially eliminated. Moreover, maintenance of the TNMP ERCOT Electric Utility System operations as a stand-alone company would increase the fixed costs associated with those operations by virtue of the loss of cost sharing with existing TNMP New Mexico operations. As a stand-alone company, the TNMP ERCOT Electric Utility System would not participate in the savings associated with the Transaction, and likely would have higher financing costs, assuming access to capital markets remained feasible.

TNMP's senior unsecured debt is rated BB+ by S&P and Ba2 by Moody's, both of which are below investment grade. In May, 2005, Moody's upgraded its rating of TNMP's senior unsecured debt to Baa3, anticipating the pending Transaction. Applicants state that the availability of capital at a reasonable cost is a necessity for

TNMP's future investment in transmission and distribution infrastructure. The increased equity in TNMP resulting from the acquisition will likely result in credit upgrades for TNMP. Therefore, the TNMP ERCOT Electric Utility System would bear the brunt of the loss of the economies. The rating agencies cited various concerns such as potential delays in TNMP's debt reduction plans, weakened credit profile at TNMP, the limited ability of TNMP to pay dividends to its parent, TNP Enterprises, and the parent's inability to generate sufficient cash to cover its debt obligations absent those dividends, as reasons for the downgrades in ratings and outlook. These concerns would be amplified if PNM were forced to divest the TNMP ERCOT Electric Utility System. As a result substantial loss of economies would occur to the TNMP ERCOT Electric Utility System if it had to be divested.<sup>9</sup>

In addition, the proposed Transaction does not raise any issue under section 11(b)(1)(B) of the Act. The transmission and distribution utility of TNMP is located and operates exclusively in Texas, which is adjacent to New Mexico where PNM's electric and gas utilities are located.

Finally, the retention of the TNMP ERCOT Electric Utility System as an additional integrated system does not raise any issues under section 11(b)(1)(C) of the

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<sup>9</sup> The Commission has recognized that integrated electric utility systems may retain small additional systems without the need for a formal study of the hypothetical effects of divestiture. In *New Century Energies, Inc.*, HCAR No. 26748 (August 1, 1997) the Commission approved the formation of a new registered holding company combining Public Service of Colorado and Southwestern Public Service Company, including its Cheyenne Light Fuel and Power Company ("Cheyenne"), located in Cheyenne, Wyoming. Cheyenne was not integrated with the rest of the system in New Mexico, Texas, Kansas, and Oklahoma. Because of its small size, the "record ... permits a finding that there would be a loss of substantial economies if New Century Energies were required to divest these properties." *Id.* at 80.

Act. The combination of the TNMP ERCOT Electric Utility System along with the PNM Resources Gas System and the New Mexico Electric Utility System under the control of a single holding company will “not [be] so large . . . as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.”

### **3. Retention of the PNM Resources Gas System**

Because the Commission has interpreted the term “integrated public-utility system” to mean a system that is either gas or electric, but not both, it was necessary to qualify the gas operations of PNM Resources (“PNM Resources Gas System”) as a qualifying “additional system.” In *PNM Resources, Inc.*, HCAR No. 27934 (December 30, 2004), the Commission determined that the PNM Resources Gas System was an additional system properly retainable by PNM. No facts have changed that would warrant a different finding.

### **4. Retention of Nonutilities**

Applicants maintain that First Choice and Avistar each qualifies as an energy-related company under rule 58 of the Act, and their retention raises no substantial issues under the Act. PNM Resources proposes to retain the active nonutility subsidiaries of the combined system. The Commission has previously authorized the retention of existing inactive subsidiaries solely for the purpose of winding up their affairs. *See, e.g. PNM Resources, Inc.*, HCAR No. 27934 (December 30, 2004). Applicants state that the factoring subsidiary exclusively services the utility operations of PNM Resources and therefore is reasonably incidental to the operation of its system. PNM Resources holds a limited partnership interest in National Corporate Tax Credit Fund XII, a passive investment qualifying for Low Income Housing Tax Credits under Section 42 of the

internal Revenue Code. Consistent with past authorizations of investments of this nature, PNM Resources takes no part in any of the management of the fund or its properties and proposes to retain its interests only so long as the tax credits are available, and expects to dispose of these interests in twelve to thirteen years.

### **B. Financing the Transaction**

The Commission may not approve the Transaction if it determines, under section 10(b)(3), that the acquisition of TNP Enterprises will unduly complicate the capital structure of PNM Resources or will be detrimental to the public interest or the interest of investors or consumers or the proper functioning of the holding company system.

Applicants state that the acquisition price will be paid to current TNP Enterprises' shareholders in equal parts of PNM Resources newly issued common stock (approximately 4.7 million shares) and cash. As a result, immediately after closing, current TNP Enterprises' shareholders will own approximately 6% of PNM Resources common stock and existing PNM Resources shareholders (including Cascade) will own approximately 94% of the then outstanding shares of PNM Resources' common stock. PNM Resources is planning to restructure the balance sheet at TNP Enterprises in conjunction with the closing of this Transaction. The planned restructuring leaves all current debt at TNMP outstanding while all debt and preferred stock at TNP Enterprises will be retired or redeemed.

Based upon the proposed capital transactions, TNMP will have a ratio of common stock to total capitalization of approximately 60% after the refinancing associated with the Transaction is completed. Also, following financings associated with the

Transaction, PNM Resource's capital structure is projected to be approximately 38% common equity to total capitalization.<sup>10</sup>

Applicants assert that the Transaction is in the public interest because the debt and preferred stock at the highly leveraged holding company, TNP Enterprises, is being eliminated and replaced principally with equity therefore significantly decreasing financial risk. Applicants state that PNM Resources is using a conservative financing plan that leaves the credit ratings and outlooks of PNM Resources and PNM unchanged at BBB/Baa2 with a stable outlook. Also, the Applicants maintain that the Transaction will result in improved financial fundamentals for TNMP consistent with a BBB-/Baa3 credit rating. As a result, Applicants expect that TNMP will move from non-investment grade to investment grade. Applicants assert that TNMP will become a financially stronger utility with investment grade ratings, and with more consistent access to the capital markets at improved rates.

Applicants also state that the affiliate interests in PNM Resources held by Cascade and Mr. Gates, which will remain in place after the Transaction is consummated, do not create any complexity in the capital structure of PNM Resources or unfairly or inequitably distribute voting power among the security holders of PNM Resources in contravention of section 10(b)(3) or section 11(b)(2).

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<sup>10</sup> Consolidated capitalization includes, where applicable, all common stock equity (comprised of common stock, additional paid in capital, retained earnings, accumulated other comprehensive income or loss, and/or treasury stock), minority interests, preferred stock, equity-linked securities, long-term debt, short-term debt and current maturities.

#### **IV. Conclusion**

PNM Resources has no current aggregate investment in exempt wholesale generators (“EWGs”) and foreign utility companies (“FUCOs”), as defined in sections 32 and 33 of the Act, respectively. The FERC has approved the Transaction in an order issued on March 2, 2005. Further, the Transaction is subject to the pre-merger notification and review requirements under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (“Hart-Scott-Rodino”). PNM Resources has filed the necessary Hart-Scott-Rodino materials with the U.S. Department of Justice and the Federal Trade Commission and the applicable waiting period has expired without comment. A determination that the Transaction is in the public interest was received from the PUCT on March 31, 2005. In an order dated May 27, 2005, the NMPRC approved the Transaction. Applicants maintain that no other state or federal commission, other than this Commission, has jurisdiction over the proposed transaction. Fees and expenses to be incurred in connection with the proposed transactions are estimated to be \$ 6,488,000.

Due notice of the filing of the Application has been given in the manner prescribed by rule 23 under the Act, and no hearing has been requested of or ordered by the Commission. Based on the facts in the record, the Commission finds that the applicable standards of the Act are satisfied and that no adverse findings are necessary.

IT IS ORDERED, under the applicable provisions of the Act and rules under the Act, that the Application be granted and permitted to become effective immediately, subject to the terms and conditions prescribed in rule 24 under the Act.

IT IS FURTHER ORDERED, that as part of its reporting under rule 24 PNM Resources will file quarterly reports stating the current capitalization and credit ratings of any of the outstanding securities of TNP Enterprises and TNMP. TNP Enterprises will immediately file a Form U5A, notification of registration.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

Margaret H. McFarland  
Deputy Secretary