

TEXAS NEW MEXICO POWER CO

Form 10-Q

November 02, 2012

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
 THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

Commission File Number	Name of Registrants, State of Incorporation, Address and Telephone Number	I.R.S. Employer Identification No.
001-32462	PNM Resources, Inc. (A New Mexico Corporation) Alvarado Square Albuquerque, New Mexico 87158 (505) 241-2700	85-0468296
001-06986	Public Service Company of New Mexico (A New Mexico Corporation) Alvarado Square Albuquerque, New Mexico 87158 (505) 241-2700	85-0019030
002-97230	Texas-New Mexico Power Company (A Texas Corporation) 577 N. Garden Ridge Blvd. Lewisville, Texas 75067 (972) 420-4189	75-0204070

Indicate by check mark whether each registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

PNM Resources, Inc. ("PNMR")	YES	<input type="checkbox"/>	NO
Public Service Company of New Mexico ("PNM")	YES	<input type="checkbox"/>	NO
Texas-New Mexico Power Company ("TNMP")	YES	<input type="checkbox"/>	NO <input type="checkbox"/>

(NOTE: As a voluntary filer, not subject to the filing requirements, TNMP filed all reports under Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months.)

Indicate by check mark whether each registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

PNMR  
PNM  
TNMP

YES ü NO  
YES ü NO  
YES ü NO

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Indicate by check mark whether registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Act).

	Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller Reporting Company
PNMR	ü			
PNM			ü	
TNMP			ü	

Indicate by check mark whether any of the registrants is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO ü

As of October 26, 2012, 79,653,624 shares of common stock, no par value per share, of PNMR were outstanding.

The total number of shares of common stock of PNM outstanding as of October 26, 2012 was 39,117,799 all held by PNMR (and none held by non-affiliates).

The total number of shares of common stock of TNMP outstanding as of October 26, 2012 was 6,358 all held indirectly by PNMR (and none held by non-affiliates).

PNM AND TNMP MEET THE CONDITIONS SET FORTH IN GENERAL INSTRUCTIONS (H) (1) (a) AND (b) OF FORM 10-Q AND ARE THEREFORE FILING THIS FORM WITH THE REDUCED DISCLOSURE FORMAT PURSUANT TO GENERAL INSTRUCTION (H) (2).

This combined Form 10-Q is separately filed by PNMR, PNM, and TNMP. Information contained herein relating to any individual registrant is filed by such registrant on its own behalf. Each registrant makes no representation as to information relating to the other registrants. When this Form 10-Q is incorporated by reference into any filing with the SEC made by PNMR, PNM, or TNMP, as a registrant, the portions of this Form 10-Q that relate to each other registrant are not incorporated by reference therein.

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PNM RESOURCES, INC. AND SUBSIDIARIES  
 PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES  
 TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES

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GLOSSARY

Definitions:

Afton	Afton Generating Station
AFUDC	Allowance for Funds Used During Construction
ALJ	Administrative Law Judge
AMS	Advanced Meter System
AOCI	Accumulated Other Comprehensive Income
APS	Arizona Public Service Company, which is the operator and a co-owner of PVNGS and Four Corners
BART	Best Available Retrofit Technology
BHP	BHP Billiton, Ltd, the Parent of SJCC
Board	Board of Directors of PNMR
CAA	Clean Air Act
CCB	Coal Combustion Byproducts
CO <sub>2</sub>	Carbon Dioxide
CTC	Competition Transition Charge
D.C. Circuit	U.S. Court of Appeals for the District of Columbia Circuit
Decatherm	Million British Thermal Units
Delta	Delta-Person Generating Station
DOE	United States Department of Energy
DOI	United States Department of Interior
ECJV	ECJV Holdings, LLC, a wholly owned subsidiary of Cascade Investment, L.L.C.
EIB	New Mexico Environmental Improvement Board
EIP	Eastern Interconnection Project
EPA	United States Environmental Protection Agency
ERCOT	Electric Reliability Council of Texas
Exchange Act	Securities Exchange Act of 1934
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FIP	Federal Implementation Plan
First Choice	FCP Enterprises, Inc. and Subsidiaries
Four Corners	Four Corners Power Plant
FPPAC	Fuel and Purchased Power Adjustment Clause
GAAP	Generally Accepted Accounting Principles in the United States of America
GEaR	Gross Earnings at Risk
GHG	Greenhouse Gas Emissions
GWh	Gigawatt hours
IBEW	International Brotherhood of Electrical Workers, Local 611
IRP	Integrated Resource Plan
KW	Kilowatt
KWh	Kilowatt Hour
Lordsburg	Lordsburg Generating Station
Luna	Luna Energy Facility
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
Moody's	Moody's Investor Services, Inc.
MW	Megawatt
MWh	Megawatt Hour
NAAQS	National Ambient Air Quality Standards
Navajo Acts	

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Navajo Nation Air Pollution Prevention and Control Act, Navajo Nation Safe Drinking Water Act, and Navajo Nation Pesticide Act

NDT Nuclear Decommissioning Trusts for PVNGS

NEC Navopache Electric Cooperative, Inc.

NERC North American Electric Reliability Corporation

NMAG New Mexico Attorney General

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NMED	New Mexico Environment Department
NMIEC	New Mexico Industrial Energy Consumers Inc.
NMPRC	New Mexico Public Regulation Commission
NOI	Notice of Inquiry
NOPR	Notice of Proposed Rulemaking
NO <sub>x</sub>	Nitrogen Oxides
NRC	United States Nuclear Regulatory Commission
NSPS	New Source Performance Standards
NSR	New Source Review
O&M	Operations and Maintenance
OCI	Other Comprehensive Income
OPEB	Other Post Employment Benefits
Optim Energy	Optim Energy, LLC, a limited liability company, formerly known as EnergyCo, LLC
OSM	United States Office of Surface Mining Reclamation and Enforcement
PCRBs	Pollution Control Revenue Bonds
PNM	Public Service Company of New Mexico and Subsidiaries, a wholly owned subsidiary of PNMR
PNM Revolving Credit Facility	PNM's \$400.0 Million Unsecured Revolving Credit Facility
PNMR	PNM Resources, Inc. and Subsidiaries
PNMR Revolving Credit Facility	PNMR's \$300.0 Million Unsecured Revolving Credit Facility
PPA	Power Purchase Agreement
PSD	Prevention of Significant Deterioration
PUCT	Public Utility Commission of Texas
PV	Photovoltaic
PVNGS	Palo Verde Nuclear Generating Station
RCRA	Resource Conservation and Recovery Act
RCT	Reasonable Cost Threshold
REA	New Mexico's Renewable Energy Act of 2004
REC	Renewable Energy Certificates
REP	Retail Electricity Provider
RFP	Request for Proposal
RMC	Risk Management Committee
RPS	Renewable Energy Portfolio Standard
SCE	Southern California Edison Company
SCR	Selective Catalytic Reduction
SEC	United States Securities and Exchange Commission
SIP	State Implementation Plan
SJCC	San Juan Coal Company
SJGS	San Juan Generating Station
SNCR	Selective Non-Catalytic Reduction
SO <sub>2</sub>	Sulfur Dioxide
SPS	Southwestern Public Service Company
S&P	Standard and Poor's Ratings Services
TECA	Texas Electric Choice Act
Tenth Circuit	U.S. Court of Appeals for the Tenth Circuit
TNMP	Texas-New Mexico Power Company and Subsidiaries, a wholly owned subsidiary of TNP TNMP's \$75.0 Million Revolving Credit Facility

TNMP Revolving  
Credit Facility

TNP  
Valencia  
VaR

TNP Enterprises, Inc. and Subsidiaries, a wholly owned subsidiary of PNMR  
Valencia Energy Facility  
Value at Risk

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

PNM RESOURCES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS  
 (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands, except per share amounts)			
Electric Operating Revenues	\$390,411	\$549,498	\$1,019,646	\$1,352,747
Operating Expenses:				
Cost of energy	110,777	250,854	297,342	582,814
Administrative and general	45,283	69,755	135,371	197,016
Energy production costs	40,365	39,730	131,546	135,510
Regulatory disallowances	—	—	—	21,402
Depreciation and amortization	42,820	42,370	122,289	119,115
Transmission and distribution costs	17,082	17,925	50,896	52,962
Taxes other than income taxes	15,934	20,580	45,218	50,564
Total operating expenses	272,261	441,214	782,662	1,159,383
Operating income	118,150	108,284	236,984	193,364
Other Income and Deductions:				
Interest income	3,130	3,748	9,808	12,010
Gains (losses) on investments held by NDT	5,716	(4,109)	) 9,376	7,688
Other income	2,484	1,755	6,991	3,559
Other deductions	(3,451)	) (4,685)	) (10,719)	) (11,638)
Net other income (deductions)	7,879	(3,291)	) 15,456	11,619
Interest Charges	30,515	31,124	90,280	92,251
Earnings before Income Taxes	95,514	73,869	162,160	112,732
Income Taxes	33,538	25,964	54,609	37,206
Net Earnings	61,976	47,905	107,551	75,526
(Earnings) Attributable to Valencia Non-controlling Interest	(3,980)	) (4,111)	) (10,699)	) (10,764)
Preferred Stock Dividend Requirements of Subsidiary	(132)	) (132)	) (396)	) (396)
Net Earnings Attributable to PNMR	\$57,864	\$43,662	\$96,456	\$64,366
Net Earnings Attributable to PNMR per Common Share:				
Basic	\$0.73	\$0.48	\$1.21	\$0.70
Diluted	\$0.72	\$0.48	\$1.20	\$0.70
Dividends Declared per Common Share	\$0.145	\$0.125	\$0.435	\$0.375

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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PNM RESOURCES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (Unaudited)

	Three Months Ended September 30, 2012		2011		Nine Months Ended September 30, 2012		2011	
	(In thousands)							
Net Earnings	\$61,976		\$47,905		\$107,551		\$75,526	
Other Comprehensive Income (Loss):								
Unrealized Gain on Investment Securities:								
Unrealized holding gains (losses) arising during the period, net of income tax (expense) of \$(4,972), \$1,123, \$(15,409), 7,587 and \$(8,157)			(1,713	)	23,511		12,448	
Reclassification adjustment for (gains) included in net earnings, net of income tax expense of \$4,248, \$1,593, \$12,786, and \$11,555	(6,481	)	(2,431	)	(19,509	)	(17,632	)
Changes in unrecognized amounts of pension and postretirement benefits, net of income tax (expense) benefit of \$(476), \$(425), \$(1,428), and \$176			648		2,181		(318	)
Fair Value Adjustment for Cash Flow Hedges:								
Change in fair market value, net of income tax (expense) benefit of \$51, \$123, \$150, and \$441	(92	)	(219	)	(270	)	(781	)
Reclassification adjustment for (gains) losses included in net earnings, net of income tax expense (benefit) of \$(16), \$(827), \$(47), and \$(1,129)	29		1,493		85		2,036	
Total Other Comprehensive Income (Loss)	1,770		(2,222	)	5,998		(4,247	)
Comprehensive Income	63,746		45,683		113,549		71,279	
Comprehensive (Income) Attributable to Valencia Non-controlling Interest	(3,980	)	(4,111	)	(10,699	)	(10,764	)
Preferred Stock Dividend Requirements of Subsidiary	(132	)	(132	)	(396	)	(396	)
Comprehensive Income Attributable to PNMR	\$59,634		\$41,440		\$102,454		\$60,119	

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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PNM RESOURCES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)

	Nine Months Ended September 30,	
	2012	2011
	(In thousands)	
Cash Flows From Operating Activities:		
Net earnings	\$ 107,551	\$ 75,526
Adjustments to reconcile net earnings to net cash flows from operating activities:		
Depreciation and amortization	153,992	151,984
Bad debt expense	2,458	20,120
Deferred income tax expense	55,141	43,167
Net unrealized (gains) losses on derivatives	3,076	(5,869 )
Realized (gains) on investments held by NDT	(9,376 )	(7,688 )
Stock based compensation expense	2,748	4,302
Regulatory disallowances	—	21,402
Other, net	(4,495 )	) 991
Changes in certain assets and liabilities:		
Accounts receivable and unbilled revenues	(31,550 )	) (88,462 )
Materials, supplies, and fuel stock	(6,769 )	) (985 )
Other current assets	(4,225 )	) (2,901 )
Other assets	(9,499 )	) (3,310 )
Accounts payable	3,973	13,781
Interest and taxes	22,336	33,049
Other current liabilities	(21,681 )	) (12,919 )
Proceeds from governmental grants	21,567	—
Other liabilities	(80,248 )	) (43,691 )
Net cash flows from operating activities	204,999	198,497
Cash Flows From Investing Activities:		
Additions to utility and non-utility plant	(214,743 )	) (236,275 )
Proceeds from sales of investments held by NDT	136,305	121,202
Purchases of investments held by NDT	(138,658 )	) (122,174 )
Proceeds from sale of First Choice	4,034	—
Return of principal on PVNGS lessor notes	23,455	32,274
Proceeds from sales of utility plant	1,367	—
Other, net	260	145
Net cash flows from investing activities	(187,980 )	) (204,828 )

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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PNM RESOURCES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)

	Nine Months Ended September 30,	
	2012	2011
	(In thousands)	
Cash Flows From Financing Activities:		
Short-term borrowings (repayments), net	30,700	67,000
Long-term borrowings	20,000	50,000
Repayment of long-term debt	(20,000)	(50,000)
Proceeds from stock option exercise	10,301	2,570
Purchases to satisfy awards of common stock	(21,930)	(5,288)
Dividends paid	(33,454)	(34,690)
Valencia's transactions with its owner	(12,034)	(11,972)
Proceeds from transmission interconnection agreements	983	1,246
Repayment of transmission interconnection agreements	(1,169)	(4,637)
Other, net	(151)	2,458
Net cash flows from financing activities	(26,754)	16,687
Change in Cash and Cash Equivalents	(9,735)	10,356
Cash and Cash Equivalents at Beginning of Period	15,091	15,404
Cash and Cash Equivalents at End of Period	\$5,356	\$25,760
Supplemental Cash Flow Disclosures:		
Interest paid, net of amounts capitalized	\$64,040	\$64,130
Income taxes paid (refunded), net	\$5,302	\$(3,744)
Supplemental schedule of noncash financing activities:		
Liability incurred for purchase of Convertible Preferred Stock, Series A		\$73,475

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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PNM RESOURCES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (Unaudited)

	September 30, 2012	December 31, 2011
	(In thousands)	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$5,356	\$15,091
Accounts receivable, net of allowance for uncollectible accounts of \$1,931 and \$1,778	119,887	87,794
Unbilled revenues	54,399	57,401
Other receivables	43,418	71,069
Materials, supplies, and fuel stock	61,000	54,231
Regulatory assets	47,899	44,993
Commodity derivative instruments	1,184	3,713
Income taxes receivable	100,802	95,130
Other current assets	38,467	33,397
Total current assets	472,412	462,819
Other Property and Investments:		
Investment in PVNGS lessor notes	54,666	79,049
Investments held by NDT	186,839	168,851
Other investments	9,977	12,207
Non-utility property, net of accumulated depreciation of \$137 and \$120	4,615	4,631
Total other property and investments	256,097	264,738
Utility Plant:		
Plant in service and plant held for future use	5,223,543	5,120,167
Less accumulated depreciation and amortization	1,766,689	1,705,520
	3,456,854	3,414,647
Construction work in progress	148,313	132,420
Nuclear fuel, net of accumulated amortization of \$50,106 and \$36,411	86,496	80,067
Net utility plant	3,691,663	3,627,134
Deferred Charges and Other Assets:		
Regulatory assets	468,991	482,155
Goodwill	278,297	278,297
Other deferred charges	92,747	89,470
Total deferred charges and other assets	840,035	849,922
	\$5,260,207	\$5,204,613

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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PNM RESOURCES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (Unaudited)

	September 30, 2012	December 31, 2011
	(In thousands, except share information)	
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Short-term debt	\$ 113,400	\$ 82,700
Current installments of long-term debt	2,387	2,387
Accounts payable	81,463	103,139
Customer deposits	17,655	15,971
Accrued interest and taxes	82,169	53,114
Commodity derivative instruments	1,888	1,632
Dividends declared	11,680	10,089
Current portion of accumulated deferred income taxes	9,080	9,080
Other current liabilities	73,269	95,156
Total current liabilities	392,991	373,268
Long-term Debt	1,672,124	1,671,626
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	705,945	645,099
Accumulated deferred investment tax credits	14,101	15,771
Regulatory liabilities	438,377	418,098
Asset retirement obligations	84,191	79,233
Accrued pension liability and postretirement benefit cost	129,858	224,766
Commodity derivative instruments	2,770	2,437
Other deferred credits	94,749	106,378
Total deferred credits and other liabilities	1,469,991	1,491,782
Total liabilities	3,535,106	3,536,676
Commitments and Contingencies (See Note 9)		
Cumulative Preferred Stock of Subsidiary		
without mandatory redemption requirements (\$100 stated value; 10,000,000 shares authorized; issued and outstanding 115,293 shares)	11,529	11,529
Equity:		
PNMR common stockholders' equity:		
Common stock outstanding (no par value; 120,000,000 shares authorized; issued and outstanding 79,653,624 shares)	1,183,886	1,193,191
Accumulated other comprehensive income (loss), net of income taxes	(60,858	) (66,856 )
Retained earnings	509,456	447,650
Total PNMR common stockholders' equity	1,632,484	1,573,985
Non-controlling interest in Valencia	81,088	82,423
Total equity	1,713,572	1,656,408
	\$ 5,260,207	\$ 5,204,613

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.



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PNM RESOURCES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
 (Unaudited)

	Attributable to PNMR			Total PNMR Common Stockholder's Equity	Non- controlling Interest in Valencia	Total Equity
	Common Stock	AOCI	Retained Earnings			
	(In thousands)					
Balance at December 31, 2011	\$1,193,191	\$(66,856 )	\$447,650	\$1,573,985	\$82,423	\$1,656,408
Proceeds from stock option exercise	10,301	—	—	10,301	—	10,301
Purchases to satisfy awards of common stock	(21,930 )	—	—	(21,930 )	—	(21,930 )
Excess tax (shortfall) from stock-based payment arrangements	(424 )	—	—	(424 )	—	(424 )
Stock based compensation expense	2,748	—	—	2,748	—	2,748
Valencia's transactions with its owner	—	—	—	—	(12,034 )	(12,034 )
Net earnings before subsidiary preferred stock dividends	—	—	96,852	96,852	10,699	107,551
Subsidiary preferred stock dividends	—	—	(396 )	(396 )	—	(396 )
Total other comprehensive income	—	5,998	—	5,998	—	5,998
Dividends declared on common stock	—	—	(34,650 )	(34,650 )	—	(34,650 )
Balance at September 30, 2012	\$1,183,886	\$(60,858 )	\$509,456	\$1,632,484	\$81,088	\$1,713,572

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.



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PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Electric Operating Revenues	\$321,731	\$323,760	\$832,242	\$797,232
Operating Expenses:				
Cost of energy	99,217	108,708	263,009	279,419
Administrative and general	41,150	37,916	120,857	110,833
Energy production costs	40,365	39,730	131,546	135,510
Regulatory disallowances	—	—	—	17,479
Depreciation and amortization	24,437	25,058	72,017	71,691
Transmission and distribution costs	11,172	11,848	33,679	35,357
Taxes other than income taxes	8,417	12,586	25,386	30,323
Total operating expenses	224,758	235,846	646,494	680,612
Operating income	96,973	87,914	185,748	116,620
Other Income and Deductions:				
Interest income	3,173	3,770	9,938	12,052
Gains (losses) on investments held by NDT	5,716	(4,109)	) 9,376	7,688
Other income	1,176	1,179	4,378	1,921
Other deductions	(1,682)	) (2,643)	) (4,553)	) (5,480)
Net other income (deductions)	8,383	(1,803)	) 19,139	16,181
Interest Charges	19,230	18,487	56,652	54,593
Earnings before Income Taxes	86,126	67,624	148,235	78,208
Income Taxes	31,235	25,052	51,929	26,574
Net Earnings	54,891	42,572	96,306	51,634
(Earnings) Attributable to Valencia Non-controlling Interest	(3,980)	) (4,111)	) (10,699)	) (10,764)
Net Earnings Attributable to PNM	50,911	38,461	85,607	40,870
Preferred Stock Dividends Requirements	(132)	) (132)	) (396)	) (396)
Net Earnings Available for PNM Common Stock	\$50,779	\$38,329	\$85,211	\$40,474

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

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PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Net Earnings	\$54,891	\$42,572	\$96,306	\$51,634
Other Comprehensive Income (Loss):				
Unrealized Gain on Investment Securities:				
Unrealized holding gains arising during the period, net of income tax (expense) of \$(4,972), \$1,123, \$(15,409), and \$(8,157)	7,587	(1,713)	) 23,511	12,448
Reclassification adjustment for (gains) included in net earnings, net of income tax expense of \$4,248, \$1,593, \$12,786 and \$11,555	(6,481)	) (2,431)	) (19,509)	) (17,632)
Change in unrecognized amounts of pension and postretirement benefits, net of income tax (expense) benefit of \$(476), \$(423), \$(1,428), and \$9		646	2,181	(13)
Fair Value Adjustment for Cash Flow Hedges:				
Reclassification adjustment for (gains) losses included in net earnings, net of income tax expense (benefit) of \$0, \$0, \$0, and \$(11)		—	—	17
Total Other Comprehensive Income (Loss)	1,833	(3,498)	) 6,183	(5,180)
Comprehensive Income	56,724	39,074	102,489	46,454
Comprehensive (Income) Attributable to Valencia Non-controlling Interest	(3,980)	) (4,111)	) (10,699)	) (10,764)
Comprehensive Income Attributable to PNM	\$52,744	\$34,963	\$91,790	\$35,690

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

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PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Nine Months Ended September 30,	
	2012	2011
	(In thousands)	
Cash Flows From Operating Activities:		
Net earnings	\$96,306	\$51,634
Adjustments to reconcile net earnings to net cash flows from operating activities:		
Depreciation and amortization	97,086	97,918
Deferred income tax expense	52,558	33,835
Net unrealized (gains) losses on derivatives	3,076	(4,120 )
Realized (gains) on investments held by NDT	(9,376	) (7,688 )
Regulatory disallowances	—	17,479
Other, net	(1,005	) 3,228
Changes in certain assets and liabilities:		
Accounts receivable and unbilled revenues	(26,183	) (25,871 )
Materials, supplies, and fuel stock	(6,404	) (974 )
Other current assets	(6,942	) 1,626
Other assets	(9,425	) 8,187
Accounts payable	2,353	(2,013 )
Interest and taxes	80,418	18,186
Other current liabilities	(9,850	) (4,173 )
Proceeds from governmental grants	21,567	—
Other liabilities	(75,629	) (45,417 )
Net cash flows from operating activities	208,550	141,837
Cash Flows From Investing Activities:		
Utility plant additions	(144,571	) (185,402 )
Proceeds from sales of NDT investments	136,305	121,202
Purchases of NDT investments	(138,658	) (122,174 )
Return of principal on PVNGS lessor notes	23,455	32,274
Other, net	(720	) 496
Net cash flows from investing activities	(124,189	) (153,604 )

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

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PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Nine Months Ended September 30,	
	2012	2011
	(In thousands)	
Cash Flows From Financing Activities:		
Short-term borrowings (repayments), net	(66,000	) 67,000
Long-term borrowings	20,000	—
Repayment of long-term debt	(20,000	) —
Valencia's transactions with its owner	(12,034	) (11,972 )
Proceeds from transmission interconnection arrangements	983	1,246
Repayment of transmission interconnection arrangements	(1,169	) (4,637 )
Dividends paid	(18,076	) (47,730 )
Other, net	(151	) 2,558
Net cash flows from financing activities	(96,447	) 6,465
Change in Cash and Cash Equivalents	(12,086	) (5,302 )
Cash and Cash Equivalents at Beginning of Period	12,307	10,336
Cash and Cash Equivalents at End of Period	\$221	\$5,034
Supplemental Cash Flow Disclosures:		
Interest paid, net of amounts capitalized	\$43,167	\$40,582
Income taxes paid (refunded), net	\$(63,114	) \$(1,539 )

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

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PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)

	September 30, 2012	December 31, 2011
	(In thousands)	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$221	\$12,307
Accounts receivable, net of allowance for uncollectible accounts of \$1,931 and \$1,778	94,315	68,661
Unbilled revenues	46,998	48,928
Other receivables	42,454	65,465
Affiliate receivables	8,930	8,912
Materials, supplies, and fuel stock	57,925	51,521
Regulatory assets	46,940	44,480
Commodity derivative instruments	1,184	3,713
Income taxes receivable	66,374	128,858
Other current assets	33,144	26,776
Total current assets	398,485	459,621
Other Property and Investments:		
Investment in PVNGS lessor notes	54,666	79,049
Investments held by NDT	186,839	168,851
Other investments	3,985	2,900
Non-utility property	976	976
Total other property and investments	246,466	251,776
Utility Plant:		
Plant in service and plant held for future use	4,075,995	4,009,873
Less accumulated depreciation and amortization	1,342,958	1,305,754
	2,733,037	2,704,119
Construction work in progress	120,303	116,030
Nuclear fuel, net of accumulated amortization of \$50,106 and \$36,411	86,496	80,067
Net utility plant	2,939,836	2,900,216
Deferred Charges and Other Assets:		
Regulatory assets	352,871	352,387
Goodwill	51,632	51,632
Other deferred charges	84,041	79,655
Total deferred charges and other assets	488,544	483,674
	\$4,073,331	\$4,095,287

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

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PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)

	September 30, 2012	December 31, 2011
	(In thousands, except share information)	
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>		
Current Liabilities:		
Short-term debt	\$—	\$66,000
Accounts payable	64,213	82,619
Affiliate payables	11,922	14,592
Customer deposits	17,655	15,971
Accrued interest and taxes	51,092	32,111
Commodity derivative instruments	1,888	1,632
Dividends declared	16,885	132
Current portion of accumulated deferred income taxes	16,562	16,562
Other current liabilities	53,219	60,944
Total current liabilities	233,436	290,563
Long-term Debt	1,215,569	1,215,540
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	562,534	504,419
Accumulated deferred investment tax credits	14,101	15,771
Regulatory liabilities	390,563	373,703
Asset retirement obligations	83,337	78,425
Accrued pension liability and postretirement benefit cost	125,840	213,688
Commodity derivative instruments	2,770	2,437
Other deferred credits	83,514	94,700
Total deferred credits and liabilities	1,262,659	1,283,143
Total liabilities	2,711,664	2,789,246
Commitments and Contingencies (See Note 9)		
Cumulative Preferred Stock		
without mandatory redemption requirements (\$100 stated value; 10,000,000 authorized; issued and outstanding 115,293 shares)	11,529	11,529
Equity:		
PNM common stockholder's equity:		
Common stock outstanding (no par value; 40,000,000 shares authorized; issued and outstanding 39,117,799 shares)	1,061,776	1,061,776
Accumulated other comprehensive income (loss), net of income taxes	(60,615	) (66,798 )
Retained earnings	267,889	217,111
Total PNM common stockholder's equity	1,269,050	1,212,089
Non-controlling interest in Valencia	81,088	82,423
Total equity	1,350,138	1,294,512
	\$4,073,331	\$4,095,287

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.



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PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
(Unaudited)

	Attributable to PNM			Total PNM Common Stockholder's Equity	Non- controlling Interest in Valencia	Total Equity
	Common Stock (In thousands)	AOCI	Retained Earnings			
Balance at December 31, 2011	\$1,061,776	\$(66,798 )	\$217,111	\$1,212,089	\$82,423	\$1,294,512
Valencia's transactions with its owner	—	—	—	—	(12,034 )	(12,034 )
Net earnings	—	—	85,607	85,607	10,699	96,306
Total other comprehensive income	—	6,183	—	6,183	—	6,183
Dividends declared on preferred stock	—	—	(396 )	(396 )	—	(396 )
Dividends declared on common stock	—	—	(34,433 )	(34,433 )	—	(34,433 )
Balance at September 30, 2012	\$1,061,776	\$(60,615 )	\$267,889	\$1,269,050	\$81,088	\$1,350,138

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.



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TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Electric Operating Revenues:				
Non-affiliates	\$68,680	\$54,787	\$187,404	\$150,175
Affiliate	—	12,196	—	30,608
Total electric operating revenues	68,680	66,983	187,404	180,783
Operating Expenses:				
Cost of energy	11,560	10,307	34,333	30,719
Administrative and general	10,130	9,998	30,700	29,798
Regulatory disallowances	—	—	—	3,923
Depreciation and amortization	13,819	12,674	37,173	33,662
Transmission and distribution costs	5,910	6,072	17,217	17,597
Taxes other than income taxes	6,291	6,381	16,322	16,113
Total operating expenses	47,710	45,432	135,745	131,812
Operating income	20,970	21,551	51,659	48,971
Other Income and Deductions:				
Interest income	—	1	1	1
Other income	771	418	1,708	1,068
Other deductions	(405	) (105	) (464	) (181
Net other income (deductions)	366	314	1,245	888
Interest Charges	7,047	7,276	21,214	21,880
Earnings Before Income Taxes	14,289	14,589	31,690	27,979
Income Taxes	5,205	5,721	11,577	10,845
Net Earnings	\$9,084	\$8,868	\$20,113	\$17,134

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

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TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES  
 A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (Unaudited)

	Three Months Ended September 30, 2012		2011		Nine Months Ended September 30, 2012		2011	
	(In thousands)							
Net Earnings	\$9,084		\$8,868		\$20,113		\$17,134	
Other Comprehensive Income (Loss):								
Change in unrecognized amounts of pension and postretirement benefits, net of income tax (expense) benefit of \$0, \$(1), \$0, and \$169	—		2		—		(305)	)
Fair Value Adjustment for Cash Flow Hedges:								
Change in fair market value, net of income tax (expense) benefit of \$51, \$110, \$150, and \$382	(92	)	(198	)	(270	)	(689	)
Reclassification adjustment for losses included in net earnings, net of income tax expense (benefit) of \$(16), \$(850), \$(47), and \$(1,052)	29		1,535		85		1,900	
Total Other Comprehensive Income (Loss)	(63	)	1,339		(185	)	906	
Comprehensive Income	\$9,021		\$10,207		\$19,928		\$18,040	

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

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TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Nine Months Ended September 30,	
	2012	2011
	(In thousands)	
Cash Flows From Operating Activities:		
Net earnings	\$20,113	\$17,134
Adjustments to reconcile net earnings to net cash flows from operating activities:		
Depreciation and amortization	41,222	36,352
Deferred income tax expense	11,337	9,981
Regulatory disallowances	—	3,923
Other, net	(275)	) (69)
Changes in certain assets and liabilities:		
Accounts receivable and unbilled revenues	(5,367)	) (8,751)
Materials and supplies	(365)	) 124
Other current assets	(709)	) (1,547)
Other assets	(498)	) (2,985)
Accounts payable	(358)	) 1,858
Interest and taxes	4,860	4,277
Other current liabilities	1,980	2,383
Other liabilities	(3,411)	) (1,101)
Net cash flows from operating activities	68,529	61,579
Cash Flows From Investing Activities:		
Additions to utility and non-utility plant	(61,168)	) (44,214)
Proceeds from sales of utility plant	1,367	—
Net cash flows from investing activities	(59,801)	) (44,214)
Cash Flow From Financing Activities:		
Short-term borrowings (repayments), net – affiliate	2,300	(1,200)
Long-term borrowings	—	50,000
Repayment of long-term debt	—	(50,000)
Dividends paid	(11,028)	) (7,066)
Other, net	—	(100)
Net cash flows from financing activities	(8,728)	) (8,366)
Change in Cash and Cash Equivalents	—	8,999
Cash and Cash Equivalents at Beginning of Period	1	1
Cash and Cash Equivalents at End of Period	\$1	\$9,000
Supplemental Cash Flow Disclosures:		
Interest paid, net of amounts capitalized	\$13,074	\$14,474
Income taxes paid (refunded), net	\$1,848	\$3,250

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.



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TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES  
 A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (Unaudited)

	September 30, 2012	December 31, 2011
	(In thousands)	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$1	\$1
Accounts receivable	25,572	19,133
Unbilled revenues	7,401	8,473
Other receivables	1,126	847
Materials and supplies	3,075	2,710
Regulatory assets	959	513
Current portion of accumulated deferred income taxes	2,273	2,272
Other current assets	1,426	694
Total current assets	41,833	34,643
Other Property and Investments:		
Other investments	267	271
Non-utility property	2,240	2,240
Total other property and investments	2,507	2,511
Utility Plant:		
Plant in service and plant held for future use	985,318	947,327
Less accumulated depreciation and amortization	338,600	323,123
	646,718	624,204
Construction work in progress	20,141	12,968
Net utility plant	666,859	637,172
Deferred Charges and Other Assets:		
Regulatory assets	116,120	129,768
Goodwill	226,665	226,665
Other deferred charges	6,078	6,686
Total deferred charges and other assets	348,863	363,119
	\$1,060,062	\$1,037,445

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

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TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)

	September 30, 2012	December 31, 2011
	(In thousands, except share information)	
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>		
Current Liabilities:		
Short-term debt – affiliate	\$3,000	\$700
Accounts payable	8,055	12,263
Affiliate payables	2,258	1,314
Accrued interest and taxes	25,525	20,666
Other current liabilities	10,412	9,480
Total current liabilities	49,250	44,423
Long-term Debt	311,432	310,963
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	170,552	159,197
Regulatory liabilities	47,814	44,395
Asset retirement obligations	737	699
Accrued pension liability and postretirement benefit cost	4,018	11,078
Other deferred credits	4,106	3,437
Total deferred credits and other liabilities	227,227	218,806
Total liabilities	587,909	574,192
Commitments and Contingencies (See Note 9)		
Common Stockholder's Equity:		
Common stock outstanding (\$10 par value; 12,000,000 shares authorized; issued and outstanding 6,358 shares)	64	64
Paid-in-capital	405,366	416,394
Accumulated other comprehensive income (loss), net of income taxes	(243	) (58
Retained earnings	66,966	46,853
Total common stockholder's equity	472,153	463,253
	\$1,060,062	\$1,037,445

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

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TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES  
 A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
 CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN COMMON STOCKHOLDER'S EQUITY  
 (Unaudited)

	Common Stock	Paid-in Capital	AOCI	Retained Earnings	Total Common Stockholder's Equity
	(In thousands)				
Balance at December 31, 2011	\$64	\$416,394	\$(58	) \$46,853	\$463,253
Net earnings	—	—	—	20,113	20,113
Total other comprehensive income (loss)	—	—	(185	) —	(185 )
Dividends declared on common stock	—	(11,028	) —	—	(11,028 )
Balance at September 30, 2012	\$64	\$405,366	\$(243	) \$66,966	\$472,153

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

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PNM RESOURCES, INC. AND SUBSIDIARIES  
PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES  
TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

(1) Significant Accounting Policies and Responsibility for Financial Statements

Financial Statement Preparation

In the opinion of management, the accompanying unaudited interim Condensed Consolidated Financial Statements reflect all normal and recurring accruals and adjustments that are necessary to present fairly the consolidated financial position at September 30, 2012 and December 31, 2011, consolidated results of operations and comprehensive income for the three and nine months ended September 30, 2012 and 2011, and consolidated cash flows for the nine months ended September 30, 2012 and 2011. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could ultimately differ from those estimated. The Notes to Condensed Consolidated Financial Statements include disclosures for PNMR, PNM, and TNMP. This report uses the term "Company" when discussing matters of common applicability to PNMR, PNM, and TNMP. Discussions regarding only PNMR, PNM, or TNMP are so indicated. Certain amounts in the 2011 Condensed Consolidated Financial Statements and Notes thereto have been reclassified to conform to the 2012 financial statement presentation.

These Condensed Consolidated Financial Statements are unaudited. Certain information and note disclosures normally included in the annual Consolidated Financial Statements have been condensed or omitted, as permitted under the applicable rules and regulations. Readers of these financial statements should refer to PNMR's, PNM's, and TNMP's audited Consolidated Financial Statements and Notes thereto that are included in their respective 2011 Annual Reports on Form 10-K. Weather causes the Company's results of operations to be seasonal in nature and the results of operations presented in the accompanying Condensed Consolidated Financial Statements are not necessarily representative of operations for an entire year.

GAAP defines subsequent events as events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued. Based on their nature, magnitude, and timing, certain subsequent events may be required to be reflected at the balance sheet date and/or required to be disclosed in the financial statements. The Company has evaluated subsequent events as required by GAAP.

Principles of Consolidation

The Condensed Consolidated Financial Statements of each of PNMR, PNM, and TNMP include their accounts and those of subsidiaries in which that entity owns a majority voting interest. PNM also consolidates the PVNGS Capital Trust and Valencia. PNM owns undivided interests in several jointly-owned power plants and records its pro-rata share of the assets, liabilities, and expenses for those plants.

PNMR shared services' administrative and general expenses, which represent costs that are primarily driven by corporate level activities, are charged to the business segments. These services are billed at cost, except those billed to Optim Energy, which included a profit element. Other significant intercompany transactions between PNMR, PNM, and TNMP include transmission and distribution services; lease, interest, and income tax sharing payments; and dividends paid on common stock. All intercompany transactions and balances have been eliminated. See Note 12.



Dividends on Common Stock

Dividends on PNMR's common stock are declared by its Board. The timing of the declaration of dividends is dependent on the timing of meetings and other actions of the Board. This has historically resulted in dividends considered to be attributable to the second quarter of each year being declared through actions of the Board during the third quarter of the year. The Board declared dividends on common stock considered to be for the second quarter of \$0.145 per share in July 2012 and \$0.125 in July 2011, which are reflected as being in the second quarter within "Dividends Declared per Common Share" on the PNMR Condensed Consolidated Statements of Earnings. The Board declared dividends on common stock for the third quarter of \$0.145 per share in September 2012 and \$0.125 per share in September 2011, which are reflected as third quarter within "Dividends Declared per Common Share."

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PNM RESOURCES, INC. AND SUBSIDIARIES  
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PNM declared a cash dividend on its common stock to PNMR of \$16.8 million in September 2012, which was paid in October 2012, and declared and paid a dividend of \$17.7 million in June 2012. PNM declared cash dividends on its common stock to PNMR of \$39.1 million in December 2010, which was paid in January 2011, \$4.6 million in March 2011, which was paid in April 2011, and \$3.6 million in June 2011, which was paid in July 2011. TNMP declared and paid cash dividends to PNMR of \$11.0 million in the nine months ended September 30, 2012 and \$7.1 million in the nine months ended September 30, 2011. TNMP dividends were recorded as reductions of its paid-in-capital.

(2) Segment Information

The following segment presentation is based on the methodology that management uses for making operating decisions and assessing performance of its various business activities. A reconciliation of the segment presentation to the GAAP financial statements is provided.

PNM Electric

PNM Electric includes the retail electric utility operations of PNM that are subject to traditional rate regulation by the NMPRC. PNM Electric provides integrated electricity services that include the generation, transmission, and distribution of electricity for retail electric customers in New Mexico. PNM Electric also includes the generation and sale of electricity into the wholesale market as well as providing transmission services to third parties. The sale of electricity includes the asset optimization of PNM's jurisdictional assets as well as the capacity excluded from retail rates. FERC has jurisdiction over wholesale and transmission rates.

TNMP Electric

TNMP Electric is an electric utility providing regulated transmission and distribution services in Texas under the TECA. TNMP's operations are subject to traditional rate regulation by the PUCT.

First Choice

First Choice, which was sold by PNMR on November 1, 2011 (Note 14), operated as a certified retail electric provider in Texas. First Choice provided electricity to residential, small commercial, and governmental customers. Although First Choice was regulated in certain respects by the PUCT, it was not subject to traditional rate regulation.

Corporate and Other

The Corporate and Other segment includes PNMR holding company activities, primarily related to corporate level debt and PNMR Services Company.

The following tables present summarized financial information for PNMR by segment. PNM and TNMP each operate in only one segment. Therefore, tabular segment information is not presented for PNM and TNMP.

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PNM RESOURCES, INC. AND SUBSIDIARIES  
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(Unaudited)

## PNMR SEGMENT INFORMATION

	PNM Electric	TNMP Electric	Corporate and Other	Consolidated
Three Months Ended September 30, 2012	(In thousands)			
Electric operating revenues	\$321,731	\$68,680	\$—	\$390,411
Cost of energy	99,217	11,560	—	110,777
Margin	222,514	57,120	—	279,634
Other operating expenses	101,104	22,331	(4,771)	) 118,664
Depreciation and amortization	24,437	13,819	4,564	42,820
Operating income	96,973	20,970	207	118,150
Interest income	3,173	—	(43)	) 3,130
Other income (deductions)	5,210	366	(827)	) 4,749
Net interest charges	(19,230)	) (7,047)	) (4,238)	) (30,515)
Segment earnings (loss) before income taxes	86,126	14,289	(4,901)	) 95,514
Income taxes (benefit)	31,235	5,205	(2,902)	) 33,538
Segment earnings (loss)	54,891	9,084	(1,999)	) 61,976
Valencia non-controlling interest	(3,980)	) —	—	(3,980)
Subsidiary preferred stock dividends	(132)	) —	—	(132)
Segment earnings (loss) attributable to PNMR	\$50,779	\$9,084	\$(1,999)	) \$57,864
Nine Months Ended September 30, 2012				
Electric operating revenues	\$832,242	\$187,404	\$—	\$1,019,646
Cost of energy	263,009	34,333	—	297,342
Margin	569,233	153,071	—	722,304
Other operating expenses	311,468	64,239	(12,676)	) 363,031
Depreciation and amortization	72,017	37,173	13,099	122,289
Operating income (loss)	185,748	51,659	(423)	) 236,984
Interest income	9,938	1	(131)	) 9,808
Other income (deductions)	9,201	1,244	(4,797)	) 5,648
Net interest charges	(56,652)	) (21,214)	) (12,414)	) (90,280)
Segment earnings (loss) before income taxes	148,235	31,690	(17,765)	) 162,160
Income taxes (benefit)	51,929	11,577	(8,897)	) 54,609
Segment earnings (loss)	96,306	20,113	(8,868)	) 107,551
Valencia non-controlling interest	(10,699)	) —	—	(10,699)
Subsidiary preferred stock dividends	(396)	) —	—	(396)
Segment earnings (loss) attributable to PNMR	\$85,211	\$20,113	\$(8,868)	) \$96,456
At September 30, 2012:				
Total Assets	\$4,073,331	\$1,060,062	\$126,814	\$5,260,207
Goodwill	\$51,632	\$226,665	\$—	\$278,297
Additions to utility and non-utility plant included in accounts payable	\$6,056	\$886	\$1,063	\$8,005



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	PNM Electric	TNMP Electric	First Choice	Corporate and Other	Consolidated
Three Months Ended September 30, 2011 (In thousands)					
Electric revenues from non-affiliates	\$ 323,760	\$ 54,787	\$ 170,999	\$(48)	) \$ 549,498
Intersegment revenues	—	12,196	—	(12,196)	) —
Total electric operating revenues	323,760	66,983	170,999	(12,244)	) 549,498
Cost of energy	108,708	10,307	144,035	(12,196)	) 250,854
Margin	215,052	56,676	26,964	(48)	) 298,644
Other operating expenses	102,080	22,451	25,076	(1,617)	) 147,990
Depreciation and amortization	25,058	12,674	346	4,292	42,370
Operating income (loss)	87,914	21,551	1,542	(2,723)	) 108,284
Interest income	3,770	1	29	(52)	) 3,748
Other income (deductions)	(5,573)	) 313	(115)	) (1,664)	) (7,039)
Net interest charges	(18,487)	) (7,276)	) (249)	) (5,112)	) (31,124)
Segment earnings (loss) before income taxes	67,624	14,589	1,207	(9,551)	) 73,869
Income taxes (benefit)	25,052	5,721	594	(5,403)	) 25,964
Segment earnings (loss)	42,572	8,868	613	(4,148)	) 47,905
Valencia non-controlling interest	(4,111)	) —	—	—	) (4,111)
Subsidiary preferred stock dividends	(132)	) —	—	—	) (132)
Segment earnings (loss) attributable to PNMR	\$ 38,329	\$ 8,868	\$ 613	\$(4,148)	) \$ 43,662
Nine Months Ended September 30, 2011					
Electric revenues from non-affiliates	\$ 797,232	\$ 150,175	\$ 405,485	\$(145)	) \$ 1,352,747
Intersegment revenues	—	30,608	—	(30,608)	) —
Total electric operating revenues	797,232	180,783	405,485	(30,753)	) 1,352,747
Cost of energy	279,419	30,719	303,285	(30,609)	) 582,814
Margin	517,813	150,064	102,200	(144)	) 769,933
Other operating expenses	329,502	67,431	67,693	(7,172)	) 457,454
Depreciation and amortization	71,691	33,662	987	12,775	119,115
Operating income (loss)	116,620	48,971	33,520	(5,747)	) 193,364
Interest income	12,052	1	63	(106)	) 12,010
Other income (deductions)	4,129	887	(494)	) (4,913)	) (391)
Net interest charges	(54,593)	) (21,880)	) (535)	) (15,243)	) (92,251)
Segment earnings (loss) before income taxes	78,208	27,979	32,554	(26,009)	) 112,732
Income taxes (benefit)	26,574	10,845	11,833	(12,046)	) 37,206
Segment earnings (loss)	51,634	17,134	20,721	(13,963)	) 75,526
Valencia non-controlling interest	(10,764)	) —	—	—	) (10,764)
Subsidiary preferred stock dividends	(396)	) —	—	—	) (396)
	\$ 40,474	\$ 17,134	\$ 20,721	\$(13,963)	) \$ 64,366

Segment earnings (loss) attributable to  
PNMR

At September 30, 2011:

Total Assets	\$3,936,468	\$1,041,613	\$274,741	\$119,818	\$5,372,640
Goodwill	\$51,632	\$226,665	\$43,013	\$—	\$321,310
Additions to utility and non-utility plant included in accounts payable	\$6,811	\$4,672	\$106	\$253	\$11,842

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## (3) Variable Interest Entities

GAAP determines how an enterprise evaluates and accounts for its involvement with variable interest entities, including determining the primary beneficiary of a variable interest entity, by focusing primarily on whether the enterprise has the power to direct the activities that most significantly impact the economic performance of a variable interest entity. GAAP also requires continual reassessment of the primary beneficiary of a variable interest entity. Additional information concerning PNM's variable interest entities is contained in Note 9 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K.

PNM has a PPA to purchase all of the electric capacity and energy from Valencia, a 145 MW natural gas-fired power plant near Belen, New Mexico, through May 2028. A third-party built, owns, and operates the facility while PNM is the sole purchaser of the electricity generated. PNM is obligated to pay fixed O&M and capacity charges in addition to variable O&M charges under this PPA. For the three and nine months ended September 30, 2012, PNM paid \$4.8 million and \$14.0 million for fixed charges and \$0.6 million and \$0.9 million for variable charges. For the three and nine months ended September 30, 2011, PNM paid \$4.6 million and \$13.7 million for fixed charges and \$0.9 million and \$1.3 million for variable charges. PNM does not have any other financial obligations related to Valencia. The assets of Valencia can only be used to satisfy obligations of Valencia and creditors of Valencia do not have any recourse against PNM's assets. PNM has concluded that the third party entity that owns Valencia is a variable interest entity and that PNM is the primary beneficiary of the entity under GAAP. As the primary beneficiary, PNM consolidates the entity in its financial statements. The assets and liabilities of Valencia set forth below are immaterial to PNM and, therefore, not shown separately on the Condensed Consolidated Balance Sheets. The owner's equity and net income of Valencia are considered attributable to non-controlling interest.

Summarized financial information for Valencia is as follows:

## Results of Operations

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Operating revenues	\$ 5,358	\$ 5,505	\$ 14,916	\$ 15,024
Operating expenses	(1,378	) (1,394	) (4,217	) (4,260
Earnings attributable to non-controlling interest	\$ 3,980	\$ 4,111	\$ 10,699	\$ 10,764

## Financial Position

	September 30, 2012	December 31, 2011
	(In thousands)	
Current assets	\$ 3,507	\$ 2,405
Net property, plant, and equipment	78,661	80,785
Total assets	82,168	83,190

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Current liabilities	1,080	767
Owners' equity – non-controlling interest	\$ 81,088	\$ 82,423

PNM leases interests in Units 1 and 2 of PVNGS under arrangements, which were entered into in 1985 and 1986, that are accounted for as operating leases. PNM is not the legal or tax owner of the leased assets. PNM has an option to purchase the leased assets at appraised value at the end of the leases, but does not have a fixed price purchase option and does not provide residual value guarantees. PNM has options to renew the leases at fixed rates set forth in the leases, which represent 50% of the amounts during the original terms of the leases, for two years beyond the termination of the original lease terms. The option



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periods on certain leases may be further extended for up to an additional six years if the appraised remaining useful lives and fair value of the leased assets are greater than parameters set forth in the leases. PNM is only obligated to make payments to the trusts for the scheduled semi-annual lease payments, which, net of amounts that will be returned to PNM through its ownership in related lessor notes, aggregate \$80.0 million as of September 30, 2012 over the remaining terms of the leases. Under certain circumstances (for example, final shutdown of the plant, the NRC issuing specified violation orders with respect to PVNGS, or the occurrence of specified nuclear events), PNM would be required to make specified payments to the beneficial owners and take title to the leased interests. If such an event had occurred as of September 30, 2012, PNM could have been required to pay the beneficial owners up to approximately \$167.6 million, which would result in PNM taking ownership of the leased assets and termination of the leases. PNM has no other financial obligations or commitments to the trusts or the beneficial owners. Creditors of the trusts have no recourse to PNM's assets other than with respect to the contractual lease payments. PNM has no additional rights to the assets of the trusts other than the use of the leased assets. PNM has evaluated the PVNGS lease arrangements and concluded that it does not have the power to direct the activities that most significantly impact the economic performance of the trusts and, therefore, is not the primary beneficiary of the trusts under GAAP. PNM has recorded no assets or liabilities related to the trusts other than the accrual of lease payments between the scheduled payment dates, which were \$11.8 million at September 30, 2012 and \$26.0 million at December 31, 2011 and are included in other current liabilities on the Condensed Consolidated Balance Sheets. For additional information regarding these leases, see Risk Factors, MD&A – Off Balance Sheet Arrangements and Note 7 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K.

PNM has a PPA covering the entire output of Delta, which is a variable interest under GAAP. This arrangement was entered into prior to December 31, 2003 and PNM has been unsuccessful in obtaining the information necessary to determine if it is the primary beneficiary of the entity that owns Delta, or to consolidate that entity if it were determined that PNM is the primary beneficiary. Accordingly, PNM is unable to make those determinations and, as provided in GAAP, continues to account for this PPA as an operating lease. PNM makes fixed and variable payments to Delta under the PPA. For the three and nine months ended September 30, 2012, PNM incurred fixed payments of \$1.6 million and \$4.7 million and variable payments of \$0.3 million and \$0.6 million under the PPA. For the three and nine months ended September 30, 2011, PNM incurred fixed payments of \$1.5 million and \$4.5 million and variable payments of \$0.7 million and \$1.0 million under the PPA. PNM's only quantifiable obligation under the PPA is to make the fixed payments, which as of September 30, 2012, aggregated \$46.7 million through the end of the PPA in 2020. PNM will also pay variable costs, which cannot be quantified since the amounts are based on how much the generating plant is in operation. PNM has no other obligations or commitments with respect to Delta.

(4) Fair Value of Derivative and Other Financial Instruments

Energy Related Derivative Contracts

Overview

The primary objective for the use of commodity derivative instruments, including energy contracts, options, and futures, is to manage price risk associated with forecasted purchases of energy or fuel used to generate electricity, or to manage anticipated generation capacity in excess of forecasted demand from existing customers. The Company's

energy related derivative contracts are designed to manage commodity risk. PNM is required to meet the demand and energy needs of its retail and firm-requirements wholesale customers. PNM is exposed to market risk for its share of PVNGS Unit 3 and the needs of its firm-requirements wholesale customers not covered under a FPPAC. PNM's operations are managed primarily through a net asset-backed strategy, whereby PNM's aggregate net open forward contract position is covered by its forecasted excess generation capabilities or market purchases. PNM could be exposed to market risk if its generation capabilities were to be disrupted or if its load requirements were to be greater than anticipated. If all or a portion of load requirements were required to be covered as a result of such unexpected situations, commitments would have to be met through market purchases. Additional information concerning the Company's energy related derivative contracts, including how commodity risk is managed, is contained in Note 8 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K.

On November 1, 2011, PNMR completed the sale of First Choice. See Note 14. Accordingly, First Choice information after October 31, 2011 is not included. The difference between PNMR and PNM amounts represents First Choice.

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## Accounting for Derivatives

Energy contracts that meet the definition of a derivative under GAAP and do not qualify, or are not designated, for the normal sales and purchases exception are recorded on the balance sheet at fair value at each period end. The changes in fair value are recognized in earnings unless specific hedge accounting criteria are met and elected. Normal sales and purchases are not marked to market and are reflected in results of operations when the underlying transactions settle. The Company had no designated cash flow or fair value hedges related to commodity derivatives in the year ended December 31, 2011 and the nine months ended September 30, 2012.

The contracts recorded at fair value that do not qualify or are not designated for cash flow hedge accounting are classified as economic hedges. Economic hedges are defined as derivative instruments, including long-term power agreements, used to economically hedge generation assets, purchased power and fuel costs, and customer load requirements. Changes in the fair value of economic hedges are reflected in results of operations and are classified between operating revenues and cost of energy according to the intent of the hedge. The Company has no trading transactions.

The Company does not offset fair value, cash collateral, and accrued payable or receivable amounts recognized for derivative instruments under master netting arrangements. At September 30, 2012 and December 31, 2011, amounts posted as cash collateral under margin arrangements were \$1.6 million and \$1.8 million for both PNMR and PNM. Cash collateral amounts are included in other current assets on the Condensed Consolidated Balance Sheets. At September 30, 2012 and December 31, 2011, PNMR and PNM had the legal right to reclaim cash collateral of \$1.6 million and zero. PNMR and PNM had no obligation to return cash collateral at September 30, 2012 and December 31, 2011.

## Commodity Derivatives

Commodity derivative instruments are summarized as follows:

	Economic Hedges	
	September 30, 2012	December 31, 2011
PNMR and PNM	(In thousands)	
Current assets	\$ 1,184	\$ 3,713
Current liabilities	(1,888	) (1,632
Long-term liabilities	(2,770	) (2,437
	(4,658	) (4,069
Net	\$ (3,474	) \$ (356

PNM has a NMPRC approved hedging plan to manage fuel and purchased power costs related to customers covered by its FPPAC. The table above includes \$0.1 million of current assets and current liabilities at September 30, 2012, and \$0.5 million of current assets and current liabilities at December 31, 2011 related to this plan. The offsets to these amounts are recorded as regulatory assets and liabilities on the Condensed Consolidated Balance Sheets.



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The following table presents the effect of commodity derivative instruments on earnings, excluding income tax effects.

	Economic Hedges			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
PNMR	(In thousands)			
Electric operating revenues	\$ (740	) \$ 2,915	\$ 897	\$ 4,250
Cost of energy	263	(2,873	) (278	) (2,788
Total gain (loss)	\$ (477	) \$ 42	\$ 619	\$ 1,462
PNM				
Electric operating revenues	\$ (740	) \$ 2,915	\$ 897	\$ 4,250
Cost of energy	263	(562	) (278	) (404
Total gain (loss)	\$ (477	) \$ 2,353	\$ 619	\$ 3,846

Commodity contract volume positions are presented in Decatherms for gas related contracts and in MWh for power related contracts. The table below presents PNMR's and PNM's net buy (sell) volume positions:

	Economic Hedges	
	Decatherms	MWh
September 30, 2012		
PNMR and PNM	1,435,000	(1,786,923
December 31, 2011		
PNMR and PNM	1,499,000	(366,448

In connection with managing its commodity risks, the Company enters into master agreements with certain counterparties. If the Company is in a net liability position under an agreement, some agreements provide that the counterparties can request collateral from the Company if the Company's credit rating is downgraded; other agreements provide that the counterparty may request collateral to provide it with "adequate assurance" that the Company will perform; and others have no provision for collateral.

The table below presents information about the Company's contingent requirements to provide collateral under commodity contracts having an objectively determinable collateral provision that are in net liability positions and are not fully collateralized with cash. Contractual liability represents commodity derivative contracts recorded at fair value on the balance sheet, determined on an individual contract basis without offsetting amounts for individual contracts that are in an asset position and could be offset under master netting agreements with the same counterparty. The table only reflects cash collateral that has been posted under the existing contracts and does not reflect letters of credit under the Company's revolving credit facilities that have been issued as collateral. Net exposure is the net contractual liability for all contracts, including those designated as normal purchases and sales, offset by existing cash collateral and by any offsets available under master netting agreements, including both asset and liability positions.

Contingent Feature – Credit Rating Downgrade	Contractual Liability	Existing Cash	Net Exposure
		Collateral	
(In thousands)			
September 30, 2012			
PNMR and PNM	\$ 3,977	\$—	\$ 3,943

December 31, 2011  
PNMR and PNM

\$4,036

\$—

\$4,036

33

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## Sale of Power from PVNGS Unit 3

Since January 1, 2011, PNM has been selling power from its interest in PVNGS Unit 3 daily at market prices. PNM has established fixed rates for the substantial majority of these sales through the end of 2013 through hedging arrangements that are accounted for as economic hedges. PNM is also partially hedged for 2014.

## Non-Derivative Financial Instruments

The carrying amounts reflected on the Condensed Consolidated Balance Sheets approximate fair value for cash, receivables, and payables due to the short period of maturity. Available-for-sale securities are carried at fair value. Available-for-sale securities for PNMR and PNM consist of PNM assets held in the NDT for its share of decommissioning costs of PVNGS and, beginning in August 2012, a trust for PNM's share of post-term reclamation costs related to the coal mines serving SJGS (Note 9), which investments are included in "other investments" on the Condensed Consolidated Balance Sheet. PNMR and PNM do not have any unrealized losses on available-for-sale securities. The fair value and gross unrealized gains of investments in available-for-sale securities are presented in the following table.

	September 30, 2012		December 31, 2011	
	Unrealized Gains	Fair Value	Unrealized Gains	Fair Value
	(In thousands)			
Equity securities:				
Domestic value	\$5,083	\$29,856	\$3,549	\$25,143
Domestic growth	20,062	53,246	16,714	52,187
International and other	434	12,064	662	12,754
Fixed income securities:				
Municipals	4,307	44,173	2,861	41,463
U.S. Government	1,451	33,479	1,353	25,367
Corporate and other	1,167	13,788	742	9,171
Cash investments	—	2,820	—	2,766
	\$32,504	\$189,426	\$25,881	\$168,851

The proceeds and gross realized gains and losses on the disposition of available-for-sale securities for PNMR and PNM are shown in the following table. Realized gains and losses are determined by specific identification of costs of securities sold.

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
	(In thousands)			
Proceeds from sales	\$90,518	\$26,312	\$136,305	\$121,202
Gross realized gains	\$6,263	\$2,800	\$11,029	\$16,290
Gross realized (losses)	\$(5,131)	\$(1,847)	\$(7,055)	\$(4,129)

Held-to-maturity securities are those investments in debt securities that the Company has the ability and intent to hold until maturity. Held-to-maturity securities consist of the investment in PVNGS lessor notes and certain items within other investments, including the EIP lessor note.

The Company has no available-for-sale or held-to-maturity securities for which carrying value exceeds fair value. There are no impairments considered to be “other than temporary” that are included in AOCI and not recognized in earnings.



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At September 30, 2012, the available-for-sale and held-to-maturity debt securities had the following final maturities:

	Fair Value		
	Available-for-Sale	Held-to-Maturity	
	PNMR and PNM	PNMR	PNM
	(In thousands)		
Within 1 year	\$ 1,543	\$ 951	\$ 951
After 1 year through 5 years	30,977	85,484	78,420
After 5 years through 10 years	14,418	2,110	—
After 10 years through 15 years	9,196	—	—
After 15 years through 20 years	12,102	—	—
After 20 years	23,204	—	—
	\$ 91,440	\$ 88,545	\$ 79,371

#### Fair Value Disclosures

The Company determines the fair values of its derivative and other instruments based on the hierarchy established in GAAP, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. GAAP describes three levels of inputs that may be used to measure fair value. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability. Level 3 inputs used in determining fair values for the Company consist of internal valuation models.

For NDT investments, Level 2 fair values are provided by the trustee utilizing a pricing service. The pricing provider predominantly uses the market approach using bid side market value based upon a hierarchy of information for specific securities or securities with similar characteristics. For commodity derivatives, Level 2 fair values are determined based on market observable inputs, which are validated using multiple broker quotes, including forward price, volatility, and interest rate curves to establish expectations of future prices. Credit valuation adjustments are made for estimated credit losses based on the overall exposure to each counterparty. For long-term debt, Level 2 fair values are provided by an external pricing service. The pricing service primarily utilizes quoted prices for similar debt in active markets when determining fair value. For investments categorized as Level 3, primarily the PVNGS lessor notes and other investments, fair values were determined by discounted cash flow models that take into consideration discount rates that are observable for similar type assets and liabilities. Management of the Company independently verifies the information provided by pricing services.

The Company records any transfers between fair value hierarchy levels as of the end of each calendar quarter. There were no transfers between levels during the nine months ended September 30, 2012 and 2011.

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Items recorded at fair value on the Condensed Consolidated Balance Sheets are presented below:

	Fair Value	GAAP Fair Value Hierarchy		
		Level 1	Level 2	Level 3
September 30, 2012				
PNMR and PNM				
Decommissioning and reclamation investments				
Cash and equivalents	\$2,820	\$2,820	\$—	\$—
Equity securities:				
Domestic value	29,856	29,856	—	—
Domestic growth	53,246	53,246	—	—
International and other	12,064	12,064	—	—
Fixed income securities:				
U.S. government	33,479	29,746	3,733	—
Municipals	44,173	—	44,173	—
Corporate and other	13,788	—	13,788	—
Total	\$189,426	\$127,732	\$61,694	\$—
Commodity derivative assets	\$1,184	\$—	\$1,184	\$—
Commodity derivative liabilities	(4,658)	) —	(4,658)	) —
Net	\$ (3,474)	) \$—	\$ (3,474)	) \$—
December 31, 2011				
PNMR and PNM				
NDT investments				
Cash and equivalents	\$2,766	\$2,766	\$—	\$—
Equity securities:				
Domestic value	25,143	25,143	—	—
Domestic growth	52,187	52,187	—	—
International and other	12,754	12,754	—	—
Fixed income securities:				
U.S. government	25,367	21,409	3,958	—
Municipals	41,463	—	41,463	—
Corporate and other	9,171	—	9,171	—
Total	\$168,851	\$114,259	\$54,592	\$—
Commodity derivative assets	\$3,713	\$—	\$3,713	\$—
Commodity derivative liabilities	(4,069)	) —	(4,069)	) —
Net	\$ (356)	) \$—	\$ (356)	) \$—

A reconciliation of the changes in Level 3 fair value measurements for PNMR is as follows. PNM had no Level 3 fair value measurements during the nine months ended September 30, 2012 and 2011.



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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
PNMR	(In thousands)			
Balance at beginning of period	\$—	\$4,392	\$—	\$(822)
Total gains (losses) included in earnings	—	(5,025)	—	201
Purchases	—	429	—	3,163
Settlements	—	1,142	—	(1,604)
Balance at end of period	\$—	\$938	\$—	\$938
Total gains (losses) included in earnings attributable to the change in unrealized gains or losses relating to assets still held at the end of the period	\$—	\$589	\$—	\$1,455

The above gains and losses (realized and unrealized) for Level 3 fair value measurements included in earnings are reported in cost of energy.

The carrying amounts and fair values of investments in PVNGS lessor notes, other investments, and long-term debt, which are not recorded at fair value on the Condensed Consolidated Balance Sheets are presented below:

	Carrying Amount	Fair Value	GAAP Fair Value Hierarchy <sup>(1)</sup>		
	(In thousands)		Level 1	Level 2	Level 3
September 30, 2012					
PNMR					
Long-term debt	\$1,674,511	\$2,107,877	\$—	\$2,102,638	\$5,239
Investment in PVNGS lessor notes	\$78,023	\$78,420	\$—	\$—	\$78,420
Other investments	\$7,390	\$12,059	\$758	\$—	\$11,301
PNM					
Long-term debt	\$1,215,569	\$1,512,711	\$—	\$1,512,711	\$—
Investment in PVNGS lessor notes	\$78,023	\$78,420	\$—	\$—	\$78,420
Other investments	\$1,398	\$1,443	\$491	\$—	\$952
TNMP					
Long-term debt	\$311,432	\$426,934	\$—	\$426,934	\$—
Other investments	\$267	\$267	\$267	\$—	\$—
December 31, 2011					
PNMR					
Long-term debt	\$1,674,013	\$1,873,002			
Investment in PVNGS lessor notes	\$107,094	\$108,742			
Other investments	\$12,207	\$14,208			
PNM					
Long-term debt	\$1,215,540	\$1,294,846			
Investment in PVNGS lessor notes	\$107,094	\$108,742			

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Other investments	\$2,900	\$3,052
TNMP		
Long-term debt	\$310,963	\$413,966
Other investments	\$271	\$271

<sup>(1)</sup> GAAP does not require disclosure of the fair value hierarchy information prior to 2012.

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## (5) Earnings Per Share

In accordance with GAAP, dual presentation of basic and diluted earnings per share is presented in the Condensed Consolidated Statements of Earnings of PNMR. Information regarding the computation of earnings per share is as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
	(In thousands, except per share amounts)			
Net Earnings Attributable to PNMR	\$57,864	\$43,662	\$96,456	\$64,366
Average Number of Common Shares:				
Outstanding during period	79,654	86,673	79,654	86,673
Equivalents from convertible preferred stock (Note 7)	—	4,363	—	4,638
Vested awards of restricted stock	114	164	156	154
Average Shares - Basic	79,768	91,200	79,810	91,465
Dilutive Effect of Common Stock Equivalents <sup>(1)</sup> :				
Stock options and restricted stock	622	542	600	516
Average Shares - Diluted	80,390	91,742	80,410	91,981
Net Earnings Per Share of Common Stock:				
Basic	\$0.73	\$0.48	\$1.21	\$0.70
Diluted	\$0.72	\$0.48	\$1.20	\$0.70

<sup>(1)</sup> Excludes the effect of out-of-the-money options for 1,108,946 shares of common stock at September 30, 2012.

## (6) Stock-Based Compensation

Additional information concerning stock-based compensation under PNMR's Performance Equity Plan ("PEP") is contained in Note 13 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K. In 2011, the Company changed its approach to awarding stock-based compensation. As a result, no stock options have been granted in 2011 or 2012 and awards of restricted stock have increased.

## Stock Options

The following table summarizes activity in stock options for the nine months ended September 30, 2012:

	Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contract Life
Outstanding at beginning of period	3,202,229	\$18.95		
Granted	—	\$—		
Exercised	(757,497)	) \$13.60		
Forfeited	(5,101)	) \$12.22		

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Expired	(265,443	) \$25.71		
Outstanding at end of period	2,174,188	\$20.01	\$9,429,630	<sup>(1)</sup> 4.52 years
Exercisable at end of period	2,033,857	\$21.39	\$8,195,812	4.32 years

<sup>(1)</sup> At September 30, 2012, the exercise price of 1,108,946 outstanding stock options is greater than the closing price of PNMR common stock on that date; therefore, those options have no intrinsic value.

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The following table provides additional information concerning stock options:

	Nine Months Ended September 30,	
	2012	2011
Weighted-average grant date fair value of options granted	\$—	\$—
Total fair value of options that vested (in thousands)	\$ 1,058	\$ 1,189
Total intrinsic value of options exercised (in thousands)	\$ 4,515	\$ 1,077

#### Restricted Stock and Performance Shares

PNMR has agreements with employees for awards of restricted stock subject to time vesting requirements. PNMR also has awards subject to achieving performance or market targets, some of which also have time vesting requirements. The grant date fair value for restricted stock and stock awards with performance targets is determined based on the market price of PNMR common stock on the date of the agreements reduced by the present value of future dividends, which will not be received prior to vesting, applied to the total number of shares that are anticipated to vest, although the number of performance shares ultimately awarded cannot be determined until after the performance periods end. The grant date fair value of stock awards with market targets is determined using Monte Carlo simulation models, which provide grant date fair values that include an expectation of the number of shares to be issued.

Compensation expense for performance-based shares is recognized ratably over the performance period and is adjusted periodically to reflect the level of achievement expected to be attained. Compensation expense related to market-based shares is recognized ratably over the measurement period, regardless of the actual level of achievement, provided the employees remain with the Company during the period. Compensation expense for other restricted stock awards is recognized ratably over the vesting period.

The following table summarizes restricted stock activity, including performance-based and market-based shares, for the nine months ended September 30, 2012:

	Shares	Weighted- Average Grant-Date Fair Value
Nonvested at beginning of period	418,730	\$ 12.36
Granted	320,597	\$ 15.63
Vested	(375,402)	) \$ 12.67
Forfeited	(7,503)	) \$ 12.48
Nonvested at end of period	356,422	\$ 14.71

The following table provides additional information concerning restricted stock, including performance-based and market-based shares:

Nine Months Ended  
September 30,



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	2012	2011
Weighted-average grant date fair value of shares granted	\$ 15.63	\$ 13.10
Total fair value of shares that vested (in thousands)	\$ 4,755	\$ 1,084
Expected quarterly dividends per share	\$ 0.145	\$ 0.125
Risk-free interest rate	0.76	% 1.20 %

Included as granted and vested in the above tables are 42,768 shares that were based on achieving performance targets during the 2009 through 2011 period. The Board approved these shares at maximum levels in March 2012. Also included as

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granted and vested in the tables above are 117,174 shares that were based upon achieving performance or market targets for 2011. The Board approved these shares in March 2012, including the performance-based shares at near maximum levels.

PNMR also has share agreements that provide for performance or market targets through 2014. Excluded from the above tables are maximums of 168,269, 190,369, and 205,878 shares for periods ending in 2012, 2013, and 2014 that would be awarded if all performance or market criteria are achieved and all executives remain eligible.

In March 2012, the Company entered into a retention award agreement with its Chairman, President, and Chief Executive Officer under which she would receive 135,000 shares of PNMR's common stock if the Company meets specific market targets at the end of 2016 and she remains an employee of the Company. If the Company achieves specific market targets at the end of 2014 and she remains an employee of the Company, she would receive 35,000 of the total shares at that time. The retention award was made under the PEP and was approved by the Board on February 28, 2012. The above tables do not include any shares under the retention award agreement.

## (7) Capitalization

Additional information concerning financing activities, including a TNMP cash-flow hedge that establishes a fixed interest rate on a variable rate loan, is contained in Note 6 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K.

## Short-term Debt

PNMR has a revolving credit financing capacity of \$300.0 million under the PNMR Revolving Credit Facility. PNM has a revolving credit financing capacity of \$400.0 million under the PNM Revolving Credit Facility. Both of these facilities included two one-year extension options, subject to approval by the lenders. In October 2012, the first of the one-year extension options for the PNMR Revolving Credit Facility and the PNM Revolving Credit Facility were exercised extending the expiration of both facilities to October 31, 2017. TNMP has a revolving credit facility with financing capacity of \$75.0 million under the TNMP Revolving Credit Facility that expires in December 2015. At September 30, 2012, the weighted average interest rate was 1.97% for borrowings outstanding under the PNMR Revolving Credit Facility. Short-term debt outstanding consisted of:

	September 30, 2012	December 31, 2011
Short-term Debt		
	(In thousands)	
PNM – Revolving credit facility	\$—	\$ 66,000
TNMP – Revolving credit facility	—	—
PNMR		
Revolving credit facility	113,400	16,700
Bi-lateral line of credit	*	—
	\$ 113,400	\$ 82,700

\* This \$5.0 million line of credit was allowed to expire in August 2012.

At October 26, 2012, PNMR, PNM, and TNMP had \$182.3 million, \$396.5 million, and \$74.7 million of availability under their respective revolving credit facilities, including reductions of availability due to outstanding letters of credit. Total availability at October 26, 2012, on a consolidated basis, was \$653.5 million for PNMR. As of October 26, 2012, TNMP had \$12.3 million in borrowings from PNMR under their intercompany loan agreement. At October 26, 2012, PNMR, PNM and TNMP had consolidated invested cash of \$6.6 million, \$6.6 million, and none.

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Financing Activities

In April 2012, PNM filed an application with the NMPRC requesting approval to participate in the refunding of \$20.0 million of PCRBs, which was approved in May 2012. PNM also received NMPRC authority to exercise the two one-year extension options under the PNM Revolving Credit Facility.

In September 2012, PNM participated in the issuance of \$20.0 million of new PCRBs by the City of Farmington, New Mexico, which bear interest at 2.54% and mature September 1, 2042 with a mandatory tender on June 1, 2017. The new PCRBs refunded a \$20.0 million series of PCRBs, which bore interest at 5.15% and matured in 2037, that were redeemed at par and retired.

Convertible Preferred Stock

PNMR had 477,800 shares of Series A convertible preferred stock outstanding through September 23, 2011 when it entered into an agreement to purchase all of the outstanding shares. The purchase closed on October 5, 2011. The Series A convertible preferred stock was convertible into PNMR common stock in a ratio of 10 shares of common stock for each share of preferred stock and received dividends equivalent to dividends paid on PNMR common stock as if the preferred stock had been converted into common stock. The Series A convertible preferred stock was entitled to vote on all matters voted upon by common stockholders, except for the election of the Board, and would have received distributions substantially equivalent to common stock in the event of liquidation of PNMR. The terms of the Series A convertible preferred stock resulted in it being substantially equivalent to common stock. Therefore, for earnings per share purposes, the number of common shares into which the Series A convertible preferred stock was convertible was included in the weighted average number of common shares outstanding for periods the Series A convertible preferred stock was outstanding. Similarly, dividends on the Series A convertible preferred stock were considered to be common dividends in the accompanying Condensed Consolidated Financial Statements.

(8) Pension and Other Postretirement Benefit Plans

PNMR and its subsidiaries maintain qualified defined benefit pension plans, postretirement benefit plans providing medical and dental benefits, and executive retirement programs (“PNM Plans” and “TNMP Plans”). PNMR maintains the legal obligation for the benefits owed to participants under these plans.

Additional information concerning pension and OPEB plans is contained in Note 12 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K. Annual net periodic benefit cost (income) for the plans is actuarially determined using the methods and assumptions set forth in that note and is recognized ratably throughout the year.

PNM Plans

The following tables present the components of the PNM Plans’ net periodic benefit cost:

Three Months Ended September 30,	
Pension Plan	OPEB Plan

	2012	2011	2012	2011	Executive Retirement Program	
	(In thousands)				2012	2011
Components of Net Periodic Benefit Cost						
Service cost	\$—	\$—	\$54	\$65	\$—	\$—
Interest cost	8,058	8,202	1,324	1,345	219	233
Long-term return on plan assets	(10,325)	(9,269)	(1,225)	(1,347)	—	—
Amortization of net loss	2,629	2,302	972	801	21	23
Amortization of prior service cost	79	79	(336)	(662)	—	—
Net periodic benefit cost	\$441	\$1,314	\$789	\$202	\$240	\$256

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	Nine Months Ended September 30,					
	Pension Plan		Other Postretirement Benefits		Executive Retirement Program	
	2012	2011	2012	2011	2012	2011
	(In thousands)					
Components of Net Periodic Benefit Cost						
Service cost	\$—	\$—	\$162	\$195	\$—	\$—
Interest cost	24,174	24,606	3,972	4,035	657	699
Long-term return on plan assets	(30,975 )	(27,807 )	(3,675 )	(4,041 )	—	—
Amortization of net loss	7,887	6,906	2,916	2,403	63	69
Amortization of prior service cost	237	237	(1,008 )	(1,986 )	—	—
Net periodic benefit cost	\$1,323	\$3,942	\$2,367	\$606	\$720	\$768

PNM made contributions to its pension plan trust of zero and \$77.7 million in the three and nine months ended September 30, 2012 and \$20.5 million and \$34.0 million in the three and nine months ended September 30, 2011. PNM does not anticipate making additional contributions to its pension trust in 2012. Based on current law, including recent amendments to funding requirements, and estimates of portfolio performance, PNM estimates minimum required contributions for its pension plan trust would total \$74.4 million for 2013-2016. Minimum required contributions were developed using current funding assumptions, including discount rates of 5.3% to 6.1%. Actual amounts required to be funded in the future will depend on the actuarial assumptions at that time, including the appropriate discount rate. PNM may make additional contributions at its discretion. PNM made contributions to the OPEB trust of \$0.8 million and \$2.4 million in the three and nine months ended September 30, 2012 and \$0.7 million and \$1.9 million in the three and nine months ended September 30, 2011. PNM expects contributions during 2012 to the OPEB trust to total \$3.2 million. Disbursements under the executive retirement program, which are funded by the Company and considered to be contributions to the plan, were \$0.4 million and \$1.1 million in the three and nine months ended September 30, 2012 and \$0.4 million and \$1.2 million in the three and nine months ended September 30, 2011 and are expected to total \$1.5 million during 2012.

## TNMP Plans

The following tables present the components of the TNMP Plans' net periodic benefit cost (income):

	Three Months Ended September 30,					
	Pension Plan		OPEB Plan		Executive Retirement Program	
	2012	2011	2012	2011	2012	2011
	(In thousands)					
Components of Net Periodic Benefit Cost (Income)						
Service cost	\$—	\$—	\$61	\$77	\$—	\$—
Interest cost	909	951	156	163	11	12
Long-term return on plan assets	(1,331 )	(1,368 )	(129 )	(133 )	—	—

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Amortization of net (gain) loss	115	86	(52	) (48	) —	—
Amortization of prior service cost	—	—	14	15	—	—
Net Periodic Benefit Cost (Income)	\$(307	) \$(331	) \$50	\$74	\$11	\$12

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	Nine Months Ended September 30,					
	Pension Plan		Other Postretirement Benefits		Executive Retirement Program	
	2012	2011	2012	2011	2012	2011
	(In thousands)					
Components of Net Periodic Benefit Cost (Income)						
Service cost	\$—	\$—	\$183	\$231	\$—	\$—
Interest cost	2,727	2,853	468	489	33	36
Long-term return on plan assets	(3,993 )	(4,104 )	(387 )	(399 )	—	—
Amortization of net (gain) loss	345	258	(156 )	(144 )	—	—
Amortization of prior service cost	—	—	42	45	—	—
Net Periodic Benefit Cost (Income)	\$(921 )	\$(993 )	\$150	\$222	\$33	\$36

TNMP made contributions to its pension plan trust of zero and \$5.3 million in the three and nine months ended September 30, 2012 and \$0.8 million and \$1.0 million in the three and nine months ended September 30, 2011. TNMP does not anticipate making additional contributions to its pension trust in 2012. Based on current law, including recent amendments to funding requirements, and estimates of portfolio performance, TNMP estimates there would be no minimum required contributions to its pension plan trust for 2013-2016. Minimum required contributions were developed using current funding assumptions, including discount rates of 5.3% and 6.1%. Actual amounts to be funded in the future will depend on the actuarial assumptions at that time, including the appropriate discount rate. TNMP may make additional contributions at its discretion. TNMP made contributions to the OPEB trust of zero and \$0.3 million in the three and nine months ended September 30, 2012 and zero and \$0.4 million in the three and nine months ended September 30, 2011. TNMP does not expect to make additional contributions during 2012 to the OPEB trust. Disbursements under the executive retirement program, which are funded by the Company and considered to be contributions to the plan, were less than \$0.1 million in the three and nine months ended September 30, 2012 and 2011 and are expected to total \$0.1 million during 2012.

## (9) Commitments and Contingencies

## Overview

There are various claims and lawsuits pending against the Company. The Company is also subject to federal, state, and local environmental laws and regulations and periodically participates in the investigation and remediation of various sites. In addition, the Company occasionally enters into financial commitments in connection with its business operations. The Company is also involved in various legal and regulatory (Note 10) proceedings in the normal course of its business. It is not possible at this time for the Company to determine fully the effect of all litigation and other legal and regulatory proceedings on its financial position, results of operations, or cash flows.

With respect to some of the items listed below, the Company has determined that a loss is not probable or that, to the extent probable, cannot be reasonably estimated. In some cases, the Company is not able to predict with any degree of certainty the range of possible loss that could be incurred. Notwithstanding these facts, the Company has assessed these matters based on current information and made judgments concerning their potential outcome, giving due



consideration to the nature of the claim, the amount and nature of damages sought, and the probability of success. Such judgments are made with the understanding that the outcome of any litigation, investigation, and other legal proceeding is inherently uncertain. In accordance with GAAP, the Company records liabilities for matters where it is probable a loss has been incurred and the amount of loss is reasonably estimable. The actual outcomes of the items listed below could ultimately differ from the judgments made and the differences could be material. The Company cannot make any assurances that the amount of reserves or potential insurance coverage will be sufficient to cover the cash obligations that might be incurred as a result of litigation or regulatory proceedings. The Company does not expect that any known lawsuits, environmental costs, and commitments will have a material effect on its financial condition, results of operations, or cash flows.

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Additional information concerning commitments and contingencies is contained in Note 16 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K.

Commitments and Contingencies Related to the Environment

Nuclear Spent Fuel and Waste Disposal

Nuclear power plant operators are required to enter into spent fuel disposal contracts with the DOE that require the DOE to accept and dispose of all spent nuclear fuel and other high-level radioactive wastes generated by domestic power reactors. Although the Nuclear Waste Policy Act required the DOE to develop a permanent repository for the storage and disposal of spent nuclear fuel by 1998, the DOE announced that it would not be able to open the repository by 1998 and sought to excuse its performance under the contract. In November 1997, the D.C. Circuit issued a decision preventing the DOE from excusing its own delay, but refused to order the DOE to begin accepting spent nuclear fuel. PNM estimates that it will incur approximately \$42.8 million (in 2010 dollars) for its share of the costs related to the on-site interim storage of spent nuclear fuel at PVNGS during the term of the operating licenses. PNM accrues these costs as a component of fuel expense as the fuel is consumed. At September 30, 2012 and December 31, 2011, PNM had a liability for interim storage costs of \$13.8 million and \$14.5 million included in other deferred credits.

On June 8, 2012, the D.C. Circuit issued its decision on a challenge by several states and environmental groups of the NRC's rulemaking regarding temporary storage and permanent disposal of high-level nuclear waste and spent nuclear fuel. The petitioners had challenged the NRC's 2010 update to the agency's Waste Confidence Decision. Previous versions of the Waste Confidence Decision had expressed the NRC's confidence, in a generic fashion, that high level nuclear waste and spent nuclear fuel safe storage could be safely stored on the sites of the country's commercial nuclear power plants until a mined geologic repository becomes available. The D.C. Circuit found that the agency's 2010 Waste Confidence Decision update constituted a major federal action, which requires either an environmental impact statement or a finding of no significant impact from the agency's actions. The D.C. Circuit found that the NRC's evaluation of the environmental risks from spent nuclear was deficient, and therefore remanded the 2010 Waste Confidence Decision update for further action. PNM is unable to predict the impact that the decision may have on the operation of PVNGS.

The Clean Air Act

Regional Haze

In 1999, EPA developed a regional haze program and regional haze rules under the CAA. The rule directs each of the 50 states to address regional haze. States are required to establish goals for improving visibility in national parks and wilderness areas (also known as Class I areas) and to develop long-term strategies for reducing emissions of air pollutants that cause visibility impairment in their own states and for preventing degradation in other states. States must establish a series of interim goals to ensure continued progress. The first planning period specifies setting reasonable progress goals for improving visibility in Class I areas by the year 2018. In July 2005, the EPA promulgated its final regional haze rule. A major provision of the rule included guidelines for states to conduct BART determinations for certain covered facilities. The BART requirements of the regional haze rule apply to facilities,

including utility boilers, built between 1962 and 1977 that have the potential to emit more than 250 tons per year of visibility impairing pollution. If it is demonstrated that the emissions from these sources cause or contribute to visibility impairment in any Class I area, then BART must be installed. The regional haze rules require that BART controls must be installed on an eligible facility by 2018.

#### SJGS

Several provisions of the CAA aim to improve visibility in certain national parks and wilderness areas to natural conditions by the year 2064. SJGS is a source that is subject to these statutory obligations to reduce visibility impacts.

Pursuant to the CAA, states have the primary role to regulate visibility requirements by promulgating SIPs. The State of New Mexico submitted its SIP on the two elements of the visibility rules - regional haze and interstate transport - for review by EPA in June 2011. The SIP found that BART to reduce NO<sub>x</sub> emissions from SJGS is selective non-catalytic reduction technology

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("SNCR") and requires SJGS to install SNCR on each of its four units. Nevertheless, on August 22, 2011, EPA published its FIP, stating that it was required to do so by virtue of a consent decree it had entered into with an environmental group in litigation concerning the interstate transport requirements of the CAA. The FIP included a regional haze BART determination for SJGS that requires installation of selective catalytic reduction technology ("SCR") on all four units within five years of the rule's effective date of September 21, 2011. The FIP also requires stringent NO<sub>x</sub> emission limits. EPA stated that it would review and act on the SIP at some future date.

PNM filed a Petition for Review in the Tenth Circuit on September 16, 2011, challenging EPA's regional haze FIP decision as arbitrary, capricious, or otherwise not in accordance with law. Additionally, in October 2011, PNM asked EPA to reconsider the FIP and in May 2012 supplemented its request for reconsideration with cost information from actual bids received in response to an RFP to install SCRs. On October 21, 2011, the Governor of New Mexico and NMED petitioned the Tenth Circuit to review EPA's decision on the same grounds as PNM's challenge and requested EPA to reconsider its decision. The New Mexico Governor and NMED also joined PNM's supplemental request for reconsideration in May 2012. These three parties filed motions with the Tenth Circuit to stay the effective date of the rule, which were denied on March 1, 2012. The same three parties have also formally asked EPA to stay the effective date of the rule. WildEarth Guardians also filed an action to challenge EPA's rule in the Tenth Circuit, seeking to shorten its compliance period from five years to three years. WildEarth Guardians, Diné Citizens Against Ruining our Environment, National Parks Conservation Association, New Energy Economy, San Juan Citizens Alliance, and Sierra Club intervened in support of EPA in both PNM's challenge and in the case brought by the New Mexico Governor and NMED. PNM has intervened in support of the challenge brought by the New Mexico Governor and NMED. PNM has also intervened in the WildEarth Guardians' action advocating that the five-year compliance period in the FIP be maintained should the FIP stand. The Tenth Circuit entered an order in March 2012 scheduling briefing on the merits in the challenges to the FIP. Oral arguments were held on October 23, 2012. During oral arguments, the court ordered the parties to file supplemental information in November 2012 and January 2013. No decision has been announced and there is no deadline for a court decision.

In litigation with several environmental groups, the U.S. District Court for the District of Columbia entered a consent decree, which, as amended, required EPA to review and take action through a proposed rulemaking on New Mexico's regional haze SIP on or before May 31, 2012 and a final rulemaking on or before November 15, 2012. On May 31, 2012, EPA issued its proposed action on the regional haze SIP, which was published in the Federal Register on June 15, 2012. EPA proposed approval of all components of the SIP, except for the BART determination for SJGS. With respect to that element of the SIP, EPA determined that with the FIP in place, it had met its obligation under the consent decree, and stated that it would issue a separate proposal or would entertain the withdrawal of the SIP in favor of an alternative that may be developed through discussions with the State of New Mexico and PNM.

On April 25, 2012, PNM received a copy of a letter from two of the five Commissioners of the NMPRC addressed to the Governor of New Mexico and the New Mexico congressional delegation. In the letter, the Commissioners ask that the parties to the litigation join to ask EPA to stay both the FIP and the litigation and to consider a "third alternative" to the FIP and the SIP. They suggest that the third alternative be retiring one or more of the existing coal-fired units at SJGS and replacing that capacity with gas-fired generation. On April 26, 2012, PNM received a copy of a letter from the Governor of New Mexico addressed to the EPA Administrator. In that communication, the Governor requested that EPA stay the FIP and respond to the SIP by approving it or explaining why it is not approvable. Furthermore, the Governor requested PNM to develop viable alternatives to the FIP, assuming that EPA stays the FIP and responds to

the SIP. PNM agreed to comply with the Governor's request. In her letter to the Governor, the EPA Administrator requested that NMED take the lead in working with the parties and stakeholders.

On July 2, 2012, the EPA Administrator replied to the Governor stating that she had signed a 90-day stay of the FIP. The stay was published in the Federal Register on July 16, 2012. The stay purports to stay the effectiveness of the FIP for a period of 90 days after publication. The stay states that any FIP requirements during the 90-day period are stayed, but also acknowledges that there are no such requirements. The only mandate of the FIP is that PNM comply with its emission limit on its ultimate compliance date. Therefore, the stay does not alter future compliance requirements of the FIP, including the compliance deadline in the FIP. The stay provides that EPA "intends" to proceed to a rulemaking at some future time to either 1) extend the compliance date, or 2) provide for an alternative proposal that might be developed during the period of the stay. Because the stay is not effective to toll the compliance date absent a subsequent formal EPA rulemaking, the compliance date currently remains September 21, 2016.

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In accordance with the Governor's request, PNM has engaged in discussions with NMED, EPA, and other stakeholders regarding an alternative to the FIP and SIP. In July 2012, the NMED established a process to elicit input from the public via open meetings across New Mexico and from a variety of stakeholders, including PNM, the Navajo Nation, local governmental representatives, and a number of environmental groups, regarding an alternative to SCRs and SNCRs. PNM supported that process and advocated for alternatives that would cost consumers less than the FIP while also achieving environmental benefits and considering economic impact to New Mexico. In September 2012, the NMED proposed an alternative to EPA suggesting the closure of Units 1 and 2 at SJGS and the installation of SNCRs on Units 3 and 4 by the end of 2017. The NMED also suggested replacement of PNM's share of the capacity from the two closed units with gas-fired generation. The Company views the NMED proposal as an important step in meeting the objectives of addressing the environmental needs of the regional haze program at a lower cost to customers while balancing the economic impact to the "four corners" region. Among other things, there would need to be an agreement in principle among EPA, NMED, and PNM in order for the NMED proposal to proceed. The proposal would also be subject to approval by the other owner of SJGS Units 1 and 2 as well as various regulatory agencies. The proposal could also be subject to administrative and judicial challenge by others.

On October 12, 2012, EPA published a notice in the Federal Register extending the existing administrative stay for an additional 45 days. The extension is intended to allow for additional time for further discussions of alternatives to EPA's FIP. The administrative stay does not extend the September 21, 2016 compliance date of the FIP.

Notwithstanding the above process, the unchanged compliance deadline of the FIP requires PNM to continue to take steps to commence installation of SCRs at SJGS. In April 2012, PNM received bids for this project from several bidders pursuant to its RFP. After further negotiations with the bidders, PNM entered into a contract on October 31, 2012 with an engineering, procurement, and construction contractor to install SCRs and is negotiating a contract with an engineering firm for construction management services on behalf of the SJGS owners. The construction contract includes termination provisions in the event that SCRs are determined in the future to be unnecessary. The construction contract contains a cost estimate, which will be refined through an "open book" subcontractor bidding process with final costs to be determined by June 30, 2013. Based on the indicative bid for construction, PNM estimates the total cost to install SCRs on all four units of SJGS will be between approximately \$824 million and \$910 million, which amounts include costs for construction management, gross receipts taxes, AFUDC, and other PNM costs. The costs for the project to install SCRs would encompass installation of technology to comply with the NAAQS requirements described below.

Based on a recently completed conceptual design study, PNM currently estimates the installation of SNCRs on all four units of SJGS would cost between approximately \$85 million and \$90 million. If SNCRs are installed at SJGS, additional equipment would be required to be installed to meet the NAAQS requirements described below, the cost of which is estimated to total between approximately \$105 million and \$110 million for all four units of SJGS. The estimates for SNCRs and the NAAQS requirements include gross receipts taxes, AFUDC, and other PNM costs.

PNM's share under either SCRs or SNCRs would be about 46.3% based upon its SJGS ownership interest. Operating costs would also increase with the installation of either SCRs or SNCRs.

Because legal challenges to the FIP are continuing and because PNM has agreed to discuss alternatives to the SIP and the FIP, PNM is working to minimize the previously planned 2012 and 2013 total project expenditures. PNM

currently estimates its share of the total project expenditures to be up to \$3 million in 2012 and \$102 million in 2013. PNM anticipates filing a request with the NMPRC in late 2012 or early 2013 for approval of the SCR project and to recover SCR costs in rates charged to customers. Furthermore, PNM will seek recovery from its ratepayers for all costs that may be incurred as a result of the CAA requirements.

Due to the compliance deadline under the FIP, PNM is preparing to install SCRs at SJGS while simultaneously pursuing two other paths regarding BART at SJGS. PNM continues to vigorously pursue litigation in the Tenth Circuit. PNM is also participating in discussions regarding an alternative to the FIP and SIP. PNM is unable to predict the ultimate outcome of these matters or what, if any, additional pollution control equipment will be required at SJGS. If additional equipment is necessary and/or final requirements result in additional operating costs being incurred, PNM believes that its access to the capital markets is sufficient to be able to finance the installation. It is possible that requirements to comply with the final BART determinations,

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combined with the financial impact of possible future climate change regulation or legislation, if any, other environmental regulations, the result of litigation, and other business considerations, could jeopardize the economic viability of SJGS or the ability of individual participants to continue participation in the plant.

Four Corners

On October 6, 2010, EPA issued its proposed regional haze determination of BART for Four Corners. The rule, as proposed, would require the installation of SCR as post-combustion controls on each of Units 1-5 at Four Corners to reduce NOx emissions. PNM estimates its share of costs incurred by APS could be up to \$69.0 million for post-combustion controls at Four Corners Units 4 and 5. Such amount does not include PNM's AFUDC and internal costs. PNM has no ownership interest in Four Corners Units 1, 2, and 3. PNM would seek recovery from its ratepayers of all costs that are ultimately incurred.

Following EPA's issuance of its proposed BART, APS submitted a letter to EPA proposing to shut down Four Corners Units 1, 2, and 3 by 2014 and to install post-combustion pollution controls for NOx on Units 4 and 5 by the end of 2018, provided that EPA agrees to a resolution of Four Corners' obligations or liability, if any, under the regional haze and reasonably attributable visibility impairment programs, the NSR program, and NSPS programs of the CAA. The proposed shut down of Four Corners Units 1, 2, and 3 is also conditioned upon the completion of APS's acquisition of SCE's ownership interest in Four Corners Units 4 and 5 and the negotiation of a new coal supply agreement. In response to APS's proposal, EPA issued a Supplemental Notice Requesting Comment in February 2011 and proposed to find that an alternative emission control strategy, largely based upon APS's proposal, would achieve more progress than EPA's October 2010 BART proposal.

On August 6, 2012, the EPA issued its final BART determination for Four Corners. The rule includes two compliance alternatives. The first emission control strategy finalized by the EPA would require the installation of post-combustion controls on each of Units 1-5 at Four Corners to reduce NOx emissions. Under the alternative emission control strategy finalized by the EPA, the owners of Four Corners would have the option to close permanently Units 1-3 by January 1, 2014 and install post-combustion NOx controls on each of Units 4 and 5 by July 31, 2018. For particulate matter emissions, EPA is requiring Units 4 and 5 to meet an emission limit of 0.015 lb/Decatherm and the plant to meet a 20% opacity limit, both of which are achievable through operation of the existing baghouses. Although unrelated to BART, the final BART rule also imposes a 20% opacity limitation on certain fugitive dust emissions from Four Corners' coal and material handling operations. The Four Corners participants have until July 1, 2013 to notify the EPA of which emission control strategy Four Corners will follow.

APS continues to work with EPA to resolve these issues. The Four Corners participants' obligations to comply with EPA's final BART determinations, coupled with the financial impact of possible future climate change regulation or legislation, other environmental regulations, and other business considerations, could jeopardize the economic viability of Four Corners or the ability of individual participants to continue their participation in Four Corners. PNM is continuing to evaluate the impacts of EPA's BART determination for Four Corners. PNM is unable to predict the ultimate outcome of this matter.

SJGS Operating Permit Challenge

On February 16, 2012, EPA issued its response to a WildEarth Guardians petition objecting to SJGS's operating permit granted by the NMED in January 2011. In its order, EPA required NMED to provide clarification on several of the matters raised by WildEarth Guardians. EPA's order in this matter does not constitute a finding that the plant has



violated any provision of the CAA or that it has violated any emission limits.

In August 2012, NMED issued a response to the EPA order. In the response, NMED stated that SJGS's operating permit would be reopened to make certain modifications to the permit. On September 19, 2012, NMED issued a public notice regarding proposed modifications to the SJGS operating permit. The proposed modifications include changes to the SO<sub>2</sub> and particulate matter emission limits that were previously incorporated into the SJGS NSR permit. In addition, NMED has proposed a requirement for the submittal of a compliance plan to address carbon monoxide emissions increases at SJGS Unit 2 raised by WildEarth

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Guardians in its protest of the permit issuance. PNM will comply with NMED's proposal and does not believe it will have a material impact.

National Ambient Air Quality Standards (“NAAQS”)

The CAA requires EPA to set NAAQS for pollutants considered harmful to public health and the environment. EPA has set NAAQS for certain pollutants, including NO<sub>x</sub>, SO<sub>2</sub>, ozone, and particulate matter. In 2010, EPA updated the primary NO<sub>x</sub> and SO<sub>2</sub> NAAQS to include a 1-hour maximum standard while retaining the annual standards for NO<sub>x</sub> and SO<sub>2</sub> and the 24-hour SO<sub>2</sub> standard. New Mexico is in attainment for the 1-hour NO<sub>x</sub> NAAQS. EPA has issued draft guidance on how to determine whether areas in a state comply with the new 1-hour SO<sub>2</sub> NAAQS. EPA conducted a stakeholder process, which concluded in June 2012, to discuss how to assess compliance with this standard. EPA announced that it will publish further guidance or initiate rulemaking on these matters after completion of that process. Although the process of determining compliance with the 1-hour SO<sub>2</sub> NAAQS has not been finalized, PNM believes that compliance with the 1-hour SO<sub>2</sub> standard may require operational changes and/or equipment modifications at SJGS. On April 6, 2012, PNM filed an application for an amendment to its air permit for SJGS, which would be required for the installation of either SCRs or SNCRs described above. In addition, this application included a proposal by PNM to install equipment modifications for the purpose of reducing fugitive emissions, including NO<sub>x</sub>, SO<sub>2</sub>, and particulate matter. These modifications would help SJGS meet the NAAQS. It is anticipated that this technology would be installed at the same time as the installation of regional haze BART controls, in order to most efficiently and cost effectively conduct construction activities at SJGS. The cost of this technology is dependent upon the type of control technology that is ultimately determined to be NO<sub>x</sub> BART at SJGS. See “Regional Haze - SJGS” above.

On June 14, 2012, EPA proposed to lower the standard for fine particulate matter. The proposed rule was published in the Federal Register on June 29, 2012. EPA took comments for nine weeks. PNM provided comments through its trade associations. A final rule is expected by December 14, 2012. PNM is currently evaluating the impact of the proposed standard on SJGS and its operations.

In January 2010, EPA announced it would strengthen the 8-hour ozone standard by setting a new standard in a range of 0.060-0.070 parts per million. EPA had intended to establish the new standard by July 31, 2011. However, in September 2011, President Obama requested that the EPA administrator withdraw the agency's proposed rule that would have replaced the existing ozone NAAQS. In his release, the President stated that work is already underway to reconsider the ozone standard, with proposed revisions expected in the fall of 2013 and a final standard published by 2014. Depending upon where the standard for ozone is set, San Juan County, where SJGS is situated, could be designated as not attaining the standard for ozone. If that were to occur, NMED would have responsibility for bringing the county into compliance and would look at all sources of NO<sub>x</sub> and volatile organic compounds since these are the pollutants that form ground-level ozone. As a result, SJGS could be required to install further NO<sub>x</sub> controls to meet a new ozone NAAQS. In addition, other counties in New Mexico, including Bernalillo County, may be designated as non-attainment. PNM cannot predict the outcome of this matter, the impact of other potential environmental mitigations, or if additional NO<sub>x</sub> controls would be required as a result of ozone non-attainment designation.

Citizen Suit Under the Clean Air Act

The operations of the SJGS are covered by a Consent Decree with the Grand Canyon Trust and Sierra Club and with the NMED that includes stipulated penalties for non-compliance with specified emissions limits. Stipulated penalty

amounts are placed in escrow on a quarterly basis pending review of SJGS's emissions performance. Over the past several years, PNM has also submitted reports addressing mercury and NO<sub>x</sub> emission controls for SJGS as required by the Consent Decree. Plaintiffs and NMED rejected PNM's reports. PNM disputes the validity of the rejection of the reports. In May 2011, PNM entered into an agreement with NMED and the plaintiffs to resolve the dispute over the applicable NO<sub>x</sub> emission limits under the Consent Decree. Under the agreement, so long as the NO<sub>x</sub> emissions limits imposed under the EPA FIP and the New Mexico SIP meet a specified emissions limit, and PNM does not challenge these limits, the parties' dispute is deemed settled.

In May 2010, PNM filed a petition with the federal district court seeking a judicial determination on the dispute relating to PNM's mercury controls. NMED and plaintiffs seek to require PNM to implement additional mercury controls. PNM estimates the implementation would increase annual mercury control costs for the entire station, which are currently \$0.6 million, to a total of \$6.0 million. The court appointed a special master to evaluate the technical arguments in the case. The special master was asked to address the detection and determination limits of the mercury monitors at SJGS and the appropriate brominated activated

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carbon injection rate that maximizes the reduction of mercury emissions from SJGS. The special master issued a report indicating he was unable to make a determination on either of these issues based on the materials provided to him under the court's order. In September 2012, PNM submitted objections to certain portions of the special master report and requested an evidentiary hearing. Also in September 2012, NMED and plaintiffs filed a motion asking the court to affirm certain findings in the special master report and order PNM to conduct additional mercury testing. PNM cannot predict the outcome of this matter.

Navajo Nation Environmental Issues

Four Corners is located on the Navajo Reservation and is held under an easement granted by the federal government, as well as a lease from the Navajo Nation. The Navajo Acts purport to give the Navajo Nation Environmental Protection Agency authority to promulgate regulations covering air quality, drinking water, and pesticide activities, including those activities that occur at Four Corners. In October 1995, the Four Corners participants filed a lawsuit in the District Court of the Navajo Nation challenging the applicability of the Navajo Acts to Four Corners. The District Court stayed these proceedings pursuant to a request by the parties and the parties are seeking to negotiate a settlement.

In May 2005, APS and the Navajo Nation signed an agreement resolving the dispute regarding the Navajo Nation's authority to adopt operating permit regulations under the Navajo Nation Air Pollution Prevention and Control Act. As a result of this agreement, APS sought, and the courts granted, dismissal of the pending litigation in the Navajo Nation Supreme Court and the Navajo Nation District Court, to the extent the claims relate to the CAA. The agreement does not address or resolve any dispute relating to other aspects of the Navajo Acts.

The Company cannot currently predict the outcome of these matters or the range of their potential impacts.

Section 114 Request

In April 2009, APS received a request from EPA under Section 114 of the CAA seeking detailed information regarding projects at and operations of Four Corners. EPA has taken the position that many utilities have made physical or operational changes at their plants that should have triggered additional regulatory requirements under the NSR provisions of the CAA. Other electric utilities have received and responded to similar Section 114 requests, and several of them have been subject to notices of violation and lawsuits by EPA. APS has responded to EPA's request. PNM is currently unable to predict the timing or content of EPA's response, if any, or any resulting actions.

Four Corners New Source Review

Following two NOIs to sue, EarthJustice filed a lawsuit in October 2011 in the U.S. District Court for New Mexico against APS and the other Four Corners participants, except PNM, alleging violations of the PSD provisions of the CAA. EarthJustice filed suit against PNMR, which is not a Four Corners participant. In January 2012, following a third NOI to sue, EarthJustice filed its First Amended Complaint, naming PNM as a party instead of PNMR. In addition to the allegations of its original complaint, EarthJustice alleged NSPS violations. PNM was served with the amended complaint in January 2012. Among other things, the plaintiffs seek to have the court enjoin operations at Four Corners until it obtains any required PSD permits and complies with the NSPS. The plaintiffs further request the Court to order the payment of civil penalties, including a beneficial mitigation project. In April 2012, the Four Corners participants, including PNM, filed motions to dismiss the complaint. The Court has not ruled on the pending motions. PNM cannot currently predict the outcome of this matter or the range of its potential impact.

Endangered Species Act

In January 2011, the Center for Biological Diversity, Diné Citizens Against Ruining Our Environment, and San Juan Citizens Alliance filed a lawsuit in the U.S. District Court for the District of Colorado against the OSM and the DOI,

alleging that OSM failed to engage in mandatory Endangered Species Act (“ESA”) consultation with the U.S. Fish and Wildlife Service (“FWS”) prior to authorizing the renewal of an operating permit for the mine that serves Four Corners. The lawsuit alleges that activities at the mine, including mining and the disposal of coal combustion residue, will adversely affect several endangered species and their critical habitats. The lawsuit requested the court to vacate and remand the mining permit and enjoin all activities carried out under the permit until OSM has complied with the ESA. Neither PNM nor APS was a party to the lawsuit. On March 14, 2012, the Court entered an order dismissing the plaintiffs' lawsuit without prejudice. On May 14, 2012, the plaintiffs appealed the Court's order to the Tenth Circuit.

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On March 19, 2012, Diné Citizens Against Ruining Our Environment, Black Mesa Water Coalition, Toh Nizhoni Ani, San Juan Citizens Alliance, and Center for Biological Diversity sent EPA a NOI threatening to file a lawsuit in federal district court on or after May 18, 2012 if EPA fails to take certain actions allegedly required under the ESA.

These environmental groups allege that EPA has failed to meet its duties under the ESA to ensure that operations at Four Corners do not jeopardize the continued existence of endangered or threatened species or their critical habitat as required under the ESA. The environmental groups also allege that the EPA has violated the ESA by failing to carry out its programs for the conservation of listed species. APS is currently evaluating the NOI to determine its potential impact on Four Corners and will continue to monitor any developments. PNM cannot predict the outcome of this matter.

Cooling Water Intake Structures

EPA issued its proposed cooling water intake structures rule in April 2011, which would provide national standards for certain cooling water intake structures at existing power plants and other facilities under the Clean Water Act. The proposed standards are intended to protect fish and other aquatic organisms by minimizing impingement mortality (the capture of aquatic wildlife on intake structures or against screens) and entrainment mortality (the capture of fish or shellfish in water flow entering and passing through intake structures). The proposed rule would require facilities such as Four Corners and SJGS to either demonstrate that impingement mortality at its cooling water intakes does not exceed a specified rate or reduce the flow at those structures to less than a specified velocity and to take certain protective measures with respect to impinged fish. To minimize entrainment mortality, the proposed rule would also require these facilities to either meet the definition of a closed cycle recirculating cooling system or conduct a “structured site-specific analysis” to determine what site-specific controls, if any, should be required.

The proposed rule would require existing facilities to comply with the impingement mortality requirements as soon as possible, but no later than eight years after the effective date of the rule, and to comply with the entrainment requirements as soon as possible under a schedule of compliance established by the permitting authority. EPA is required to issue a final rule by June 27, 2013. PNM and APS continue to follow the rulemaking and are performing analyses to determine the potential costs of compliance with the proposed rule. PNM is unable to predict the outcome of this matter or a range of the potential costs of compliance.

Santa Fe Generating Station

PNM and the NMED are parties to agreements under which PNM installed a remediation system to treat water from a City of Santa Fe municipal supply well, an extraction well, and monitoring wells to address gasoline contamination in the groundwater at the site of the former Santa Fe Generating Station and service center. PNM believes the observed groundwater contamination originated from off-site sources, but agreed to operate the remediation facilities until the groundwater meets applicable federal and state standards or until the NMED determines that additional remediation is not required, whichever is earlier. The municipal well continues to operate and meets federal drinking water standards. PNM is not able to assess the duration of this project.

The Superfund Oversight Section of the NMED has conducted multiple investigations into the chlorinated solvent plume in the vicinity of the site of the former Santa Fe Generating Station. In February 2008, a NMED site inspection report was submitted to EPA, which states that neither the source nor extent of contamination has been determined and also states that the source may not be the former Santa Fe Generating Station. The NMED investigation is ongoing. PNM is unable to predict the outcome of this matter.

Coal Combustion Byproducts Waste Disposal  
Regulation

CCBs consisting of fly ash, bottom ash, and gypsum from SJGS are currently disposed of in the surface mine pits adjacent to the plant. SJGS does not operate any CCB impoundments. The Mining and Minerals Division of the New Mexico Energy, Minerals and Natural Resources Department currently regulates mine placement of ash with federal oversight by the OSM. APS disposes of CCBs in ash ponds and dry storage areas at Four Corners and also sells a portion of its fly ash for beneficial uses, such as a constituent in concrete production. Ash management at Four Corners is regulated by EPA and the New Mexico State Engineer's Office.

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In June 2010, EPA published a proposed rule that includes two options for waste designation of coal ash. One option is to regulate CCBs as a hazardous waste, which would allow EPA to create a comprehensive federal program for waste management and disposal of CCBs. The other option is to regulate CCBs as a non-hazardous waste, which would provide EPA with the authority to develop performance standards for waste management facilities handling the CCBs and would be enforced primarily by state authorities or through citizen suits. Both options allow for continued use of CCBs in beneficial applications. EPA's proposal does not address the placement of CCBs in surface mine pits for reclamation. A final rule regarding waste designation for coal ash is not expected from EPA before the end of 2012. An OSM CCB rulemaking team has been formed to develop a proposed rule.

On April 5, 2012, several environmental groups, including Sierra Club, filed a citizen suit in the D.C. Circuit claiming that EPA has failed to review and revise RCRA's regulations with respect to CCBs. The groups allege that EPA has already determined that revisions to the CCBs regulations are necessary. They also claim that EPA now has a non-discretionary duty to revise the regulations. The environmental groups asked the court to direct EPA to complete its review of the regulation of CCBs and a hazardous waste analytical procedure and to issue necessary revisions of such regulations as soon as possible. PNM and industry groups are evaluating the potential implications of the suit on EPA's rulemaking agenda for CCBs.

PNM advocates for the non-hazardous regulation of CCBs. However, if CCBs are ultimately regulated as a hazardous waste, costs could increase significantly. PNM would seek recovery from its ratepayers of all costs that are ultimately incurred. PNM cannot predict the outcome of EPA's or OSM's proposed rulemaking regarding CCB regulation, including mine placement of CCBs, or whether these actions will have a material impact on its operations, financial position, or cash flows.

**Sierra Club Allegations**

In December 2009, PNM and PNMR received a NOI to sue under RCRA from the Sierra Club ("RCRA Notice"). The RCRA Notice was also sent to all SJGS owners, to SJCC, which operates the San Juan Mine that supplies coal to SJGS, and to BHP. Additionally, PNM was informed that SJCC and BHP received a separate NOI to sue under the Surface Mine Control and Reclamation Act ("SMCRA") from the Sierra Club. In April 2010, the Sierra Club filed suit in the U.S. District Court for the District of New Mexico against PNM and PNMR. Also named in the lawsuit were SJCC and BHP. In the complaint, as amended, Sierra Club alleged that activities at SJGS and the San Juan Mine were causing imminent and substantial harm to the environment, including ground and surface water in the region, and that placement of CCBs at the San Juan Mine constituted "open dumping" in violation of RCRA. The suit also includes claims against SJCC and BHP under SMCRA. The complaint requested judgment for injunctive relief, payment of civil penalties, and an award of plaintiffs' attorney's fees and costs.

On March 28, 2012, the parties filed an executed consent decree with the court, which was approved by the court on April 12, 2012, settling the litigation. Under the terms of the consent decree, the SJGS owners and SJCC will construct and operate a slurry wall and recovery trench, fund other environmental projects, and pay Sierra Club's attorneys' and experts' fees. The total estimated cost of the settlement is \$10.2 million, of which about \$4.5 million is PNM's share. Substantially all of the income statement impact related to this settlement was recorded in 2011. The consent decree also includes a release of claims and covenant not to sue by Sierra Club. PNM is complying with the requirements of the consent decree.

**Hazardous Air Pollutants ("HAPs") Rulemaking**



In December 2011, the EPA issued its final Mercury and Air Toxics Standards (“MATS”). MATS is designed to reduce emissions of heavy metals, including mercury, arsenic, chromium, and nickel, as well as acid gases, including hydrochloric and hydrofluoric gases, from coal and oil-fired electric generating units with a capacity of at least 25 MW. Existing facilities will generally have up to four years to demonstrate compliance with the new rule. PNM's assessment of MATS indicates that the control equipment currently used at SJGS allows the plant to meet the emission standards set forth in the rule although the plant may be required to install additional monitoring equipment. With regard to mercury, stack testing performed for EPA during the MATS rulemaking process showed that SJGS achieved a mercury removal rate of 99% or greater. APS will conduct testing to determine what additional controls, if any, will be required at Four Corners. If additional controls are required, the costs are not expected to be material.

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Other Commitments and Contingencies

Coal Supply

The coal requirements for SJGS are being supplied by SJCC, a wholly owned subsidiary of BHP. In addition to coal delivered to meet the current needs of SJGS, PNM prepays SJCC for certain coal mined but not yet delivered to the plant site. At September 30, 2012 and December 31, 2011, prepayments for coal, which are included in other current assets, amounted to \$10.7 million and \$14.6 million. These amounts reflect delivery of a portion of the prepaid coal and its utilization due to the mine fire incident described below. SJCC holds certain federal, state, and private coal leases and has an underground coal sales agreement to supply processed coal for operation of SJGS through 2017. Under the coal sales agreement, SJCC is reimbursed for all costs for mining and delivering the coal, including an allocated portion of administrative costs, and receives a return on its investment. BHP Minerals International, Inc. has guaranteed the obligations of SJCC under the coal agreement. The coal agreement contemplates the delivery of coal that would supply substantially all the requirements of the SJGS through December 31, 2017.

APS purchases all of Four Corners' coal requirements from a supplier with a long-term lease of coal reserves with the Navajo Nation. The Four Corners coal contract runs through July 6, 2016 with pricing determined using an escalating base-price. Negotiations concerning the coal supply contract are continuing.

In 2010, PNM updated its study of the final reclamation costs for both the surface mines that previously provided coal to SJGS and the current underground mine providing coal and revised its estimates of the final reclamation costs. The estimate for decommissioning the Four Corners mine was also revised in 2010. Based on the most recent estimates, remaining payments for mine reclamation, in future dollars, are estimated to be \$49.8 million for the surface mines at both SJGS and Four Corners and \$21.5 million for the underground mine at SJGS as of September 30, 2012. At September 30, 2012 and December 31, 2011, liabilities, in current dollars, of \$23.5 million and \$26.5 million for surface mine reclamation and \$4.4 million and \$4.2 million for underground mine reclamation were recorded in other deferred credits. On June 1, 2012, the SJGS owners entered into a trust funds agreement to provide funding to compensate SJCC for post-term reclamation obligations under the coal sales agreement. The trust funds agreement requires each owner to enter into an individual trust agreement with a financial institution as trustee, create an irrevocable trust, and deposit initial funding into the trust by August 30, 2012. Thereafter, deposits, which are based on funding curves, must be made on an annual basis. PNM made its initial funding requirement of \$2.6 million in August 2012 and estimates funding an additional \$0.8 million by December 31, 2012.

PNM collects a provision for surface and underground mine reclamation costs in its rates. The NMPRC has capped the amount that can be collected from ratepayers for final reclamation of the surface mines at \$100.0 million. Previously, PNM recorded a regulatory asset for the \$100.0 million and recovers the amortization of this regulatory asset in rates. If future estimates increase the liability for surface mine reclamation, the excess would be expensed at that time.

San Juan Underground Mine Fire Incident

On September 9, 2011, a fire was discovered at the underground mine owned and operated by SJCC that provides coal for SJGS. The federal Mine Safety and Health Administration ("MSHA") was notified of the incident. On September 12, 2011, SJCC informed PNM that the fire was extinguished. However, MSHA required sealing the incident area and confirmation of a noncombustible environment before allowing re-entry of the sealed area. SJCC regained entry into the sealed area of the mine in early March 2012. At that time, MSHA conducted a root cause analysis inspection of the incident area, but has not yet issued its report. SJCC has completed inspection of the mine equipment and reported no significant damage. SJCC removed the equipment from the impacted mine panel and reassembled it at a new panel face. On May 4, 2012, SJCC received approval from MSHA and resumed longwall mining operations. However, if

further difficulties occur in the longwall mining operation, PNM and the other owners of SJGS would need to consider alternatives for operating SJGS, including running at less than full capacity or shutting down one or more units, the impacts of which cannot be determined at the current time.

The costs of the mine recovery flow through the cost-reimbursable component of the coal supply agreement. PNM anticipates that it will recover through its FPPAC the portion of such costs attributable to its customers subject to New Mexico regulation. The staff of the NMPRC has requested that PNM provide information segregating the impacts of this incident on the FPPAC. PNM's filings with the NMPRC reflect a preliminary estimate that this incident increased the deferral under the FPPAC

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through April 30, 2012 by \$17.3 million. Based on information PNM has received from SJCC to date, PNM does not expect the mine fire to have a material effect on its financial condition, results of operations, or cash flows.

**Nuclear Fuel**

The PVNGS participants are continually identifying their future nuclear fuel resource needs and negotiating arrangements to fill those needs. In late August 2012, one of PVNGS's suppliers that converts uranium concentrates to uranium hexafluoride invoked the force majeure provision in its contract when it shut down its conversion plant due to regulatory compliance issues. The PVNGS participants have sufficient strategic reserves of enriched uranium such that they do not anticipate a short-term impact on nuclear fuel supplies as a result of the force majeure declaration. The PVNGS participants are evaluating alternate long-term options for securing conversion services.

**PVNGS Liability and Insurance Matters**

The PVNGS participants have insurance for public liability exposure for a nuclear incident totaling \$12.6 billion per occurrence. Commercial insurance carriers provide \$375 million and \$12.2 billion is provided through a mandatory industry wide retrospective assessment program. If losses at any nuclear power plant covered by the program exceed the accumulated funds, PNM could be assessed retrospective premium adjustments. Based on PNM's 10.2% interest in each of the three PVNGS units, PNM's maximum potential assessment per incident for all three units is \$36.0 million, with an annual payment limitation of \$5.4 million.

The PVNGS participants maintain "all risk" (including nuclear hazards) insurance for damage to, and decontamination of, property at PVNGS in the aggregate amount of \$2.75 billion, a substantial portion of which must first be applied to stabilization and decontamination. These coverages are provided by Nuclear Electric Insurance Limited ("NEIL"). If NEIL's losses in any policy year exceed accumulated funds, PNM is subject to retrospective assessments of \$4.3 million for each retrospective assessment declared by NEIL's Board of Directors. The insurance coverages discussed in this and the previous paragraph are subject to policy conditions and exclusions.

**Water Supply**

Because of New Mexico's arid climate and periodic drought conditions, there is concern in New Mexico about the use of water, including that used for power generation. PNM has secured groundwater rights in connection with the existing plants at Reeves Station, Delta, Valencia, Afton, Luna, and Lordsburg. Water availability does not appear to be an issue for these plants at this time.

PNM, APS, and BHP have undertaken activities to secure additional water supplies for SJGS, Four Corners, and related mines to accommodate the possibility of inadequate precipitation in coming years. Since 2004, PNM has entered into agreements for voluntary sharing of the impacts of water shortages with tribes and other water users in the San Juan basin. The current agreements run through December 31, 2012 and renewals have been negotiated, but not fully executed. In addition, in the case of water shortage, PNM, APS, and BHP have reached agreement with the Jicarilla Apache Nation on a long-term supplemental contract relating to water for SJGS and Four Corners that runs through 2016. Although the Company does not believe that its operations will be materially affected by drought conditions at this time, it cannot forecast the weather or its ramifications, or how policy, regulations, and legislation may impact the Company should water shortages occur in the future.

In April 2010, APS signed an agreement on behalf of the PVNGS participants with five cities to provide cooling water essential to power production at PVNGS for the next forty years.

**PVNGS Water Supply Litigation**

In 1986, an action commenced regarding the rights of APS and the other PVNGS participants to the use of groundwater and effluent at PVNGS. APS filed claims that dispute the court's jurisdiction over PVNGS' groundwater

rights and their contractual rights to effluent relating to PVNGS and, alternatively, seek confirmation of those rights. In 1999, the Arizona Supreme Court issued a decision finding that certain groundwater rights may be available to the federal government and Indian tribes. In addition, the Arizona Supreme Court issued a decision in 2000 affirming the lower court's criteria for resolving groundwater claims. Litigation

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on these issues has continued in the trial court. No trial dates have been set in these matters. PNM does not expect that this litigation will have a material impact on its results of operation, financial position, or cash flows.

**San Juan River Adjudication**

In 1975, the State of New Mexico filed an action in New Mexico District Court to adjudicate all water rights in the San Juan River Stream System. PNM was made a defendant in the litigation in 1976. The action is expected to adjudicate water rights used at Four Corners and SJGS. In 2005, the Navajo Nation and various parties announced a settlement of the Navajo Nation's surface water rights. In March 2009, President Obama signed legislation confirming the settlement with the Navajo Nation. Under the terms of the settlement agreement, the Navajo water rights would be settled and finally determined by entry by the court of two proposed adjudication decrees. The court has ordered that settlement of the Navajo Nation's claims under the settlement agreement and entry of the proposed decrees be heard in an expedited proceeding.

PNM's water rights in the San Juan Basin may be affected by the rights recognized in the settlement agreement as being owned by the Navajo Nation (which comprise a significant portion of water available from sources on the San Juan River and in the San Juan Basin). Therefore, PNM has elected to participate in this proceeding. The Company is unable to predict the ultimate outcome of this matter or estimate the amount or range of potential loss and cannot determine the effect, if any, of any water rights adjudication on the present arrangements for water at SJGS and Four Corners. Final resolution of the case cannot be expected for several years. An agreement reached with the Navajo Nation in 1985, however, provides that if Four Corners loses a portion of its rights in the adjudication, the Navajo Nation will provide, for an agreed upon cost, sufficient water from its allocation to offset the loss.

**Complaint Against Southwestern Public Service Company**

In September 2005, PNM filed a complaint under the Federal Power Act against SPS. PNM argued that SPS had been overcharging PNM for deliveries of energy through its fuel cost adjustment clause practices. PNM also intervened in a proceeding brought by other customers raising similar arguments relating to SPS' fuel cost adjustment clause practices (the "Golden Spread proceeding"). In April 2008, FERC issued its order in the Golden Spread proceeding. FERC affirmed the decision of an ALJ that SPS violated its fuel cost adjustment clause tariffs. However, FERC shortened the refund period applicable to the violation of the fuel cost adjustment clause issues. PNM and SPS have filed petitions for rehearing and clarification of the scope of the remedies that were ordered and reversal of various rulings in the order. FERC has not yet acted upon the requests for rehearing or clarification and they remain pending further decision. PNM cannot predict the final outcome of the case at FERC or the range of possible outcomes.

**Begay v. PNM et al**

A putative class action was filed against PNM and other utilities in February 2009 in the U.S. District Court in Albuquerque. Plaintiffs claim to be allottees, members of the Navajo Nation, who pursuant to the Dawes Act of 1887, were allotted ownership in land carved out of the Navajo Nation. Plaintiffs, including an allottee association, make broad, general assertions that defendants, including PNM, are rights-of-way grantees with rights-of-way across the allotted lands and are either in trespass or have paid insufficient fees for the grant of rights-of-way or both. The plaintiffs, who have sued the defendants for breach of fiduciary duty, seek a constructive trust. They have also included a breach of trust claim against the United States and its Secretary of the Interior. PNM and the other defendants filed motions to dismiss this action. In March 2010, the court ordered that the entirety of the plaintiffs' case be dismissed. The court did not grant plaintiffs leave to amend their complaint, finding that they instead must pursue and exhaust their administrative remedies before seeking redress in federal court.

In May 2010, Plaintiffs filed a Notice of Appeal with the Bureau of Indian Affairs ("BIA"), which was denied by the BIA Regional Director. In May 2011, plaintiffs appealed the Regional Director's decision to the DOI Board of

Appeals. Briefings on the merits of the appeal are complete and a decision is pending. PNM is participating in order to preserve its interests regarding any PNM-acquired rights-of-way implicated in the appeal. PNM cannot predict the outcome of the proceeding or the range of potential outcomes at this time.

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Transmission Issues

Cargill Complaint

In April 2010, Cargill Power Markets, LLC (“Cargill”) filed a complaint with FERC, asserting that PNM improperly processed its transmission service queue and unfairly invalidated a transmission service request by Cargill. In July 2010, FERC issued an order establishing a schedule for hearing and settlement procedures. In its order, FERC determined that PNM had improperly invalidated a single Cargill transmission service request submitted in February 2008 and set the issue for hearing to determine an appropriate remedy. In August 2010, Cargill filed a motion for rehearing. In January 2011, PNM and Cargill filed a settlement agreement with FERC in which PNM agreed to pay Cargill \$0.2 million and put Cargill's transmission service request back into the queue. The settlement also left Cargill's rehearing motion in place before FERC. One intervenor in the proceeding contested the settlement. In December 2011, FERC issued an order approving the settlement as filed but requiring a compliance filing to modify the standard of review for third parties and FERC. Pursuant to the December 2011 order, the settlement agreement has been modified to reflect the change to the standard of review and was filed with FERC in March 2012. On May 25, 2012, FERC issued an order accepting the modified settlement agreement. PNM paid the \$0.2 million in July 2012. On October 9, 2012, Cargill made a filing urging FERC to rule on Cargill's outstanding motion for rehearing. FERC has not ruled on Cargill's outstanding motion for rehearing. PNM is unable to predict the final outcome of this matter at FERC.

TGP Complaint

On March 2, 2012, TGP Granada, LLC and its affiliate (collectively, “TGP”) filed a complaint at FERC against PNM and Tortoise Capital Resources Corp. (“TTO”). PNM owns 60% of the EIP and leases the other 40% from TTO. TGP's filing requested FERC to direct PNM and TTO to identify the party that will immediately assume the obligation of making transmission capacity on the EIP available to customers for use after the April 1, 2015 expiration of the EIP lease agreement. TGP also requested a declaratory order or waiver regarding certain provisions of PNM's Open Access Transmission Tariff to allow its affiliate to change the point-of-receipt associated with a transmission service agreement related to the EIP without losing its transmission service priority. PNM's lease of the portion of the EIP owned by TTO expires on April 1, 2015. The lease provides PNM the options (“End-of-Lease Options”), with 24 months advance notice, of purchasing the leased assets at the end of the lease for fair market value, or purchasing the leased assets prior to the lease expiration at the greater of fair market value and stipulated values contained in the lease. The lease also allows PNM to renew the lease for a series of terms with lease payments at the fair market value rate and provides PNM the option, if certain conditions are met, to renew the lease at 50% of the current lease payments for a maximum term to be calculated at the end of the initial lease term. On April 2, 2012, PNM filed its response to TGP's complaint. PNM argued that the claims in the complaint are without legal merit, but took no position on the declaratory order or waiver request. On July 2, 2012, PNM notified TTO that PNM does not intend to invoke any of the End-of-Lease Options and that PNM is evaluating whether any NMPRC approvals are required in order to finalize its decision not to invoke any End-of-Lease Options. On July 3, 2012, PNM informed FERC that PNM had notified TTO of its election. On July 5, 2012, FERC issued an order denying TGP's requests for declaratory order and waiver. In addition, FERC directed PNM, in consultation with TTO, to identify the party that will provide long-term transmission service over the leased portion of the EIP within 30 days of the date of FERC's order. On August 13, 2012, FERC granted PNM's and TTO's requests for an additional 30 days to identify the party that will provide long-term transmission service over the leased portion of the EIP.



On September 5, 2012, PNM filed an informational filing with FERC stating that PNM and TTO had reached an agreement in principle setting out the terms and conditions under which PNM would exercise its option to purchase the 40% leased capacity as provided under the lease on April 1, 2015 and provide long-term transmission service on the leased capacity after April 1, 2015. PNM's informational filing also stated that PNM and TTO would use their reasonable best efforts to execute a definitive purchase agreement by October 31, 2012 and, within fourteen days of such date of execution, to request FERC approval(s) of the purchase agreement. On October 9, 2012, TGP filed comments requesting that FERC direct PNM and TTO to conclude their negotiations expeditiously and ensure that the leased capacity is being made available to transmission customers now for use on a long-term basis pursuant to FERC's open access requirements. On November 1, 2012, PNM and TTO entered into a definitive agreement for PNM to exercise the option to purchase on April 1, 2015 the leased capacity at fair market value, which the parties agreed

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would be \$7.7 million. The definitive agreement sets forth the terms and conditions under which PNM would also assume responsibility for scheduling long-term transmission service on the leased capacity. The agreement is subject to FERC approval and could be challenged by other parties. PNM cannot predict the outcome of this proceeding.

(10)Regulatory and Rate Matters

The Company is involved in various regulatory matters, some of which contain contingencies that are subject to the same uncertainties as those described in Note 9. Additional information concerning regulatory and rate matters is contained in Note 17 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K. PNM

Renewable Portfolio Standard

The REA establishes a mandatory RPS requiring a utility to acquire a renewable energy portfolio equal to 5% of retail electric sales by January 1, 2006, increasing to 10% by 2011, 15% by 2015, and 20% by 2020. The NMPRC requires renewable energy portfolios to be “fully diversified” beginning in 2011, with at least 20% from wind energy, 20% from solar energy, 10% from other renewable technologies, and 1.5% from distributed generation with the distributed generation component increasing to 3% in 2015. The REA provides for streamlined proceedings for approval of utilities' renewable energy procurement plans, assures utilities recovery of costs incurred consistent with approved procurement plans, and requires the NMPRC to establish a RCT for the procurement of renewable resources to prevent excessive costs being added to rates. The NMPRC has established a RCT for 2011 of 2% of all customers' aggregated overall annual electric charges that increases by 0.25% annually until reaching 3% in 2015. The NMPRC has docketed a new rulemaking to determine the appropriate calculation methodology of the RCT and whether the RCT level should be increased. The rulemaking also proposes changes to the RPS diversity requirements. A hearing on the RCT level was held on October 24, 2012.

In July 2010, PNM filed its renewable energy procurement plan for 2011. The NMPRC ultimately rejected PNM's proposal to satisfy its 2011 RPS requirement through the purchase of wind RECs and ordered PNM to procure actual wind energy in 2011. While the rejection of RECs was under appeal at the New Mexico Supreme Court, PNM procured the wind energy as ordered in 2011. PNM requested a variance from the diversity requirements for solar and certain “other resources” for 2011 based on the RCT and availability constraints, which the NMPRC granted conditioned upon PNM including in its 2012 procurement plan a proposal that would meet the diversity requirements by April 5, 2013. On June 7, 2012, the New Mexico Supreme Court dismissed the appeal as moot because the energy had been procured.

In July 2011, PNM filed its renewable energy procurement plan for 2012. The plan requested a variance from the RPS due to RCT limitations. The plan was diversity-compliant based on the reduced RPS, except for non-wind/non-solar resources, which were not currently available. In December 2011, the NMPRC approved PNM's 2012 plan with modifications. Under the modified plan, PNM must propose to spend \$0.9 million more on renewable procurements in 2012 than it originally proposed. If PNM's proposed additional procurements are approved by the NMPRC, the resulting portfolio of renewable resources will constitute approximately 7.3% of PNM's energy sales in 2012, which is less than the statutory RPS of 10% due to the RCT. The NMPRC has not acted on the proposed additional procurements. The NMPRC also required PNM to file a supplemental plan by April 30, 2012, within which PNM was authorized to include an early filing of its 2013 renewable energy procurement plan proposing procurements to meet the 10% RPS by 2014 or sooner. PNM made the required filing on April 30, 2012, which included its renewable energy procurement plan for 2013. The 2013 plan proposes procurements for 2013 and 2014 of 20 MW of

PNM-owned solar PV facilities, wind and solar REC purchases in 2013, and a purchased power agreement for the output of a new geothermal facility. The estimated cost of the new 20 MW of solar PV capacity is \$45.5 million. If the proposed projects are approved and develop as planned, PNM will comply with the statutory RPS amount in 2013, but will require a variance from the NMPRC's diversity requirements in 2013 while the proposed geothermal facilities are being constructed. This plan is expected to achieve full RPS quantity and diversity compliance by 2014 without exceeding the RCT. A hearing on the 2013 plan was held September 4, 2012 and a final order is expected by November 30, 2012.

PNM is unable to predict the outcome or impact of these matters. PNM is recovering certain renewable procurement costs from customers through a rate rider. See Renewable Energy Rider below.

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Energy Efficiency and Load Management

Program Costs

Public utilities are required to obtain NMPRC approval to implement energy efficiency and load management programs. Costs to implement approved programs are recovered through a rate rider. On October 5, 2012, PNM filed an energy efficiency program application for programs to be offered beginning in May 2013. The filing included proposed program costs of \$22.5 million plus proposed profit incentive adder revenues of \$4.2 million. PNM requested that the NMPRC issue an order in this matter by April 1, 2013. Additional information concerning the program costs is contained in Note 17 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K.

Disincentives/Incentives Adder

The Efficient Use of Energy Act requires the NMPRC to remove utility disincentives to implementing energy efficiency and load management programs and to provide incentives for such programs. A rule approved by the NMPRC authorized electric utilities to collect rate adders of \$0.01 per KWh for lifetime energy savings and \$10 per KW for demand savings related to energy efficiency and demand response programs beginning in 2010. The NMAG and NMIEC appealed the NMPRC order adopting this rule to the New Mexico Supreme Court. PNM began implementing a rate rider under the rule to collect adders related to its 2010 program savings in December 2010 while the appeal of the rule was pending. In July 2011, the Supreme Court annulled and vacated the order adopting the rule and remanded the matter to the NMPRC. As a result of the Supreme Court decision, PNM filed revised tariffs and ceased collecting this adder for 2010 program savings on August 21, 2011. Of the \$4.2 million authorized for recovery, \$2.6 million was collected through August 20, 2011.

In June 2011, prior to the Supreme Court decision, the NMPRC approved PNM-specific adders of \$0.002 per KWh and \$4 per KW for savings due to programs implemented in 2011. PNM is presently collecting \$1.3 million in adder revenues consistent with this order. After the Supreme Court decision vacating the rule, the NMPRC initiated a proceeding to determine whether PNM should be required to cease collecting the adders and to refund all adder revenues collected since December 2010. In November 2011, the NMPRC issued orders that PNM is not required to refund any adder revenues and is authorized to continue collecting the adders. However, in an order on rehearing, which it subsequently rescinded, the NMPRC further reduced the amount of the authorized adders. Prior to the rescission, PNM appealed the rehearing order to the Supreme Court. In March 2012, the Supreme Court granted PNM's motion to vacate the rehearing order and dismiss PNM's appeal. In a separate appeal and writ proceeding in the Supreme Court, NMIEC and the NMAG seek to overturn the NMPRC order allowing PNM to continue to collect adders in light of the 2011 Supreme Court decision. On May 21, 2012 the Supreme Court dismissed the writ proceeding. Oral arguments on the appeal are scheduled for December 10, 2012 before the Supreme Court and a decision in the appeal is expected in 2013. PNM is unable to predict the outcome of the appeal.

Decoupling Rulemaking

On May 15, 2012, the NMPRC issued a NOPR that would amend the NMPRC's energy efficiency rule to authorize use of a decoupling mechanism to recover certain fixed costs of providing retail electric service from the rates charged on a per KWh of consumption, as the mechanism for removal of disincentives associated with the implementation of energy efficiency programs. The proposed mechanism was generally consistent with the decoupling proposal that PNM included, and subsequently agreed to withdraw, in its 2010 Electric Rate Case application. The proposed rule

addressed both disincentives and incentives associated with energy efficiency. On July 26, 2012, the NMPRC closed the proposed rulemaking and opened a new energy efficiency rulemaking that may address decoupling and incentives. Workshops to develop a proposed rule have been held, but no order proposing a rule has been issued. PNM is unable to predict the outcome of this matter.

#### 2010 Electric Rate Case

PNM filed its 2010 Electric Rate Case application with the NMPRC in June 2010 to increase rates for its New Mexico retail customers. On August 21, 2011, PNM implemented a \$72.1 million annual increase in rates as authorized by an order of the NMPRC, which modified a stipulation agreed to by PNM and several other parties. The amended stipulation allows PNM to file a new general rate case for rates to be effective as soon as July 1, 2013. In addition, the stipulation limits the amount that can be recovered on an annual basis for fuel costs, renewable energy costs, and energy efficiency costs during certain years as described in the stipulation. Recovery of costs in excess of the limits is to be deferred for recovery, without carrying costs, in future periods.

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The cap for the FPPAC year beginning July 1, 2012 is \$38.8 million, which PNM began collecting at that time. PNM estimates that at June 30, 2013 approximately \$28.8 million of FPPAC costs incurred will be deferred for future collection. Costs attributed to the mine fire incident discussed in Note 9 are included in the FPPAC amounts.

Additional information concerning the 2010 Electric Rate Case is contained in Note 17 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K.

Renewable Energy Rider

In January 2012, PNM filed an application for a rate rider that PNM proposed would go into effect in August 2012 to collect costs for renewable energy procurements incurred after December 31, 2010 that are not otherwise being collected in rates. These costs include the procurement of solar RECs from customers, wind resource procurements during November and December 2011 as ordered by the NMPRC, and the revenue requirements for PNM-owned solar PV facilities and a solar battery storage demonstration project that went into service during 2011. The rider's rate for 2012 would be set at 2.081% of the retail customer's monthly bill. The rate would be reset to 2.695% as of January 1, 2013 to reflect unrecovered costs from 2012 and projected costs to be incurred in 2013. The rider would terminate upon a final order in PNM's next general rate case unless that order authorized a continuation of the rider. Amounts that can be collected under the proposed rider are capped at \$18.0 million in 2012 and \$24.6 million in 2013 under the stipulation in PNM's 2010 Electric Rate Case. Any amounts above the caps are deferred for future recovery without carrying costs. As a separate component of the rider, PNM proposes that if its earned return on jurisdictional equity in 2013 exceeds 10.5%, it would refund to customers during May through December 2014 the amount over 10.5%. On August 14, 2012, the NMPRC issued an order approving the rider with modifications. The NMPRC ordered that the rider be billed on a per KWh basis, rather than as a percentage of the bill. The approved rate is \$0.0022335 per KWh in 2012 and \$0.0028371 per KWh in 2013. The order disapproved the recovery of the cost of the supplemental procurement ordered by the NMPRC in the 2012 procurement plan because the NMPRC had not acted on the specific \$0.9 million procurement proposed by PNM, which is discussed under Renewable Portfolio Standard above. In October 2012, a motion by an intervenor for rehearing was granted in part by the NMPRC to clarify that no separate hearing is required prior to increasing the rider rate for new procurements if a legally appropriate hearing on the increase was conducted as part of the hearing on the procurement plan. PNM implemented the rider on August 20, 2012.

2011 Integrated Resource Plan

NMPRC rules require that investor owned utilities file an IRP every three years. The IRP is required to cover a 20-year planning period and contain an action plan covering the first four years of that period. In its most recent IRP, which was filed in July 2011, PNM indicated that it planned to meet its anticipated load growth through a combination of new natural gas-fired generating plants, renewable energy resources, load management, and energy efficiency programs. However, PNM has not entered into any commitments regarding these plans beyond what is otherwise described herein. As required by NMPRC rules, PNM utilized a public advisory group process during the development of the 2011 IRP. Two protests were filed to the IRP requesting rejection of the plan. The NMPRC assigned the case to a Hearing Examiner and designated a mediator to facilitate negotiations. The NMPRC staff filed a motion in December 2011 to dismiss the protests and terminate the proceeding on the ground that PNM's IRP fully complies with NMPRC rules. PNM is unable to predict the outcome of this matter.

Emergency FPPAC

In 2008, the NMPRC authorized PNM to implement an Emergency FPPAC from June 2, 2008 through June 30, 2009. The NMPRC order approving the Emergency FPPAC also provided that if PNM's base load generating units did not operate at or above a specified capacity factor and PNM was required to obtain replacement power to serve

jurisdictional customers, PNM would be required to make a filing with the NMPRC seeking approval of the replacement power costs. In its required filing, PNM stated that the costs of the replacement power amounting to \$8.0 million were prudently incurred and made a motion that they be approved. The NMPRC staff opposed PNM's motion and recommended that PNM be required to refund the amount collected. Auditors selected by the NMPRC found that PNM was prudent in operating its base load units and in securing replacement power but had not obtained prior NMPRC approval in the manner required by the NMPRC order. PNM continues to assert that its recovery of replacement power costs was proper and did not violate the NMPRC's order. The NMPRC has not ruled on this matter. Under the terms of the approved stipulation in the 2010 Electric Rate Case, the parties to the stipulation, including the NMPRC staff, jointly requested that the NMPRC take no further action in this matter and close the docket. No party has opposed that request. PNM is unable to predict the outcome of this matter.

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Transmission Rate Case

In October 2010, PNM filed a notice with FERC to increase its wholesale electric transmission revenues by \$11.1 million annually, based on a return on equity of 12.25%. The filing also seeks to revise certain Open Access Transmission Tariff provisions and bi-lateral contractual terms. If approved, the rate increase would apply to all of PNM's wholesale electric transmission service customers, which include other utilities, electric cooperatives, and entities that use PNM's transmission system to transmit power at the wholesale level. The proposed rate increase would not impact PNM's retail customers. In December 2010, FERC issued an order accepting PNM's filing and suspending the proposed tariff revisions for five months. The proposed rates were implemented on June 1, 2011, subject to refund. On July 3, 2012, PNM filed an unopposed settlement agreement with the FERC. Under the settlement agreement, PNM would increase transmission service revenues by \$2.9 million annually and would refund amounts collected in excess of the settled rates. In addition, the parties agreed that if PNM files for a formula based rate change within one year from FERC's approval of the settlement agreement, no party will oppose the general principle of a formula rate, although the parties may still object to particular aspects of the formula. The ALJ has certified the settlement, which is subject to FERC approval. PNM is unable to predict the outcome of this proceeding.

Firm-Requirements Wholesale Customer Rate Case

In September 2011, PNM filed an unexecuted amended sales agreement between PNM and NEC with FERC. The agreement proposes a cost of service based rate for the electric service and ancillary services PNM provides to NEC, which would result in an annual increase of \$8.7 million or a 39.8% increase over existing rates. PNM also requested a FPPAC and full recovery of certain third-party transmission charges PNM incurs to serve NEC. NEC filed a protest to PNM's filing with FERC. In November 2011, FERC issued an order accepting the agreement as filed, suspending the effective date for a five-month period, to be effective April 14, 2012, subject to refund, and set the proceeding for settlement. On June 25, 2012, the FERC settlement judge issued a settlement status report stating the parties had reached a settlement in principle and recommending that the settlement process be continued. The parties are currently working on finalizing the settlement. The finalized settlement would be subject to FERC approval. PNM is unable to predict the outcome of this proceeding.

TNMP

Interest Rate Compliance Tariff

Following a revision of the interest rate on TNMP's CTC, TNMP filed a compliance tariff to implement the new lower 8.31% rate. Intervenors asserted objections and, after regulatory proceedings, the PUCT issued an order making the new rate retroactive to July 20, 2006. TNMP successfully appealed to the District Court in Austin, Texas for the new rate not to be effective prior to December 27, 2007. However, the Texas 3rd Court of Appeals reversed the District Court and reaffirmed the PUCT's decision. Due to the new retroactive ratemaking theory contained in the Texas 3<sup>rd</sup> Court of Appeals opinion, TNMP recorded a pre-tax regulatory disallowance of \$3.9 million in the three months ended June 30, 2011 to reflect the impact of applying the 8.31% rate retroactively. TNMP petitioned the Texas Supreme Court for review in July 2011. On June 8, 2012, the Texas Supreme Court denied TNMP's petition for review. TNMP filed a motion for rehearing on June 25, 2012, which was denied in August 2012 concluding this matter.

Advanced Meter System Deployment and Surcharge Request

In July 2011, the PUCT approved a settlement and authorized an advanced meter deployment plan that permits TNMP to collect \$113.3 million in deployment costs through a surcharge over a 12-year period. TNMP began collecting the surcharge on August 11, 2011. Deployment of advanced meters began in September 2011 and is scheduled to be completed over a 5-year period. In February 2012, the PUCT opened a proceeding to consider the feasibility of an



“opt-out” program for retail consumers that wish to decline receipt of an advanced meter. The PUCT has requested comments and convened a public meeting to hear various issues. No proposal or decision has yet been announced by the PUCT. However, various individuals filed a petition with the PUCT seeking a moratorium on any advanced meter deployment. The PUCT denied the petition and an appeal was filed with the Texas District Court on September 28, 2012. Any opt-out program would apply to all transmission and distribution utilities in ERCOT. TNMP cannot predict the outcome or effect of this proceeding.

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Remand of ERCOT Transmission Rates for 1999 and 2000

Following a variety of appeals, the ERCOT transmission rates approved in 1999 and 2000 were remanded back to the PUCT. These dockets concern the recalculation of rates for the fourth quarter of 1999 and all of 2000. In October 2011, TNMP joined in a non-unanimous settlement of the issues relating to resettlement of the last four months of 1999. In January 2012, the PUCT approved the non-unanimous settlement. TNMP received \$1.6 million under the settlement. In June 2012, TNMP filed its transmission cost recovery factor filing ("TCRF") seeking \$3.2 million in additional transmission costs. The PUCT staff requested a hearing asserting the settlement proceeds from the 1999 remand settlement need to be credited against the costs TNMP requested in its TCRF. TNMP maintains that the settlement proceeds should not be passed on to customers since TNMP was unable to recover those costs in 1999. Subsequently, the PUCT staff agreed to interim rate relief permitting TNMP to add \$1.6 million in uncontested costs to its existing TCRF and add \$1.6 million in costs in a subsequent TCRF if TNMP is successful in the contested case. The ALJ approved the interim relief on July 16, 2012. TNMP implemented the interim rates on September 1, 2012. On September 26, 2012, the contested portion of the case was remanded back to the PUCT pursuant to a joint motion of TNMP and PUCT staff. The joint filing represents an agreed resolution that permits the \$1.6 million in interim rates to become final and authorizes TNMP to institute a surcharge in March 2013 to collect the additional \$1.6 million in initially disputed costs plus interest at the PUCT under-billing rate. The matter is pending approval from the PUCT. TNMP cannot predict the ultimate outcome of this matter.

Transmission Cost of Service Rates

On August 23, 2012, TNMP filed an application to update its transmission rates to reflect changes in its invested capital. The requested increase in total rate base is \$26.4 million, which will increase revenues \$2.5 million annually. The proposed rates reflect the addition and retirement of transmission facilities, including depreciation, federal income tax, and other associated taxes, and the approved rate of return on such facilities. The PUCT approved the interim adjustment and TNMP implemented it on September 27, 2012.

(11) Optim Energy

Additional information concerning Optim Energy is discussed in Note 21 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K. PNMR and ECJV each had a 50 percent ownership interest in Optim Energy, a limited liability company, until September 23, 2011, when Optim Energy was restructured and PNM's interest was reduced to 1%. On January 4, 2012, ECJV exercised its option to acquire PNMR's remaining 1% ownership interest in Optim Energy at fair market value, which was determined to be zero. PNMR accounted for its investment in Optim Energy using the equity method of accounting until September 23, 2011 and then used the cost method through January 4, 2012. PNMR Services Company provided certain corporate services to Optim Energy through December 31, 2011 and is continuing to provide services with respect to certain open tax matters.

PNMR fully impaired its investment in Optim Energy at December 31, 2010 and, in accordance with GAAP, did not recognize losses of Optim Energy from January 1, 2011 through September 23, 2011, when PNMR ceased to account for its investment using the equity method of accounting. Accordingly, Optim Energy had no impact on PNMR's December 31, 2011 balance sheet or the statements of earnings and statements of cash flows for 2012 and 2011.

Therefore, summarized financial information for Optim Energy is not presented.

(12) Related Party Transactions

PNMR, PNM, and TNMP are considered related parties as defined under GAAP. TNMP provides transmission and distribution services to First Choice. On November 1, 2011, PNMR sold First Choice. TNMP revenues from First Choice through October 31, 2011 were related party revenues and included in the table below. PNMR Services Company provides corporate services to PNMR and its subsidiaries in accordance with shared services agreements. Optim Energy was a related party prior to September 23, 2011. PNMR Services Company provided corporate services to Optim Energy under a services agreement. There was also a services agreement for Optim Energy to provide services to PNMR. See Note 11 for information concerning Optim Energy.

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The table below summarizes the nature and amount of related party transactions of PNMR, PNM, and TNMP:

	Three Months Ended		Nine Months Ended	
	September 30, 2012	2011	September 30, 2012	2011
	(In thousands)			
Electricity, transmission and distribution related services billings:				
TNMP to PNMR	\$—	\$ 12,196	\$—	\$ 30,608
Services billings:				
PNMR to PNM	22,143	24,680	68,030	70,849
PNMR to TNMP	6,439	7,295	20,206	21,250
PNM to TNMP	184	40	473	327
TNMP to PNMR	4	48	12	145
PNMR to Optim Energy	—	1,277	—	4,083
Optim Energy to PNMR	—	4	—	23
Interest billings:				
PNMR to TNMP	22	8	72	36
PNMR to PNM	—	9	1	45
PNM to PNMR	45	33	134	97
Income tax sharing payments:				
PNMR to PNM	—	—	63,114	—
PNMR to TNMP	—	—	1,952	—

## (13) New Accounting Pronouncements

Information concerning recently issued accounting pronouncements that have not been adopted by the Company and could have a material impact is presented below.

## Accounting Standards Update 2011-11 - Balance Sheet: Disclosures about Offsetting Assets and Liabilities

The FASB released amended guidance that will require entities to disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. In addition, the update requires disclosure of collateral received and posted in connection with master netting agreements or similar agreements. The update is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods therein. The disclosures required by this amendment will be applied retrospectively for all comparative periods presented. The Company does not believe this guidance will have a material impact on the Company's financial statements and will comply with the disclosure requirements in 2013.

## (14) Sale of First Choice

On September 23, 2011, PNMR entered into an agreement for the sale of First Choice to Direct LP, Inc. for \$270.0 million, subject to adjustment to reflect the amounts of certain components of working capital at closing. Closing

occurred on November 1, 2011, with PNMR receiving \$329.3 million, which included an estimate of the components of working capital. For accounting purposes, the sale was effective as of the close of business on October 31, 2011. PNMR recognized a pre-tax gain of \$174.9 million on the sale. In early 2012, the purchaser asserted that the amount paid at closing for working capital at October 31, 2011 was overstated by \$2.4 million. PNMR responded disputing the purchaser's calculation and indicating that the amount paid at closing for working capital at October 31, 2011 was understated by \$5.8 million. In accordance with the agreement for the sale, this matter was submitted to an independent party for a decision binding on the parties. A decision was received in August 2012. The decision resulted in PNMR being awarded \$6.4 million of the \$8.2 million in dispute. PNMR recorded an additional pre-tax gain of \$1.0 million, which is included in other income in the three months ended September 30, 2012. PNMR Services Company provided

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certain services at cost to First Choice for a transitional period through August 1, 2012. Because PNMR continues to have direct cash flows resulting from transmission and distribution services provided by TNMP to First Choice, First Choice is not reflected as discontinued operations. After October 31, 2011, TNMP's revenues from First Choice are not intercompany and are not eliminated in consolidation by PNMR.

(15) Goodwill and Other Intangible Assets

The excess purchase price over the fair value of the assets acquired and the liabilities assumed by PNMR for its June 6, 2005 acquisition of TNP was recorded as goodwill and was pushed down to the businesses acquired. In 2007, the TNMP assets that were included in its New Mexico operations, including goodwill, were transferred to PNM. Additionally, the trade name "First Choice" and the First Choice customer list were acquired in the TNP acquisition. The trade name was considered to have an indefinite useful life; therefore, no amortization was recorded. The useful life of the customer list was estimated to be approximately eight years. As discussed in Note 14, PNMR completed the sale of First Choice on November 1, 2011. As a result, the goodwill and other intangible assets of First Choice are no longer included in PNMR's Condensed Consolidated Balance Sheet and PNMR no longer has any other intangible assets.

GAAP requires the Company to evaluate its goodwill and non-amortizing intangible assets for impairment annually at the reporting unit level or more frequently if circumstances indicate that the goodwill or intangible assets may be impaired. Application of the impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, and determination of the fair value of each reporting unit. A discounted cash flow methodology is primarily used to estimate the fair value of each reporting unit. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of long-term growth rates for the business, and determination of appropriate weighted average cost of capital for each reporting unit. Changes in these estimates and assumptions could materially affect the determination of fair value and the conclusion of impairment for each reporting unit.

For goodwill, the first step of the impairment test requires that the Company compare the fair value of each reporting unit with its carrying value, including goodwill. If as a result of this analysis, the Company concludes there is an indication of impairment in a reporting unit having goodwill, the Company is required to perform the second step of the impairment analysis, determining the amount of goodwill impairment to be recorded. The amount is calculated by comparing the implied fair value of the goodwill to its carrying amount. This exercise would require the Company to allocate the fair value determined in step one to the individual assets and liabilities of the reporting unit. Any remaining fair value would be the implied fair value of goodwill on the testing date. To the extent the recorded amount of goodwill of a reporting unit exceeds the implied fair value determined in step two, an impairment loss would be reflected in results of operations. Prior to 2012, the Company compared the fair value of non-amortizing intangibles other than goodwill to the recorded values.

The annual evaluations performed as of April 1, 2012 and 2011 did not indicate impairments of the goodwill or other intangible assets of any of the Company's reporting units. Since the annual evaluation, there have been no indications that the fair values of the reporting units with recorded goodwill have decreased below the carrying values. Additional information concerning the Company's goodwill, other intangible assets, and impairments is contained in Note 23 of



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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations for PNMR is presented on a combined basis, including certain information applicable to PNM and TNMP. The MD&A for PNM and TNMP is presented as permitted by Form 10-Q General Instruction H (2). This report uses the term "Company" when discussing matters of common applicability to PNMR, PNM, and TNMP. A reference to a "Note" in this Item 2 refers to the accompanying Notes to Condensed Consolidated Financial Statements (Unaudited) included in Item 1, unless otherwise specified. Certain of the tables below may not appear visually accurate due to rounding.

MD&A FOR PNMR

EXECUTIVE SUMMARY

Company Overview and Strategy

PNMR is a holding company with two regulated utilities serving approximately 739,000 residential, commercial, and industrial customers and end-users of electricity in New Mexico and Texas. In the latter part of 2011, PNMR exited both of its competitive businesses, First Choice and Optim Energy, and repositioned itself as a holding company solely operating its electric utilities, PNM and TNMP. Optim Energy had no impact on 2011 results of operations because it was written off in 2010 and PNMR had no further financial commitment to Optim Energy.

Strategic Goals

PNMR is focused on achieving the following strategic goals:

Earning authorized returns on its regulated businesses

Continuing to improve credit ratings

Providing a top-quartile total return to investors

PNMR's success in accomplishing these strategic goals is highly dependent on continued favorable regulatory treatment for its utilities. Both PNM and TNMP seek cost recovery for their investments through general rate cases and various rate riders. The PUCT has approved mechanisms that allow for recovery of capital invested in transmission and distribution projects without having to file a general rate case and allows for more timely recovery of amounts invested in TNMP's systems.

PNM and TNMP completed rate proceedings before their state regulators in 2011. PNM has two rate cases pending before FERC. A settlement in one case is pending FERC approval and an agreement in principle has been reached in the other. In August 2012, the NMPRC approved PNM's application for a renewable energy rider to recover NMPRC approved renewable energy costs. Additional information about rate filings is provided in Note 17 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K and in Note 10. PNM previously announced that it intended to file a request for an increase in the rates charged to New Mexico retail customers in late 2012, but now anticipates this filing will occur in mid-2013, partially due to the lack of clarity around the timing and amount of capital that will be required for BART at SJGS, as discussed below.

Fair and timely rate treatment from regulators is crucial to achieving PNMR's strategic goals because it leads to PNM and TNMP earning their allowed returns. PNMR believes that if the utilities earn their allowed returns, it would be viewed positively by rating agencies and would further improve credit ratings, which could lower costs to customers. Also, earning allowed returns should result in increased earnings for PNMR, which should lead to increased total returns to investors.

PNM's interest in PVNGS Unit 3 is permanently excluded from NMPRC jurisdictional rates. While PVNGS Unit 3's financial contribution is not calculated in the authorized returns on its regulated business, it impacts PNM's earnings



and has demonstrated to be a valuable asset. Power generated from PNM's 134 MW interest in PVNGS Unit 3 is currently sold into the wholesale market and any earnings or losses are attributable to shareholders.

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### Exit from Competitive Businesses

As a result of the exit from its competitive businesses, First Choice and Optim Energy, PNMR's business model is centered on its electric utilities. The elimination of the competitive businesses should reduce PNMR's risk and earnings volatility. Additional discussion about the exit from the competitive businesses is found in Notes 2 and 21 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K.

### Business Principles

In addition to its strategic goals, three principles drive PNMR's business strategy and decision-making:

- Contribute to the economic vitality of the communities we serve
- Demonstrate environmental stewardship
- Exhibit social responsibility

In support of these principles, PNMR works closely with customers, stakeholders, legislators, and regulators to ensure that our resource plans and infrastructure investments benefit from robust public dialogue and balance the diverse needs of our communities.

#### Economic Vitality

PNMR and its utilities are keenly aware of the roles they play in enhancing economic vitality in their New Mexico and Texas service territories. We believe there is a direct connection between electric infrastructure and economic growth. When considering expanding or relocating to other communities, businesses consider energy affordability and energy reliability to be important factors. PNM and TNMP strive to balance service affordability with infrastructure investment to maintain a high level of electric reliability. The utilities also work to ensure that rates reflect actual costs of providing service.

Investing in PNM's and TNMP's infrastructure is critical to ensure reliability and meet future energy needs. Both utilities have long-established records of providing customers with top-tier electric reliability. In September 2011, TNMP began its deployment of smart meters in homes and businesses across its Texas service area. As part of the State of Texas' long-term initiative to create a smart electric grid, the smart meter rollout will ultimately give consumers more energy consumption data and help them make more informed decisions. TNMP's deployment is expected to be completed in 2016.

#### Environmental Stewardship

For years, PNMR has demonstrated its commitment to environmental stewardship. PNMR's environmental objectives focus on four areas:

- Deploying renewable energy
- Reducing emissions from existing fossil-fueled power plants
- Increasing energy efficiency participation
- Reducing waste

In 2011, PNM completed its \$95 million investment in a utility-owned renewable energy project when five utility-scale solar facilities went online. The five solar sites located in Alamogordo, Deming, Los Lunas, Las Vegas, and Albuquerque provide a combined 22 MW of power. A sixth facility, the 500-KW PNM Prosperity Energy Storage Project, uses advanced batteries to store solar power and dispatch the energy either during high-use periods or when solar production is limited. The project features one of the largest combinations of battery storage and PV energy in the nation and involves extensive research and development of smart grid concepts with the Electric Power Research Institute, East Penn Manufacturing Co., Northern New Mexico College, Sandia National Laboratories, and the University of New Mexico. When the facility went online in September 2011, it was the nation's first solar storage facility fully integrated into a utility's power grid.

In addition, PNM's resource portfolio includes the purchase of 200 MW of wind power. PNM also purchases power from a customer-owned distributed solar generation program having an installed capacity of 14 MW at the end of

2011, which capacity is expected to increase to 21 MW by the end of 2012. Distributed generation, wind, and solar power are key means for PNM to meet the RPS established by the REA and related regulations issued by the NMPRC. These rules require a utility to achieve prescribed levels of energy sales from renewable sources within its generation mix, if that can be accomplished without exceeding the RCT cost limit set by the NMPRC, which aims to moderate the cost to consumers when utilities use more renewable resources.

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PNM sought and received a waiver from the NMPRC excusing it from meeting the RPS in 2012 because the cost to achieve the full RPS would exceed the RCT. However, PNM will continue to procure renewable resources while balancing the bill impact to customers in order to meet New Mexico's escalating RPS requirements.

On April 30, 2012, PNM filed its 2013 Renewable Energy Plan, which calls for:

20 MW of PNM-owned solar facilities to be in service by the end of 2013

▲ 20-year PPA for the output of a 10-MW geothermal facility to be in service by January 1, 2014

¶ Limited wind and solar REC purchases in 2013

The proposed plan would achieve RPS quantity compliance in 2013, but likely will be slightly below the 20% solar renewable energy diversity requirement. However, the plan would achieve full quantity and diversity compliance in 2014 and will be beneath the RCT for both years. A hearing on the proposed plan was held in September 2012 before the NMPRC and a decision is expected by November 30, 2012.

PNM's SJGS near Farmington, New Mexico, is one of the top performers in the nation with respect to mercury removal. The plant outperforms the mercury limit imposed by EPA in the 2011 Mercury and Air Toxics Standards. Major environmental upgrades on each of the four units at SJGS, which were completed in early 2009, have significantly reduced emissions of NO<sub>x</sub>, SO<sub>2</sub>, particulate matter, and mercury. PNM's share of the costs of these upgrades was \$161 million. Since 2006, SJGS has reduced NO<sub>x</sub> emissions by 38%, SO<sub>2</sub> by 69%, particulate matter by 65%, and mercury by 99%.

In order to keep costs to customers as low as possible while also reducing visibility impairment related to regional haze, PNM has supported the installation of SNCRs at SJGS, a technology also proposed by the State of New Mexico to meet the regional haze regulations. However, EPA issued its FIP requiring SCRs to be installed at SJGS, which PNM estimates would significantly exceed the cost of installing SNCRs. Due to the compliance deadline under the FIP, PNM is preparing to install SCRs at SJGS while simultaneously pursuing two other paths regarding BART at SJGS. PNM is pursuing legal relief in the Tenth Circuit and administrative relief from the EPA regarding the FIP. PNM is also participating in discussions with stakeholders regarding an alternative to the FIP and SIP. See Note 9. PNM is challenging EPA's proposal in the courts and administratively within EPA. Oral arguments on the court challenge were held October 23, 2012, but no decision has been issued. There is no deadline for a court decision. In July 2012, the NMED established a process to explore whether stakeholders could reach agreement on an alternative to SCRs and SNCRs. PNM supported that process and advocated for alternatives that would cost consumers less than the FIP while also achieving environmental benefits and considering economic impact to New Mexico. In September 2012, NMED proposed an alternative to EPA suggesting the closure of Units 1 and 2 at SJGS and the installation of SNCRs on Units 3 and 4 by the end of 2017. The NMED also suggested replacement of PNM's share of the capacity from the two closed units with gas-fired generation. The Company views the NMED proposal as an important step in meeting the objectives of addressing the environmental needs of the regional haze program at a lower cost to customers while balancing the economic impact to the "four corners" region. In order for the NMED proposal to proceed, there would need to be an agreement in principle among EPA, NMED, and PNM. The proposal would also be subject to approval by the other owner of SJGS Units 1 and 2, as well as various regulatory agencies. The proposal could also be subject to administrative and judicial challenge by others.

In order to be able to install SCRs on all four units of SJGS by the compliance deadline set forth in the FIP, PNM obtained bids for the installation of SCR technology. PNM entered into a contract on October 31, 2012 with an engineering, procurement, and construction contractor to install SCRs and is negotiating a contract with an engineering firm for construction management services on behalf of the SJGS owners. The construction contract includes termination provisions in the event that SCRs are determined in the future to be unnecessary. The construction contract contains a cost estimate, which will be refined through an "open book" subcontractor bidding process with final costs to be determined by June 30, 2013. Based on the indicative bid for construction, PNM estimates the total cost to install SCRs on all four units of SJGS will be between approximately \$824 million and \$910 million, which amounts include costs for construction management, gross receipts taxes, AFUDC, and other PNM costs. PNM's share of the costs would be about 46.3% based upon its SJGS ownership interest.

Energy efficiency also plays a significant role in helping to keep customers' electricity costs low and meeting their energy needs. PNM's and TNMP's energy efficiency and load management portfolios continue to be robust. In 2011, annual energy saved as a result of PNM's portfolio of energy efficiency programs was approximately 58,900 MWh. This is equivalent to the consumption of approximately 7,700 homes in PNM's service territory. PNM's load management and energy efficiency programs also help lower peak demand requirements. TNMP's energy efficiency programs in 2011 resulted in energy savings totaling an estimated 13,435 MWh.

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In 2008, PNMR established a three-year waste-reduction goal in which all facilities were to maintain recycling programs and identify significant waste streams. The target called for at least 75% of facilities to implement plans to reduce a minimum of one waste stream by 15% below 2009 levels. By the end of 2011, more than 87% of PNMR facilities had achieved the waste-reduction goal.

### Social Responsibility

Through outreach, collaboration, and various community-oriented programs, PNMR continues to make significant progress in two of its key focus areas of low-income assistance and energy efficiency support in New Mexico and Texas.

Building off work that began in 2008, continuing outreach efforts include numerous community events that connected low-income customers with non-profit community service providers offering support and help with such needs as utility bills, food, clothing, medical programs, services for seniors, and weatherization. Additionally, four of the largest grants awarded in 2011 by PNMR supported nonprofits in various areas such as:

#### ▲Adult literacy

▲Assistance for families trying to emerge from poverty

▲Food rescue from restaurants and grocers to help feed those in need

▲Assistance for low-income individuals to build a home, start a small business, or pursue higher education

In 2011, the PNM Good Neighbor Fund provided \$1.2 million of assistance with utility bills to 9,907 families. Further, as part of the settlement in its 2010 Electric Rate Case, PNM agreed to voluntarily contribute an additional \$1.3 million to the Good Neighbor Fund. This fund, along with additional collaboration with various other agencies, has helped to reduce the electricity affordability gap for many vulnerable customer groups such as seniors, young families, and medically challenged households.

The PNM Resources Foundation helps nonprofits become more energy efficient through Reduce Your Use grants. For 2012, the foundation awarded \$0.3 million to 55 New Mexico nonprofits for such projects as shade structure installations, window replacements, and efficient appliance purchases. In 2011, the foundation gave more than \$0.3 million to support 87 projects in New Mexico and Texas that helped purchase energy efficiency appliances and install high-performance windows and solar panels. Since the program's inception in 2008, Reduce Your Use grants have provided nonprofit agencies in New Mexico and Texas with a total of \$1.3 million of support.

### Economic Factors

In the three months ended September 30, 2012, PNM experienced a decrease in weather-normalized, retail load of 0.3% and TNMP experienced an increase in weather-normalized, retail load of 3.7% compared to the three months ended September 30, 2011. In the nine months ended September 30, 2012, PNM and TNMP experienced increases in weather-normalized, retail load of 0.2% and 4.1% compared to the nine months ended September 30, 2011. In recent years, New Mexico and Texas have fared better than the national average in unemployment. However, New Mexico's figures may be misleading due to people dropping out of the work force. Employment growth is much more telling, as Texas leads the way with growth rates well above the national rate while New Mexico's employment is relatively flat.

### Rate Base Potential Growth

Based on the 5-year capital plan announced in December 2011, PNM expects rate base to grow at a 2% compound annual rate through 2013. That growth figure could be 7% from 2011 through 2016 through additional potential capital investments. The largest of these involves possibly being required to install SCRs to reduce emissions at SJGS and Four Corners. The addition of other facilities, such as renewable resources and peaking capacity, could also expand rate base. TNMP's compound annual rate base growth rate through 2013 is estimated at 8%, predicated on the utility's 5-year capital plan announced in December 2011. A significant portion of TNMP's capital additions should be

recovered through expedited transmission and distribution cost recovery mechanisms authorized by the PUCT. PNMR will continue to carefully balance the potential rate base growth for PNM and TNMP with customer rate impacts.

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## Results of Operations

A summary of net earnings attributable to PNMR is as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	Change	2012	2011	Change
	(In millions, except per share amounts)					
Net earnings	\$57.9	\$43.7	\$14.2	\$96.5	\$64.4	\$32.1
Average diluted common and common equivalent shares	80.4	91.7	(11.4 )	80.4	92.0	(11.6 )
Net earnings per diluted share	\$0.72	\$0.48	\$0.24	\$1.20	\$0.70	\$0.50

The components of the change in earnings attributable to PNMR are:

	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
	(In millions)	
PNM Electric	\$12.5	\$44.7
TNMP Electric	0.2	3.0
First Choice	(0.6 )	(20.7 )
Corporate and Other	2.1	5.0
Net change	\$14.2	\$32.1

PNMR's operational results were affected by the following:

• Exit from unregulated businesses - PNMR sold First Choice in 2011; therefore 2012 results of operations do not include First Choice

• Rate increases for PNM and TNMP - Additional information about these rate increases is provided in Note 17 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K

• Decrease in the number of common and common equivalent shares primarily due to PNMR's purchase of its equity described in Note 6 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K

• Other factors impacting results of operation for each segment are discussed under Results of Operations below

## Liquidity and Capital Resources

During 2011, PNMR and PNM replaced their revolving credit facilities with new facilities. The new facilities provide capacities for short-term borrowing and letters of credit of \$300.0 million for PNMR and \$400.0 million for PNM. In addition, TNMP has a \$75.0 million revolving credit facility. Total availability for PNMR on a consolidated basis was \$653.5 million at October 26, 2012. The Company utilizes these credit facilities and cash flows from operations to provide funds for both construction and operational expenditures. PNMR also has intercompany loan agreements with each of its subsidiaries.

The Company projects that its total capital requirements, consisting of construction expenditures and dividends, will total \$1,526.9 million for 2012-2016, including amounts expended through September 30, 2012. This estimate does not include amounts for environmental upgrades at SJGS or Four Corners that may be required by EPA to address regional haze or other environmental compliance requirements, additional renewable resources that may be required to meet the RPS, or additional peaking resources that may be needed to meet needs outlined in PNM's current IRP. In addition to internal cash generation, the Company anticipates that it will be necessary to obtain additional long-term financing in the form of debt refinancing, new debt issuances, and/or new equity in order to fund its capital requirements through 2016. The Company currently believes that its internal cash generation, existing credit arrangements, and access to public and private capital markets will provide sufficient resources to meet the Company's capital requirements.





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## RESULTS OF OPERATIONS

## Segment Information

The following discussion is based on the segment methodology that PNMR's management uses for making operating decisions and assessing performance of its various business activities. See Note 2 for more information on PNMR's operating segments.

The following discussion and analysis should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto. Trends and contingencies of a material nature are discussed to the extent known. Refer also to Disclosure Regarding Forward Looking Statements and to Part II, Item 1A. Risk Factors.

## PNM Electric

The following table summarizes the operating results for PNM Electric:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	Change	2012	2011	Change
	(In millions)					
Electric operating revenues	\$ 321.7	\$ 323.8	\$ (2.1 )	\$ 832.2	\$ 797.2	\$ 35.0
Cost of energy	99.2	108.7	(9.5 )	263.0	279.4	(16.4 )
Margin	222.5	215.1	7.4	569.2	517.8	51.4
Operating expenses	101.1	102.1	(1.0 )	311.5	329.5	(18.0 )
Depreciation and amortization	24.4	25.1	(0.6 )	72.0	71.7	0.3
Operating income	97.0	87.9	9.1	185.7	116.6	69.1
Other income (deductions)	8.4	(1.8 )	10.2	19.1	16.2	3.0
Net interest charges	(19.2 )	(18.5 )	(0.7 )	(56.7 )	(54.6 )	(2.1 )
Earnings before income taxes	86.1	67.6	18.5	148.2	78.2	70.0
Income (taxes)	(31.2 )	(25.1 )	(6.2 )	(51.9 )	(26.6 )	(25.4 )
Valencia non-controlling interest	(4.0 )	(4.1 )	0.1	(10.7 )	(10.8 )	0.1
Preferred stock dividend requirements	(0.1 )	(0.1 )	—	(0.4 )	(0.4 )	—
Segment earnings	\$ 50.8	\$ 38.3	\$ 12.5	\$ 85.2	\$ 40.5	\$ 44.7

The following table summarizes the significant changes to electric operating revenues, cost of energy, and margin:

	2011/2012 Change					
	Three Months Ended September 30, Electric			Nine Months Ended September 30, Electric		
	Operating Revenues	Cost of Energy	Margin	Operating Revenues	Cost of Energy	Margin
	(In millions)					
Retail rate increases	\$ 5.6	\$ —	\$ 5.6	\$ 40.3	\$ —	\$ 40.3
Wholesale rate increases	1.4	—	1.4	2.8	—	2.8
Retail load, fuel, and transmission	(11.7 )	(9.1 )	(2.6 )	(13.7 )	(17.4 )	3.7
Energy efficiency rider	7.2	—	7.2	17.1	—	17.1
Renewable energy rider	1.5	0.6	0.9	1.5	0.6	0.9
Unregulated margin	(1.4 )	(0.1 )	(1.3 )	(5.5 )	0.7	(6.2 )
Net unrealized economic hedges	(4.7 )	(0.9 )	(3.8 )	(7.5 )	(0.3 )	(7.2 )



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The following table shows electric operating revenues by customer class and average number of customers:

	Three Months Ended			Nine Months Ended September		
	September 30,			30,		
	2012	2011	Change	2012	2011	Change
	(In millions, except customers)					
Residential	\$126.1	\$124.8	\$1.3	\$318.9	\$291.4	\$27.5
Commercial	120.4	115.7	4.7	317.1	287.8	29.3
Industrial	29.4	28.0	1.4	77.6	71.3	6.3
Public authority	8.1	7.4	0.7	19.3	17.8	1.5
Other retail	2.3	2.7	(0.4)	9.5	7.3	2.2
Transmission	10.8	14.3	(3.5)	29.3	35.3	(6.0)
Firm requirements wholesale	10.5	8.1	2.4	28.8	25.1	3.7
Other sales for resale	15.8	19.8	(4.0)	35.4	57.4	(22.0)
Mark-to-market activity	(1.7)	3.0	(4.7)	(3.7)	3.8	(7.5)
	\$321.7	\$323.8	\$(2.1)	\$832.2	\$797.2	\$35.0
Average retail customers (thousands)	505.6	503.8	1.8	505.3	503.7	1.6

The following table shows GWh sales by customer class:

	Three Months Ended			Nine Months Ended September		
	September 30,			30,		
	2012	2011	Change	2012	2011	Change
Residential	975.7	1,006.0	(30.3)	2,573.3	2,587.2	(13.9)
Commercial	1,103.5	1,130.0	(26.5)	3,064.1	3,060.2	3.9
Industrial	471.6	429.4	42.2	1,313.0	1,187.8	125.2
Public authority	84.0	84.1	(0.1)	211.1	214.1	(3.0)
Firm requirements wholesale	162.0	154.6	7.4	485.8	481.0	4.8
Other sales for resale	536.9	580.4	(43.5)	1,263.4	1,709.9	(446.5)
	3,333.7	3,384.5	(50.8)	8,910.7	9,240.2	(329.5)

On August 21, 2011, PNM implemented a \$72.1 million annual non-fuel rate increase for its retail customers. This rate increase improved revenues and margin by \$5.6 million and \$40.3 million for the three and nine months ended September 30, 2012. Lower retail loads, driven by weather, reduced revenues and margin for the three and nine months ended September 30, 2012 by \$4.7 million and \$0.8 million, as milder weather in the third quarter was partially offset by warmer weather in the second quarter. The average number of retail customers and usage per customer have stayed relatively flat during 2012. The increase in fuel costs and the reduction in off-system sales volumes resulting from the fire incident at the mine providing coal to SJGS are recovered through PNM's FPPAC and did not negatively impact 2012 results. See Note 9 for more discussion on the SJGS mine fire incident.

PNM implemented new rates, subject to refund, for one of its firm-requirements wholesale customers in April 2012, which improved revenues and margin by \$1.4 million and \$2.8 million for the three and nine months ended September 30, 2012. See Note 10.

PNM offers several energy efficiency programs and initiatives to its retail customers regulated by the NMPRC. In addition, PNM is allowed to earn adders on these programs, based on energy savings of the programs. PNM recovers these energy efficiency program costs via a rate rider. For the three and nine months ended September 30, 2012, revenues and margin improved by \$7.2 million and \$17.1 million, of which \$0.3 million and \$0.8 million is adder revenues and the remaining \$6.9 million and \$16.3 million is offset by an increase in operating expense for energy efficiency program costs.

On August 20, 2012, PNM implemented its renewable energy rider, a mechanism approved by NMPRC, which will recover renewable energy procurement costs, including the investment in and an allowed return on the 22 MW PNM-owned solar PV facilities incurred to meet PNM's RPS. See Note 10. For the three and nine months ended September 30, 2012, PNM revenues

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increased by \$1.5 million and cost of energy for the purchase of RECs increased by \$0.6 million. Revenues included a return on investment of \$0.3 million and the remaining revenues recover renewable energy operating expenses and depreciation.

For the three and nine months ended September 30, 2012, lower unregulated revenues of \$1.4 million and \$5.5 million and margin of \$1.3 million and \$6.2 million resulted from lower market power prices on sales from and increases in nuclear fuel costs associated with PNM's share of PVNGS Unit 3, which is excluded from retail regulation.

Changes in unrealized mark-to-market gains and losses are based on economic hedges in place for sales and fuel costs not covered under the FPPAC, primarily associated with PVNGS Unit 3. Unrealized losses of \$1.1 million for the three months ended September 30, 2012 compared to unrealized gains of \$2.7 million for the three months ended September 30, 2011, decreased margin by \$3.8 million. Unrealized losses of \$3.1 million for the nine months ended September 30, 2012 compared to unrealized gains of \$4.1 million for the nine months ended September 30, 2011, decreased margin by \$7.2 million.

For the three months ended September 30, 2012, operating expenses decreased by \$1.0 million. For the nine months ended September 30, 2012, operating expenses decreased by \$18.0 million, primarily due to a regulatory disallowance of \$17.5 million recorded in the second quarter of 2011. See Note 17 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K. PNM incurred \$1.0 million and \$2.7 million in the three and nine months ended September 30, 2011 to implement several process improvement activities, which did not recur in 2012 resulting in lower operating expenses. The benefits of these process improvement initiatives and labor savings further reduced operating expenses by \$3.0 million and \$4.9 million for the three and nine months ended September 30, 2012. Lower incentive compensation of \$1.8 million and \$1.9 million reduced operating expenses for the three and nine months ended September 30, 2012. Adjustments of \$4.4 million and \$6.1 million for additional taxes other than income, primarily gross receipts taxes, were recorded in the three and nine months ended September 30, 2011 with no such adjustments recorded in 2012, resulted in reduced operating expenses in 2012 compared to 2011. For the nine months ended September 30, 2012, improved plant performance at SJGS and PVNGS reduced maintenance expenses by \$2.4 million compared to 2011. Also, the timing of a planned outage at a gas facility in 2011 of \$1.4 million and lower vegetation management costs of \$1.0 million reduced expenses for the nine months ended September 30, 2012. For the three and nine months ended September 30, 2012, these savings were offset by increases of \$6.9 million and \$16.3 million of energy efficiency program costs, which are recovered through revenues discussed above.

For the three months ended September 30, 2012, other income (deductions) was \$10.2 million higher than 2011, primarily related to improved performance of the NDT assets of \$10.8 million. PNM incurred net losses, including impairments of the NDT investments of \$4.1 million, in the third quarter of 2011, compared to net gains of \$5.7 million in the third quarter 2012. In addition, the equity portion of AFUDC of \$0.9 million improved other income. For the nine months ended September 30, 2012, other income (deductions) was \$3.0 million higher, primarily related to improved performance of the NDT assets of \$2.8 million, higher equity portion of AFUDC of \$3.0 million, offset by lower interest income on the PVNGS lessor notes of \$2.1 million due to lower outstanding balances.

For the three and nine months ended September 30, 2012, interest expense increased \$2.2 million and \$6.6 million due to the issuance of \$160.0 million of 5.35% long-term debt in October 2011, which increases were partially offset by \$0.5 million and \$2.0 million increases in the debt portion of AFUDC and \$0.7 million and \$2.8 million of interest charges on PNM's investment in renewable resources that are deferred for recovery through the renewable energy rider. As discussed above, PNM implemented its renewable energy rider in August 2012 and interest costs associated with its investment in renewable energy are included in amounts being recovered through the rider.



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## TNMP Electric

The following table summarizes the operating results for TNMP Electric:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	Change	2012	2011	Change
	(In millions)					
Total electric operating revenues	\$ 68.7	\$ 67.0	\$ 1.7	\$ 187.4	\$ 180.8	\$ 6.6
Cost of energy	11.6	10.3	1.3	34.3	30.7	3.6
Margin	57.1	56.7	0.4	153.1	150.1	3.0
Operating expenses	22.3	22.5	(0.1)	64.2	67.4	(3.2)
Depreciation and amortization	13.8	12.7	1.1	37.2	33.7	3.5
Operating income	21.0	21.6	(0.6)	51.7	49.0	2.7
Other income (deductions)	0.4	0.3	0.1	1.2	0.9	0.4
Net interest charges	(7.0)	(7.3)	0.2	(21.2)	(21.9)	0.7
Earnings before income taxes	14.3	14.6	(0.3)	31.7	28.0	3.7
Income (taxes)	(5.2)	(5.7)	0.5	(11.6)	(10.8)	(0.7)
Segment earnings	\$ 9.1	\$ 8.9	\$ 0.2	\$ 20.1	\$ 17.1	\$ 3.0

The following table summarizes the significant changes to total electric operating revenues, cost of energy, and margin:

	2011/2012 Change			2011/2012 Change		
	Three Months Ended September 30,			Nine Months Ended September 30,		
	Operating Revenues	Cost of Energy	Margin	Operating Revenues	Cost of Energy	Margin
	(In millions)					
Rate increases	\$—	\$—	\$—	\$0.7	\$—	\$0.7
Customer usage/load	(1.1)	—	(1.1)	(2.6)	—	(2.6)
Transmission cost recovery	1.4	1.3	0.1	3.4	3.6	(0.2)
AMS surcharge	2.1	—	2.1	5.4	—	5.4
Other	(0.7)	—	(0.7)	(0.3)	—	(0.3)
Net change	\$ 1.7	\$ 1.3	\$ 0.4	\$ 6.6	\$ 3.6	\$ 3.0

The following table shows total electric operating revenues by retail tariff consumer class, including intersegment revenues, and average number of consumers:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	Change	2012	2011	Change
	(In millions, except consumers)					
Residential	\$ 33.2	\$ 34.5	\$(1.3)	\$ 79.9	\$ 77.8	\$ 2.1
Commercial	22.7	21.7	1.0	65.1	62.0	3.1
Industrial	3.2	3.3	(0.1)	10.1	9.5	0.6
Other	9.6	7.5	2.1	32.3	31.5	0.8
	\$ 68.7	\$ 67.0	\$ 1.7	\$ 187.4	\$ 180.8	\$ 6.6
Average consumers (thousands) <sup>(1)</sup>	233.6	232.2	1.4	232.7	231.3	1.4

<sup>(1)</sup> TNMP provides transmission and distribution services to REPs that provide electric service to consumers in TNMP's service territories. The number of consumers above represents the customers of these REPs. Under TECA, consumers in Texas have the ability to choose any REP to provide energy. The average consumers reported above



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66,273 and 67,549 consumers for the three and nine months ended September 30, 2011, who had chosen First Choice as their REP. These consumers are also included as customers in the First Choice segment.

The following table shows GWh sales by retail tariff consumer class:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	Change	2012	2011	Change
Residential	930.4	1,015.0	(84.6 )	2,173.4	2,319.4	(146.0 )
Commercial	692.5	703.7	(11.2 )	1,796.7	1,825.7	(29.0 )
Industrial	695.4	675.2	20.2	2,025.6	1,931.1	94.5
Other	26.5	28.7	(2.2 )	78.0	82.5	(4.5 )
	2,344.8	2,422.6	(77.8 )	6,073.7	6,158.7	(85.0 )

The GWh sales reported above include 324.1 and 775.3 GWhs for the three and nine months ended September 30, (1) 2011 used by consumers who had chosen First Choice as their REP. These GWhs are also included below in the First Choice segment.

For the three months ended September 30, 2012, temperatures were cooler compared to the extremely warm summer in 2011 reducing revenues and margin. The reductions in revenues and margin were partially offset by an increase in the average number of consumers and higher usage per consumer, excluding impacts from weather. For the nine months ended September 30, 2012, milder weather compared to 2011, also reduced revenues and margin. An increase in the number of consumers, increased usage per consumer, and an increase in rates partially offset the weather impacts. For the three and nine months ended September 30, 2012, the AMS surcharge improved revenues and margin by \$2.1 million and \$5.4 million, including a return on investment of \$0.2 million and \$0.8 million. The remaining surcharge revenues offset increases in operating expenses and depreciation. On September 27, 2012, TNMP implemented a \$2.5 million annual increase in its transmission cost of service rates to recover additional investment in transmission plant and associated costs. See Note 10.

For the three months ended September 30, 2012, savings from process improvement initiatives and labor efficiencies of \$1.0 million reduced operating expenses. These reductions are offset by \$1.1 million costs associated with the implementation of AMS, which are recovered via the surcharge described above. For the nine months ended September 30, 2012, operating expenses are lower compared to the same period in 2011, primarily due to a regulatory disallowance of \$3.9 million recorded in the second quarter of 2011. See Note 10. In addition, operating expenses for the nine months ended September 30, 2012 reflect reductions due to process improvement initiatives and labor efficiencies of \$2.6 million and lower maintenance costs of \$1.1 million due to a spike in reliability related costs caused by severe drought conditions in 2011. An increase of \$2.1 million of AMS related costs, which are recovered via a surcharge, offset these savings.

Increases in depreciation and amortization expenses for the three and nine months ended September 30, 2012 are mainly due to the AMS investment, which is recovered through the surcharge discussed above. In addition, increases in transmission plant also increased depreciation expense.

Interest expense decreased in 2012 as a result of TNMP refinancing its term loan in September 2011.

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## First Choice

As discussed in Note 14, PNMR sold First Choice on November 1, 2011. The table below summarizes the operating results for First Choice for the three and nine months ended September 30, 2011:

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
	(In millions)	
Total electric operating revenues	\$ 171.0	\$ 405.5
Cost of energy	144.0	303.3
Margin	27.0	102.2
Operating expenses	25.1	67.7
Depreciation and amortization	0.3	1.0
Operating income	1.5	33.5
Other income (deductions)	(0.1 )	(0.4 )
Net interest charges	(0.2 )	(0.5 )
Earnings before income taxes	1.2	32.6
Income (taxes)	(0.6 )	(11.8 )
Segment earnings	\$0.6	\$ 20.7

The following table shows total electric operating revenues by customer class and actual number of customers:

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
	(In millions, except customers)	
Residential	\$ 104.2	\$ 241.9
Commercial	62.5	152.2
Other	4.3	11.4
	\$ 171.0	\$ 405.5
Actual customers (thousands) <sup>(1,2)</sup>	223.1	223.1

<sup>(1)</sup> See note above in the TNMP Electric segment discussion about the impact of TECA.

<sup>(2)</sup> Due to the competitive nature of First Choice's business, actual customer counts are presented in the table above as a more representative business indicator than the average consumers that are shown in the table for TNMP.

The following table shows GWh electric sales by customer class<sup>(1)</sup>:

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Residential	812.8	1,871.5
Commercial	569.5	1,397.8
	1,382.3	3,269.3

<sup>(1)</sup> See note above in the TNMP Electric segment discussion about the impact of TECA.

During the three and nine months ended September 30, 2011, favorable weather and increases in both MWh sales and number of customers, which were partially offset by a decrease in average revenue rates, favorably impacted operating revenues. Due to extreme temperatures during the three months ended September 30, 2011, First Choice incurred significantly higher purchased power costs per MWh which negatively impacted the total amount of cost of energy.

First Choice managed its exposure to fluctuations in market energy prices by matching sales contracts with supply instruments designed to preserve targeted margin. Accordingly, First Choice had forward contracts for the purchase of energy to cover the future load requirements for most of its fixed price sales contracts. Gains or losses on

unrealized economic hedges

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represent changes in unrealized fair value estimates related to these forward supply contracts. Changes in the fair value of supply contracts that were not designated or were not eligible for hedge or normal purchase or sales accounting were marked to market through current period earnings as required by GAAP. During 2011, market energy prices increased, which resulted in unrealized mark-to-market gains on certain of First Choice's forward supply contracts. First Choice was not required to mark the related fixed price sales contracts to market, which would likely show offsetting gains and losses as market energy prices fluctuate. Gains on unrealized economic hedges increased segment earnings by \$1.7 million in the nine months ended September 30, 2011.

The allowance for uncollectible accounts and related bad debt expense was based on collections and write-off experience. Lower customer departures, lower default rates, and an increase in commercial customers reduced bad debts in 2011 compared to previous years. Initiatives to reduce bad debts included efforts to reduce the default rate experienced for customers switching to another REP and increased focus on identifying new customer prospects that were more likely to demonstrate desired payment behavior. First Choice focused its marketing efforts on commercial customers and customers with established payment patterns. First Choice also increased the credit score required to become a customer and expanded the circumstances where customers were required to provide advance deposits to obtain service, or both. Bad debt expense was \$7.6 million and \$17.9 million for the three and nine months ended September 30, 2011.

During 2011, increases in marketing and operational costs were partially offset by a decrease in incentive compensation expense. The increases in operational costs were primarily related to developing a pre-pay option for customers and establishing local office locations. Interest expense decreased in 2011 primarily due to lower short-term debt.

## Corporate and Other

The table below summarizes the operating results for Corporate and Other:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	Change	2012	2011	Change
	(In millions)					
Total revenues	\$—	\$(12.2)	) \$12.2	\$—	\$(30.8)	) \$30.8
Cost of energy	—	(12.2)	) 12.2	—	(30.6)	) 30.6
Margin	—	—	—	—	(0.1)	) 0.1
Operating expenses	(4.8)	) (1.6)	) (3.2)	) (12.7)	) (7.2)	) (5.5)
Depreciation and amortization	4.6	4.3	0.3	13.1	12.8	0.3
Operating income (loss)	0.2	(2.7)	) 2.9	(0.4)	(5.7)	) 5.3
Other income (deductions)	(0.9)	) (1.7)	) 0.8	(4.9)	) (5.0)	) 0.1
Net interest charges	(4.2)	) (5.1)	) 0.9	(12.4)	) (15.2)	) 2.8
Earnings (loss) before income taxes	(4.9)	) (9.6)	) 4.7	(17.8)	) (26.0)	) 8.2
Income (taxes) benefit	2.9	5.4	(2.5)	) 8.9	12.0	(3.1)
Segment earnings (loss)	\$(2.0)	) \$(4.1)	) \$2.1	\$(8.9)	) \$(14.0)	) \$5.0

The Corporate and Other segment includes consolidation elimination of revenue and cost of energy between business segments, primarily related to TNMP's sale of transmission services to First Choice prior to November 1, 2011, when PNMR sold First Choice. Accordingly, there was no elimination of intersegment revenue in 2012.

Operating expense decreased primarily due to legal and consulting expenses incurred in 2011 related to assessment of strategic alternatives for PNMR's competitive businesses that did not recur in 2012.

Depreciation expense increased \$1.0 million and \$2.6 million in the three and nine months ended September 30, 2012 compared to 2011 due to accelerated amortization of leasehold improvements for part of its corporate headquarters.

The accelerated amortization is offset by lower depreciation on software applications of \$0.9 million and \$2.5 million for the three and nine months ended September 30, 2012 compared to 2011. Changes in depreciation and amortization are offset in operating expenses as a result of allocation of these costs to other business segments. PNM and TNMP defer their allocations of the accelerated amortization of leasehold improvements as regulatory assets to be recovered through rates.

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Other income and deductions increased for the three months ended September 30, 2012 compared to 2011 as a result of recording an additional pre-tax gain of \$1.0 million on the sale of First Choice (Note 14). This gain was offset by lower performance on other investments for the nine months ended September 30, 2012 compared to 2011.

Interest charges decreased \$1.2 million and \$3.5 million for the three and nine months ended September 30, 2012 compared to 2011 due to the re-acquisition of \$50.0 million of PNMR 9.25% senior unsecured notes in November 2011.

## LIQUIDITY AND CAPITAL RESOURCES

## Statements of Cash Flows

The changes in PNMR's cash flows for the nine months ended September 30, 2012 compared to September 30, 2011 are summarized as follows:

	Nine Months Ended September 30,		
	2012	2011	Change
	(In millions)		
Net cash flows from:			
Operating activities	\$ 205.0	\$ 198.5	\$ 6.5
Investing activities	(188.0)	) (204.8	) 16.8
Financing activities	(26.8	) 16.7	(43.5 )
Net change in cash and cash equivalents	\$ (9.7	) \$ 10.4	\$ (20.1 )

The changes in PNMR's cash flows from operating activities relate primarily to improved results of operations at PNM and TNMP, primarily due to rate increases, and the receipt of \$21.6 million for governmental grants related to renewable energy initiatives. Increases were offset by contributions to the PNM and TNMP pension and other postretirement benefit plans of \$86.9 million in 2012 compared to \$38.6 million in 2011 and income taxes paid of \$5.3 million in 2012 compared to refunds of \$3.7 million in 2011.

The changes in PNMR's cash flows from investing activities relate primarily to changes in utility plant additions. At PNM, total utility plant additions in 2012 compared to 2011 decreased by \$40.8 million, after an increase of \$4.0 million related to nuclear fuel purchases. PNM additions in 2011 included \$57.0 million related to solar projects, which were completed by the end of 2011. TNMP utility plant additions increased \$17.0 million in 2012 compared to 2011, including increases of \$10.8 million in transmission projects and \$1.5 million related to the AMS deployment. Plant additions at the Corporate and Other segment also increased \$2.3 million in 2012. Construction expenditures were funded primarily through cash flows from operating activities and short-term borrowings in both 2012 and 2011.

The changes in cash flows from financing activities relate primarily to increased short-term borrowings in 2012. Net cash outflows of \$11.6 million to satisfy stock-based awards in 2012 compared to \$2.7 million in 2011 also contributed to the change.

## Financing Activities

See Note 6 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K, for additional information concerning the Company's financing activities. In May 2012, PNM received NMPRC approval to participate in the refunding of \$20.0 million of PCRBs. PNM also received NMPRC authority to exercise the two one-year extension options under the PNM Revolving Credit Facility. The PNMR Revolving Credit Facility also provides for two one-year extension options although NMPRC authority to exercise them is not required. In October 2012, the first of the one-year extension options for the PNMR Revolving Credit Facility and the PNM Revolving

Credit Facility were exercised extending the expiration of both facilities to October 31, 2017.

In September 2012, PNM participated in the issuance of \$20.0 million of new PCRBs by the City of Farmington, New Mexico, which bear interest at 2.54% and mature September 1, 2042 with a mandatory tender on June 1, 2017. The new PCRBs refunded a \$20.0 million series of PCRBs, which bore interest at 5.15% and matured in 2037, that were redeemed at par and retired.



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## Capital Requirements

Total capital requirements consist of construction expenditures and cash dividend requirements for PNMR common stock and PNM preferred stock. Key activities in PNMR's current construction program include:

- Upgrading generation resources and additional renewable energy projects
- Expanding the electric transmission and distribution systems
- Purchasing nuclear fuel

Projected capital requirements, including amounts expended through September 30, 2012, are:

	2012	2013-2016	Total
	(In millions)		
Construction expenditures	\$283.9	\$1,011.0	\$1,294.9
Dividends on PNMR common stock	44.6	184.8	229.4
Dividends on PNM preferred stock	0.5	2.1	2.6
Total capital requirements	\$329.0	\$1,197.9	\$1,526.9

The construction expenditure estimates are under continuing review and subject to ongoing adjustment, as well as to Board review and approval. Estimates for construction expenditures currently do not include any significant expenditures for environmental control facilities. The construction expenditures above do not include amounts for environmental upgrades at SJGS or Four Corners that may be required by EPA to address regional haze or other environmental compliance requirements, additional renewable resources that may be required to meet the RPS, or additional peaking resources that may be needed to meet needs outlined in PNM's current IRP. Potential expenditures to address regional haze are discussed in Note 9. PNM currently estimates that additional potential expenditures of approximately \$120 million for renewable resources and \$80 million for peaking resources could be incurred in the 2013-2016 period, subject to NMPRC approval and other considerations. The ability of PNMR to pay dividends on its common stock is dependent upon the ability of PNM and TNMP to be able to pay dividends to PNMR. Note 5 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K describes regulatory and contractual restrictions on the payment of dividends by PNM and TNMP.

During the nine months ended September 30, 2012, PNMR met its capital requirements and construction expenditures through cash generated from operations, as well as its liquidity arrangements.

In addition to the capital requirements for construction expenditures and dividends, the Company has long-term debt that must be paid or refinanced at maturity. Note 6 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K contains information about the maturities of long-term debt. The Company has from time to time refinanced or repurchased portions of its outstanding debt before scheduled maturity. Depending on market conditions, the Company may refinance other debt issuances or make additional debt repurchases in the future.

**Liquidity**

PNMR's liquidity arrangements include the PNMR Revolving Credit Facility and the PNM Revolving Credit Facility that both expire in 2017 and the TNMP Revolving Credit Facility that expires in December 2015. The PNMR Revolving Credit Facility has a financing capacity of \$300.0 million, the PNM Revolving Credit Facility has a financing capacity of \$400.0 million, and the TNMP Revolving Credit Facility has a financing capacity of \$75.0 million. The Company believes the terms and conditions of its facilities are consistent with those of other investment grade revolving credit facilities in the utility industry. Each of the facilities contains one financial covenant, which requires the maintenance of debt-to-capital ratios of less than or equal to 65%. These ratios for PNMR and PNM reflect the present value of payments under the PVNGS and EIP leases as debt.

These facilities provide short-term borrowing capacity and also allow letters of credit to be issued. Letters of credit reduce the available capacity under the facilities. The Company utilizes these credit facilities and cash flows from operations to provide funds for both construction and operational expenditures. The Company's business is seasonal with more revenues and cash flows from operations being generated in the summer months. In general, the Company

relies on the credit facilities to be the initial funding source for construction expenditures. Accordingly, borrowings under the facilities increase over time. Depending on market and other conditions, the Company will periodically sell long-term debt and use the proceeds to reduce the borrowings under the credit facilities. Short-term borrowings at PNMR ranged from \$113.0 million to \$130.7 million during the three months ended September 30, 2012 and from \$14.0 million to \$141.1 million during the nine months ended September 30, 2012. PNM

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short-term borrowings ranged from zero to \$88.5 million during the three months ended September 30, 2012 and from zero to \$167.9 million during the nine months ended September 30, 2012. There were no borrowings under the TNMP Revolving Credit Facility during the nine months ended September 30, 2012. At September 30, 2012, the average interest rate was 1.97% for borrowings outstanding under the PNMR Revolving Credit Facility. PNMR also had a \$5.0 million bi-lateral line of credit with a single financial institution that was allowed to expire in August 2012. The Company currently believes that its capital requirements can be met through internal cash generation, existing credit arrangements, and access to public and private capital markets. To cover the difference in the amounts and timing of internal cash generation and cash requirements, the Company intends to use short-term borrowings under its current and future liquidity arrangements. However, if difficult market conditions experienced during the recent recession return or worsen, the Company may not be able to access the capital markets or renew credit facilities when they expire. Should that occur, the Company would seek to improve cash flows by reducing capital expenditures and exploring other available alternatives. Also, PNM may consider seeking authorization for the issuance of first mortgage bonds to improve access to the capital markets.

In addition to its internal cash generation, the Company anticipates that it will be necessary to obtain additional long-term financing to fund its capital requirements through 2016. This could include debt refinancing, new debt issuances, and/or new equity.

The Company's ability to access the credit and capital markets at a reasonable cost is largely dependent upon its:

Ability to earn a fair return on its investments

Results of operations

Ability to obtain required regulatory approvals

Conditions in the financial markets

Credit ratings

The credit ratings for PNMR, PNM, and TNMP were set forth under the heading Liquidity in the MD&A contained in the 2011 Annual Reports on Form 10-K. On April 13, 2012, S&P raised the corporate credit rating for PNMR as well as the senior debt ratings for PNMR and TNMP and the preferred stock rating for PNM. S&P changed the outlook to stable for all entities. As of October 26, 2012, ratings on the Company's securities were as follows:

	PNMR	PNM	TNMP
S&P			
Senior secured debt	*	*	BBB+
Senior unsecured debt	BB+	BBB-	*
Preferred stock	*	BB	*
Moody's			
Senior secured debt	*	*	A3
Senior unsecured debt	Ba1	Baa3	*
Preferred stock	*	Ba2	*

\* Not applicable

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A summary of liquidity arrangements as of October 26, 2012 is as follows:

	PNMR Separate	PNM Separate (In millions)	TNMP Separate	PNMR Consolidated
Financing capacity - revolving credit facility	\$ 300.0	\$ 400.0	\$ 75.0	\$ 775.0
Amounts outstanding as of October 26, 2012:				
Revolving credit facility	106.4	—	—	106.4
Letters of credit	11.3	3.5	0.3	15.1
Total short-term debt and letters of credit	117.7	3.5	0.3	121.5
Remaining availability as of October 26, 2012	\$ 182.3	\$ 396.5	\$ 74.7	\$ 653.5
Invested cash as of October 26, 2012	\$—	\$ 6.6	\$—	\$ 6.6

The above table excludes intercompany debt. The remaining availability under the revolving credit facilities at any point in time varies based on a number of factors, including the timing of collections of accounts receivables and payments for construction and operating expenditures.

For offerings of securities registered with the SEC, PNMR has a shelf registration statement expiring in March 2014. This shelf registration statement has unlimited availability and can be amended to include additional securities, subject to certain restrictions and limitations. PNMR can also offer new shares of common stock through the PNM Resources Direct Plan under a separate SEC shelf registration statement that expires in August 2015. PNM has a shelf registration statement for up to \$440.0 million of senior unsecured notes that will expire in May 2014.

Off-Balance Sheet Arrangements

PNMR's off-balance sheet arrangements include PNM's operating lease obligations for PVNGS Units 1 and 2, the EIP transmission line, and Delta. These arrangements help ensure PNM the availability of lower-cost generation needed to serve customers. See MD&A - Off-Balance Sheet Arrangements and Note 7 of the Notes to Consolidated Financial Statements in the 2011 Annual Reports on Form 10-K. See Note 9 for additional information concerning the EIP lease.

Commitments and Contractual Obligations

PNMR, PNM, and TNMP have contractual obligations for long-term debt, operating leases, purchase obligations, and certain other long-term liabilities. See MD&A - Commitments and Contractual Obligations in the 2011 Annual Reports on Form 10-K.

Contingent Provisions of Certain Obligations

As discussed in the 2011 Annual Reports on Form 10-K, PNMR, PNM, and TNMP have a number of debt obligations and other contractual commitments that contain contingent provisions. Some of these, if triggered, could affect the liquidity of the Company. In the unlikely event that the contingent requirements were to be triggered, PNMR, PNM, or TNMP could be required to provide security, immediately pay outstanding obligations, or be prevented from drawing on unused capacity under certain credit agreements. The contingent provisions also include contractual increases in the interest rate charged on certain of the Company's short-term debt obligations in the event of a downgrade in credit ratings. The Company believes its financing arrangements are sufficient to meet the requirements of the contingent provisions. No conditions have occurred that would result in any of the above contingent provisions being implemented.

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## Capital Structure

The capitalization tables below include the current maturities of long-term debt, but do not include short-term debt and do not include operating lease obligations as debt.

	September 30, 2012	December 31, 2011	
<b>PNMR</b>			
PNMR common equity	49.2	% 48.3	%
Preferred stock of subsidiary	0.3	% 0.3	%
Long-term debt	50.5	% 51.4	%
Total capitalization	100.0	% 100.0	%
<b>PNM</b>			
PNM common equity	50.8	% 49.7	%
Preferred stock	0.5	% 0.5	%
Long-term debt	48.7	% 49.8	%
Total capitalization	100.0	% 100.0	%
<b>TNMP</b>			
Common equity	60.3	% 59.8	%
Long-term debt	39.7	% 40.2	%
Total capitalization	100.0	% 100.0	%

## OTHER ISSUES FACING THE COMPANY

## Climate Change Issues

## Background

In 2011, PNM's generating plants emitted approximately 7.1 million metric tons of CO<sub>2</sub>, which comprises the vast majority of its GHG. By comparison, the total GHG in the United States in 2010, the latest year for which EPA has published this data, were approximately 6.8 billion metric tons, of which approximately 5.7 billion metric tons were CO<sub>2</sub>. According to EPA data, electricity generation accounted for approximately 2.3 billion metric tons, or 40%, of the CO<sub>2</sub> emissions.

PNM has several programs underway to reduce GHG from its generating plants, thereby reducing its exposure to climate change regulation. See Note 10. In 2011, PNM completed construction of 22 MW of utility-scale solar generation located at five sites on PNM's system throughout New Mexico. In April 2012, PNM filed its 2013 Renewable Energy Plan, which calls for an additional 20 MW of PNM-owned solar facilities to be in service by the end of 2013 and a 20-year PPA for the output of a 10-MW geothermal facility to be in service by January 1, 2014. Additionally, PNM has a customer distributed solar generation program that is expected to grow distributed solar from the 14 MW installed at the end of 2011 to 21 MW by the end of 2012. Once fully subscribed, the distributed solar programs will reduce PNM's production from fossil-fueled electricity generation by 82 GWh per year. PNM offers its customers a comprehensive portfolio of energy efficiency and load management programs, with a 2012 annual budget of over \$17 million that projects electricity savings in 2012 of an estimated 63 GWh. Over the next 19 years, PNM projects the expanded energy efficiency and load management programs will provide the equivalent of approximately 12,870 GWh of electricity, which will avoid at least 6.1 million metric tons of CO<sub>2</sub> based upon projected emissions from PNM's system-wide portfolio with and without these programs. These estimates are subject to change given that it is difficult to accurately estimate avoidance because of the high uncertainty of many of the underlying variables and complex interrelationships between those variables, including changes in demand for electricity.

Management periodically updates the Board on implementation of corporate environmental policy and the Company's environmental management systems, promotion of energy efficiency and use of renewable resources. The Board is also advised of the Company's practices and procedures to assess the sustainability impacts of operations on the environment. The Board

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regularly considers associated issues around climate change, the Company's GHG exposures, and potential financial consequences that might result from potential federal and/or state regulation of GHG.

Approximately 81.9% of PNM's owned and leased generating capacity at December 31, 2011 consisted of coal or gas-fired generation that produces GHG, all of which is located within the United States. The Company does not anticipate any direct impact from any near-term international accords. Based on current forecasts, the Company does not expect its output of GHG from existing sources to increase significantly in the near-term. Many factors affect the amount of GHG, including plant performance. For example, if PVNGS experienced prolonged outages, PNM might be required to utilize other power supply resources such as gas-fired generation, which could increase GHG. If new natural gas-fired generation resources are added to meet increased load as anticipated in PNM's current IRP, GHG would be incrementally increased. Because of the Company's dependence on fossil-fueled generation, any legislation that imposes a limit or cost on GHG will impact the cost at which electricity is produced. While PNM expects to be entitled to recover that cost through rates, the timing and outcome of proceedings for cost recovery is uncertain. In addition, to the extent that any additional costs are recovered through rates, customers may reduce their demand, relocate facilities to other areas with lower energy costs, or take other actions that ultimately would adversely impact the Company.

Given the geographic location of its facilities and customers, PNM generally has not been exposed to the extreme weather events and other physical impacts commonly attributed to climate change, with the possible exception of periodic drought conditions. Climate changes are generally not expected to have material consequences in the near-term. Drought conditions in northwestern New Mexico could impact the availability of water for cooling coal-fired generating plants. Water shortage sharing agreements have been in place since 2004, although no shortage has been declared due to sufficient precipitation in the San Juan basin. PNM also has a supplemental water contract in place with the Jicarilla Tribe to help address any water shortages from primary sources. The contract expires on December 31, 2016. TNMP has operations in the Gulf Coast area of Texas, which experiences periodic hurricanes and drought conditions. In addition to potentially causing physical damage to TNMP owned facilities, which disrupt the ability to generate, transmit, and/or distribute energy, hurricanes can temporarily reduce customers' usage and demand for energy.

#### EPA Regulation

In April 2007, the U.S. Supreme Court held that EPA has the authority to regulate GHG under the CAA. This decision heightened the importance of this issue for the energy industry. In December 2009, EPA released its endangerment finding stating that the atmospheric concentrations of six key greenhouse gases (CO<sub>2</sub>, methane, nitrous oxides, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride) endanger the public health and welfare of current and future generations.

In May 2010, EPA released the final PSD and Title V Greenhouse Gas Tailoring Rule (the "Tailoring Rule") to address GHG from stationary sources under the CAA permitting programs. The purpose of the rule is to "tailor" the applicability of two programs, PSD and Title V operating permit programs, to avoid impacting millions of small GHG emitters. The rule focuses on the largest sources of GHG, including fossil-fueled electric generating units. This program currently covers new construction projects that emit GHG of at least 100,000 tons per year (even if PSD is not triggered for other pollutants). In addition, modifications at existing facilities that increase GHG by at least 75,000 tons per year will be subject to PSD permitting requirements, even if they do not significantly increase emissions of any other pollutant. EPA had indicated in its original Tailoring Rule that it might extend PSD regulation to smaller emission sources. However, on July 3, 2012, EPA finalized the third phase of the rule by keeping the permitting thresholds where they are. All of PNM's fossil-fueled generating plants are classified as PSD major CO<sub>2</sub> sources and potentially subject to the Tailoring Rule, but the existing plants do not have any currently planned projects that would trigger PSD permitting for GHG. Any newly constructed power plant would likely be subject to the Tailoring Rule. On June 26, 2012, the U.S. Court of Appeals for the District of Columbia Circuit rejected challenges to EPA's 2009 GHG endangerment finding, GHG emission standards for light-duty vehicles, PSD Interpretive Memorandum (EPA's so-called GHG "Timing Rule"), and Tailoring Rule. The Court found that EPA's endangerment finding and its light-duty vehicle rule "are neither arbitrary nor capricious," that "EPA's interpretation of the governing CAA provisions is unambiguously correct," and that "no petitioner has standing to challenge the Timing and Tailoring

Rules."

On March 27, 2012, EPA issued its proposed carbon pollution standards for the emission of GHG from new fossil-fueled electric generating units ("EGUs"). The proposed NSPS sets a limit of 1,000 lb CO<sub>2</sub>/MWh and covers newly constructed fossil-fueled EGUs that are larger than 25 MW. The proposed limit is based on the performance of natural gas combined cycle technology. Therefore, coal-fired power plants would likely only be able to comply with the standard by using carbon capture and sequestration technology. The proposed rule includes an exemption for simple cycle EGUs. However, during the comment period, EPA solicited

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comments on whether to drop the exemption and instead exempt any fossil-fueled EGU that limits electric generation to one-third of its annual generating capacity. The proposed rule, as written, does not include limits that apply to existing power plants, or proposed plants that already have a complete preconstruction permit and commence construction within 12 months of the issuance of the proposed rule. In a separate future action, EPA may issue existing sources CO<sub>2</sub> emission guidelines. The proposal is the first NSPS issued for CO<sub>2</sub>, and although it is limited to new sources, it has potential far-reaching implications for the utility industry. When finalized, the standard could serve as Best Available Control Technology analysis for PSD permitting for new GHG sources under the Tailoring Rule. It is not clear whether this standard might also apply to existing sources making major modifications that would require pre-construction permits under the Tailoring Rule, but completion of the proposed NSPS for new EGUs is a prerequisite for EPA to promulgate GHG standards for existing sources. The proposed rule was published in the Federal Register on April 13, 2012. EPA accepted comment on the proposed rule through June 25, 2012.

EPA regulation of GHG from large stationary sources will impact PNM's operations due to its reliance on fossil-fueled electric generation. The impact to PNM is unknown because the regulatory requirements, including Best Available Control Technology implications and NSPS requirements, are still developing. Impacts could involve investments in efficiency improvements and/or control technologies at the fossil-fueled generating plants. Although there are no commercially viable GHG control technologies at this time, such technologies may become viable in the future. It is also possible that the costs of such improvements or technologies could impact the economic viability of some plants.

### Federal Legislation

Prospects for enactment of legislation imposing a new or enhanced regulatory program to address climate change in the current Congress are unlikely, although Congress could address these issues at a future time. Instead, EPA is the primary venue for GHG regulation in the near future.

The Company has assessed, and continues to assess, the impacts of potential climate change legislation or regulation on its business. This assessment is preliminary, and future changes arising out of the legislative or regulatory process could impact the assessment significantly. The Company's assessment includes assumptions regarding the specific GHG limits, the timing of implementation of these limits, the level of emissions allowances allocated and the level that must be purchased, the development of technologies for renewable energy and to reduce emissions, the cost of emissions allowances, the degree to which offsets may be used for compliance, and provisions for cost containment. Moreover, the assessment assumes various market reactions such as with respect to the price of coal and gas and regional plant economics. These assumptions, at best, are preliminary and speculative. However, based upon these assumptions, the enactment of climate change legislation would likely, among other things, result in significant compliance costs, including significant capital expenditures by the Company, and could jeopardize the economic viability of certain generating facilities. See Note 9. In turn, these consequences would lead to increased costs to customers and could affect results of operations, cash flows, and financial condition if the incurred costs are not fully recovered through regulated rates. Higher rates could also contribute to reduced demand for electricity. The Company's assessment process is ongoing, but too preliminary and speculative at this time for the meaningful prediction of financial impact.

### State and Regional Activity

Pursuant to New Mexico law, each utility must submit an IRP to the NMPRC every three years to evaluate renewable energy, energy efficiency, load management, distributed generation, and conventional supply-side resources on a consistent and comparable basis. The IRP is required to take into consideration risk and uncertainty of fuel supply, price volatility, and costs of anticipated environmental regulations when evaluating resource options to meet supply needs of the utility's customers. The NMPRC issued an order in June 2007, requiring that New Mexico utilities factor a standardized cost of carbon emissions into their IRPs using prices ranging between \$8 and \$40 per metric ton of CO<sub>2</sub> emitted and escalating these costs by 2.5% per year. Under the NMPRC order, each utility must analyze these standardized prices as projected operating costs. Reflecting the developing nature of this issue, the NMPRC order states that these prices may be changed in the future to account for additional information or changed circumstances. However, PNM is required to use these prices for purposes of its IRP, and the prices may not reflect the costs that it ultimately will incur. PNM's IRP filed with the NMPRC on July 18, 2011 (Note 10) showed that

while consideration of the NMPRC required carbon emissions costs did not significantly change the resource decisions regarding future facilities over the next 20 years, it did slightly impact the projected in-service dates of some of the identified resources. Much higher GHG costs than assumed in the NMPRC analysis are necessary to impact future resource decisions. The primary consequence of the standardized cost of carbon emissions was an increase to generation portfolio costs.

In 2007, seven western states, including New Mexico, and three Canadian provinces entered into an accord, called the Western Regional Climate Action Initiative (the "WCI"), to reduce GHG from automobiles and certain industries, including utilities.

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The WCI released design recommendations for elements of a regional cap-and-trade program in September 2008 and created several subcommittees to develop detailed implementation recommendations. Under the WCI recommendations, GHG from the electricity sector and fossil fuel consumption of the industrial and commercial sectors would be capped at then current levels and subject to regulation starting in 2012. Over time, producers would be required to reduce their GHG. Implementation of the design elements for GHG reductions would fall to each state and province. On June 4, 2010, the NMED filed a petition with the EIB for the adoption of rules required to implement a WCI cap-and-trade program. A hearing was held in September 2010. On November 2, 2010, the EIB approved the NMED's proposal to institute a regional cap-and-trade rule that would affect sources regulated by NMED that emit more than 25,000 metric tons of CO<sub>2</sub> per year. The cap would start with an emissions baseline established in 2011. NMED would grant allowances for free to regulated sources based on their baseline and a 2% annual reduction. In order to take effect, New Mexico and California must recognize each other as trading partners under the WCI regional trading program, which has not occurred. On October 20, 2011, the California Air Resources Board adopted a final cap-and-trade regulation that calls for quarterly auctions of GHG allowances starting in November 2012. Also, several market elements including allowance tracking and a trading market must be established by WCI. The EIB adopted the proposed rule in December 2010. PNM appealed the EIB's decision and after various legal proceedings, the EIB voted to repeal the cap-and-trade program regulation on February 6, 2012. New Energy Economy ("NEE"), a non-profit environmental advocacy organization, and Western Resource Advocates filed a joint notice of appeal of the EIB's decision with the New Mexico Court of Appeals on April 6, 2012.

In April 2011, NEE moved to intervene in PNM's appeal, which motion was denied by the New Mexico Court of Appeals. After further procedural steps in the Court of Appeals, NEE filed a Writ of Superintending Control in the New Mexico Supreme Court in June 2011 and also sought to vacate the remand order entered by the Court of Appeals. After oral argument, the Supreme Court held on July 27, 2011 that NEE has the right to be a party on appeal. However, the remand of PNM's appeal, in which NEE is now an appellee, remains in effect.

In December 2008, NEE petitioned the EIB to amend existing regulations and adopt new regulations that would reduce GHG from certain sources regulated by the State of New Mexico. Following extensive litigation regarding the EIB's authority to regulate GHG, which did not resolve the issue, the rulemaking hearing on the NEE petition concluded in October 2010. On December 8, 2010, the EIB adopted a modified version of the petition. The modifications pushed the effective date to January 1, 2013 or six months after NMED's cap-and-trade rule described above is no longer in force, whichever is later. PNM filed testimony in the rulemaking hearing estimating the cost of electricity to PNM's customers would increase by approximately \$8 million each year over the prior year if the NEE's proposed rule is adopted. PNM appealed the EIB's decision and, after various legal proceedings, the EIB voted to repeal the NEE rule on March 16, 2012. NEE and Western Resource Advocates filed a joint notice of appeal of the EIB's decision with the New Mexico Court of Appeals on May 31, 2012.

The status of the NMED cap-and-trade rule and the NEE rule is currently uncertain and it is possible the EIB, the courts, or the legislature might take further action on them. In addition, the Governor of New Mexico established a small-business task force to review recent regulations shortly after her inauguration. The task force issued its recommendations on April 1, 2011. The recommendations include changing New Mexico's status in the WCI from participant to observer and revising the cap-and-trade rule approved in November 2010. New Mexico is no longer a participant in the WCI. However, the State is continuing to work with other states and provinces on other North American climate initiatives and clean energy policies and strategies.

On August 2, 2012, thirty-three New Mexico organizations representing public health, business, environmental, consumers, Native American and other interested parties filed a petition for rulemaking with the NMPRC. The petition asks the NMPRC to issue a NOPR regarding the implementation of an Optional Clean Energy Standard for electric utilities located in New Mexico. The proposed standard would have utilities that elect to participate reduce their CO<sub>2</sub> emissions by 3% per year. Utilities that opt into the program would be assured recovery of their reasonable compliance costs. The NMPRC scheduled a workshop to discuss whether they have authority to proceed with the NOPR.

Transmission Issues

FERC has pending numerous notices of inquiry and rulemaking dockets related to transmission issues. Such actions may lead to changes in FERC administrative rules or ratemaking policy, but have no time frame in which action must be taken or a docket closed with no further action. Further, such notices and rulemaking dockets do not apply strictly to PNM, but will have industry-wide effects in that they will apply to all FERC-regulated entities. The Company monitors and often submits comments taking a position in such notices and rulemaking dockets or may join in larger group responses. The Company often cannot determine the full impact of a proposed rule and policy change until the final determination is made by FERC and PNM is unable to predict the outcome of these matters.

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On November 24, 2009, FERC issued Order 729 approving two Modeling, Data, and Analysis Reliability Standards ("Reliability Standards") submitted by NERC – MOD-001-1 (Available Transmission System Capability) and MOD-029-1 (Rated System Path Methodology). Both MOD-001-1 and MOD-029-1 require a consistent approach, provided for in the Reliability Standards, to measuring the total transmission capability ("TTC") of a transmission path. The TTC level established using the two Reliability Standards could result in a reduction in the available transmission capacity currently used by PNM to deliver generation resources necessary for its jurisdictional load and for fulfilling its obligations to third-party users of the PNM transmission system.

During the first quarter of 2011, at the request of PNM and other southwestern utilities, NERC advised all transmission owners and transmission service providers they have delayed the implementation of portions of the MOD-029 methodology for "Flow Limited" paths until such time as a modification to the standard can be developed that will mitigate the technical concerns identified by the transmission owners and transmission service providers. PNM and other western utilities filed a Standards Action Request with NERC in the second quarter of 2012. Several months to over a year will likely be required to process the request through the NERC's standards development process.

In July 2011, FERC issued Order 1000 adopting new requirements for transmission planning, cost allocation, and development. Order 1000 calls for significant changes to the transmission process of WestConnect, an organization of utility companies providing transmission of electricity, in the western region that includes PNM. The impacts of the new requirements of Order 1000 relating to future transmission development and ownership on PNM are uncertain. Much of the work needed to be able to comply must be done at the subregional level and PNM is working through WestConnect in developing both its own and regional compliance filings. PNM and other WestConnect participants filed a modified version of Attachment K to their transmission tariffs for regional compliance on October 11, 2012. A second compliance filing will be made in April 2013 to address the planning and cost allocation between WestConnect and other regions.

### Financial Reform Legislation

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, which is intended to improve regulation of financial markets, was signed into law. Although many of the rules required to implement the legislation have not yet been finalized, the U.S. Commodity Futures Trading Commission ("CFTC") has published final rules defining several key terms related to the act, including the end-user exception to the clearing requirement for swaps.

The Company expects to qualify for the end-user exception and expects to be able to comply with its requirements within the time frame required by the CFTC. The Company continues to evaluate developments regarding this legislation and cannot predict the ultimate impact it may have on the Company's financial condition, results of operations, cash flows, or liquidity.

### Other Matters

As discussed under Employees in Item 1. Business in the 2011 Annual Reports on Form 10-K, at December 31, 2011, PNM Electric had 635 employees in its power plant and operations areas covered by a collective bargaining agreement with the IBEW that was entered into in May 2009. PNMR has no other employees represented by unions. Negotiations for a new agreement with the IBEW began on January 30, 2012. In the negotiations, PNM focused its efforts towards meeting four objectives: improved safety, continued compliance, continued reliability, and cost management. The IBEW and PNM reached a tentative agreement on July 7, 2012 for the period of July 7, 2012 to April 30, 2015. The agreement was ratified by the IBEW on July 27, 2012. The agreement includes wage increase provisions of 2% effective July 7, 2012, May 1, 2013, and May 1, 2014. The wages and benefits for all PNM employees who are members of the IBEW are typically included in the rates charged to electric customers, subject to approval of the NMPRC.

See Notes 9 and 10 herein and Notes 16 and 17 in the 2011 Annual Reports on Form 10-K for a discussion of commitments and contingencies and rate and regulatory matters.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires Company management to select and apply accounting policies that best provide the framework to report the results of operations and financial position for PNMR, PNM, and TNMP. The selection and application of those policies requires management to make difficult, subjective, and/or complex judgments concerning reported amounts of revenue and expenses during the reporting period and the reported amounts of assets and liabilities at the date of the financial statements. As a result, there exists the likelihood that materially different amounts would be reported under different conditions or using different assumptions.

As of September 30, 2012, there have been no significant changes with regard to the critical accounting policies disclosed in PNMR's, PNM's, and TNMP's 2011 Annual Reports on Forms 10-K. The policies disclosed included unbilled revenues, regulatory accounting, impairments, decommissioning costs, derivatives, pension and other postretirement benefits, accounting for contingencies, income taxes, and market risk.

#### MD&A FOR PNM

#### RESULTS OF OPERATIONS

PNM operates in only one reportable segment, PNM Electric, as presented above in Results of Operations for PNMR.

#### MD&A FOR TNMP

#### RESULTS OF OPERATIONS

TNMP operates in only one reportable segment, TNMP Electric, as presented above in Results of Operations for PNMR.

#### DISCLOSURE REGARDING FORWARD LOOKING STATEMENTS

Statements made in this filing that relate to future events or PNMR's, PNM's, or TNMP's expectations, projections, estimates, intentions, goals, targets, and strategies are made pursuant to the Private Securities Litigation Reform Act of 1995. Readers are cautioned that all forward-looking statements are based upon current expectations and estimates. PNMR, PNM, and TNMP assume no obligation to update this information.

Because actual results may differ materially from those expressed or implied by these forward-looking statements, PNMR, PNM, and TNMP caution readers not to place undue reliance on these statements. PNMR's, PNM's, and TNMP's business, financial condition, cash flows, and operating results are influenced by many factors, which are often beyond their control, that can cause actual results to differ from those expressed or implied by the forward-looking statements. These factors include:

- The ability of PNM and TNMP to recover costs and earn allowed returns in regulated jurisdictions
- The ability of the Company to successfully forecast and manage its operating and capital expenditures
- State and federal regulatory, legislative, and judicial decisions and actions on ratemaking, tax, and other matters
- State and federal regulation or legislation relating to environmental matters, including the resultant costs of compliance and other impacts on the operations and economic viability of PNM's generating plants
- The risk that recently enacted reliability standards regarding available transmission capacity and other FERC rulemakings may negatively impact the operation of PNM's transmission system
- The performance of generating units, transmission systems, and distribution systems, which could be negatively affected by operational issues, extreme weather conditions, terrorism, and cybersecurity breaches
- Variability of prices and volatility and liquidity in the wholesale power and natural gas markets
- Changes in price and availability of fuel and water supplies
- Uncertainties surrounding the mine fire incident at the mine supplying coal to SJGS
- Uncertainty surrounding the status of PNM's participation in jointly-owned generation projects resulting from the scheduled expiration of the operational agreements for the projects
- The risks associated with completion of generation, transmission, distribution, and other projects
- Regulatory, financial, and operational risks inherent in the operation of nuclear facilities, including spent fuel disposal uncertainties
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- Uncertainty regarding the requirements and related costs of decommissioning power plants and coal mines supplying certain power plants, as well as the ability to recover decommissioning costs from customers
- The impacts on the electricity usage of the Company's customers due to performance of state, regional, and national economies and mandatory energy efficiency measures, weather, seasonality, and other changes in supply and demand
- The Company's ability to access the financial markets, including disruptions in the credit markets, actions by ratings agencies, and fluctuations in interest rates
- The potential unavailability of cash from PNMR's subsidiaries due to regulatory, statutory, or contractual restrictions



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- The impacts of decreases in the values of marketable equity securities maintained to provide for nuclear decommissioning and pension and other postretirement benefits
- Commodity and counterparty credit risk transactions and the effectiveness of risk management
- The outcome of legal proceedings, including the extent of insurance coverage
- Changes in applicable accounting principles

Any material changes to risk factors occurring after the filing of PNMR's, PNM's, and TNMP's 2011 Annual Reports on Form 10-K are disclosed in Item 1A, Risk Factors, in Part II of this Form 10-Q.

For information about the risks associated with the use of derivative financial instruments, see Item 3. "Quantitative and Qualitative Disclosures About Market Risk."

## SECURITIES ACT DISCLAIMER

Certain securities described or cross-referenced in this report have not been registered under the Securities Act of 1933, as amended, or any state securities laws and may not be reoffered or sold in the United States absent registration or an applicable exemption from the registration requirements of the Securities Act of 1933 and applicable state securities laws. This Form 10-Q does not constitute an offer to sell or the solicitation of an offer to buy any securities.

## WEBSITES

The PNMR website, [www.pnmresources.com](http://www.pnmresources.com), is an important source of Company information. New or updated information for public access is routinely posted. PNMR encourages analysts, investors, and other interested parties to register on the website to automatically receive Company information by e-mail. This information includes news releases, notices of webcasts, and filings with the SEC. Participants can unsubscribe at any time and will not receive information that was not requested.

Our Internet addresses are:

• PNMR: [www.pnmresources.com](http://www.pnmresources.com)

• PNM: [www.pnm.com](http://www.pnm.com)

• TNMP: [www.tnmp.com](http://www.tnmp.com)

The contents of these websites are not a part of this Form 10-Q. The SEC filings of PNMR, PNM, and TNMP, including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, are accessible free of charge on the PNMR website as soon as reasonably practicable after they are filed with, or furnished to, the SEC. These reports are also available in print upon request from PNMR free of charge.

Also available on the Company's website at [www.pnmresources.com/investors/governance.com](http://www.pnmresources.com/investors/governance.com) and in print upon request from any shareholder are our:

• Corporate Governance Principles

• Code of Ethics (Do the Right Thing-Principles of Business Conduct)

• Charters of the Audit and Ethics Committee, Nominating and Governance Committee, Compensation and Human Resources Committee, and Finance Committee

The Company will post amendments to or waivers from its code of ethics (to the extent applicable to the Company's executive officers and directors) on its website.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of business, PNMR and its subsidiaries are exposed to a variety of market risks. Market risk is the potential loss or gain that may occur as a result of changes in the market or fair value of a particular instrument or commodity. All financial and commodity-related instruments, including derivatives, are subject to market risk. The Company had no trading transactions during the year ended December 31, 2011 and the nine months ended September 30, 2012.

The Company controls the scope of its various forms of risk through a comprehensive set of policies and procedures and oversight by senior level management and the Board. The Board's Finance Committee sets the risk limit parameters. The RMC, comprised of corporate and business segment officers, oversees all of the risk management activities, which include commodity

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risk, credit risk, interest rate risk, equity risk, and business risk. The RMC has oversight for the ongoing evaluation of the adequacy of the risk control organization and policies. The Company has risk control organizations, which are assigned responsibility for establishing and enforcing the policies, procedures, and limits and evaluating the risks inherent in proposed transactions, on an enterprise-wide basis.

The RMC's responsibilities include: establishment of policies regarding risk exposure levels and activities in each of the business segments; authority to approve the types of derivatives entered into; authority to establish a general policy regarding counterparty exposure and limits; authority to approve and revise the corporate risk policy; authorization and delegation of transaction limits; review and approval of controls and procedures for derivative activities; review and approval of models and assumptions used to calculate mark-to-market and market risk exposure; authority to approve and open brokerage and counterparty accounts for derivatives; review of hedging and risk activities; the extent and type of reporting to be performed for monitoring of limits and positions; and quarterly reporting to the Audit and Finance Committees on these activities. The RMC also proposes risk limits to the Finance Committee for its approval.

It is the responsibility of each business segment to create its own control procedures and policies within the parameters established by the Corporate Financial Risk Management Policy, approved by the RMC. The RMC reviews and approves these policies, which are created with the assistance of the Risk Management Department and the Vice President and Treasurer. Each business segment's policies address the following controls: authorized instruments and markets; authorized personnel; policies on segregation of duties; policies on mark-to-market accounting; responsibilities for deal capture; confirmation responsibilities; responsibilities for reporting results; statement on the role of derivative transactions; and limits on individual transaction size (nominal value).

**Commodity Risk**

PNMR is exposed to the impact of changes in price for energy and energy-related products, which is partially mitigated by PNMR's use of commodity derivatives. To the extent an open position exists, fluctuating commodity prices can impact financial results and financial position, either favorably or unfavorably. As a result, the Company cannot predict with certainty the impact that its risk management decisions may have on its businesses, operating results, or financial position.

Information concerning accounting for derivatives and the risks associated with commodity contracts is set forth in Note 4. Note 4 also contains a summary of the fair values of mark-to-market energy related derivative contracts included in the Condensed Consolidated Balance Sheets.

The following table details the changes in PNMR's net asset or liability balance sheet position for mark-to-market energy transactions other than cash flow hedges:

	Nine Months Ended	
	September 30,	
	2012	2011
	(In thousands)	
<b>Economic Hedges</b>		
Sources of fair value gain (loss):		
Net fair value at beginning of period	\$ (356 )	\$ (22,975 )
Amount realized on contracts delivered during period	(3,695 )	4,407
Changes in fair value	619	1,462
Net mark-to-market change recorded in earnings	(3,076 )	5,869
Net change recorded as regulatory assets and liabilities	(42 )	(140 )
Unearned/prepaid option premiums	—	904
Settlement of de-designated cash flow hedges	—	183
Net fair value at end of period	\$ (3,474 )	\$ (16,159 )

The following table provides the maturity of PNMR's net assets (liabilities) other than cash flow hedges, giving an indication of the calendar year in which these mark-to-market amounts will settle and generate (use) cash.



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## Fair Value of Mark-to-Market Instruments at September 30, 2012

	Settlement Dates				
	2012	2013	2014	2015	2016
	(In thousands)				
Economic hedges					
Prices actively quoted	\$—	\$—	\$—	\$—	\$—
Prices provided by other external sources	587	(1,820 )	(1,300 )	(633 )	(308 )
Prices based on models and other valuations	—	—	—	—	—
Total	\$587	\$(1,820 )	\$(1,300 )	\$(633 )	\$(308 )

During the year ended December 31, 2011 and the nine months ended September 30, 2012, PNMR had no commodity derivative instruments designated as cash flow hedging instruments.

PNM measures the market risk of its long-term contracts and wholesale activities using a VaR calculation to measure price movements. The VaR calculation reports the possible market loss for the respective transactions. This calculation is based on the transaction's fair market value on the reporting date. PNM utilizes the Monte Carlo VaR simulation model with a 95% confidence level and a three day holding period. The Monte Carlo model utilizes a random generated simulation based on historical volatility to generate portfolio values. For example, if VaR is calculated at \$10.0 million, it is estimated that in 950 out of 1,000 market simulations the pre-tax loss in liquidating the portfolio would not exceed \$10.0 million in the three days that it would take to liquidate the portfolio. The quantitative risk information, however, is limited by the parameters established in creating the model.

PNM measures VaR for all transactions that are not directly asset-related and have economic risk. PNM did not have any non-asset backed transactions for the nine months ended September 30, 2012 and 2011. PNM also measures VaR for the positions in its wholesale portfolio.

First Choice measured the market risk of its retail sales commitments and supply sourcing activities using a GEaR calculation to monitor potential risk exposures related to taking contracts to settlement and a VaR calculation to measure short-term market price impacts. Because of its obligation to serve customers, First Choice was required to take certain contracts to settlement. Accordingly, a measure that evaluated the settlement of First Choice's positions against earnings provided management with a useful tool to manage its portfolio. Over a rolling 12 month period, First Choice used a hold-to-maturity at risk calculation for its GEaR measurement. The calculation utilized a Monte Carlo simulation with a 95% confidence level and holding each position to settlement. The quantitative risk information, however, was limited by the parameters established in creating the model.

First Choice utilized a VaR measure to manage its market risk. The VaR limit was based on the same total portfolio approach as the GEaR measure; however, the VaR measure was intended to capture the effects of changes in market prices over the life of the total portfolio and was intended to capture the effects of changes in market prices over a three day holding period. The VaR calculations utilized a Monte Carlo simulation at a 95% confidence level.

The Company's risk measures are regularly monitored by the Company's RMC. The RMC has put in place procedures to ensure that increases in risk measures that exceed the prescribed limits are reviewed and, if deemed necessary, acted upon to reduce exposures. VaR or GEaR limits were not exceeded during the nine months ended September 30, 2012 or 2011.

The VaR and GEaR limits represent an estimate of the potential losses that could be recognized on the Company's portfolios, subject to market risk, given current volatility in the market, and are not necessarily indicative of actual

results that may occur, since actual future gains and losses will differ from those estimated. Actual gains and losses may differ due to actual fluctuations in market prices, operating exposures, and the timing thereof, as well as changes to the underlying portfolios during the year.

#### Credit Risk

PNMR is also exposed to credit risk from its retail and wholesale customers, as well as counterparties to derivative instruments. Credit risk relates to the risk of loss resulting from counterparties' nonperformance of their contractual obligations. The Company conducts counterparty risk analysis across business segments and uses a credit management process to assess the

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financial conditions of counterparties. Credit exposure is regularly monitored by the RMC. The RMC has put procedures in place to ensure that increases in credit risk that exceed the prescribed limits are reviewed and, if deemed necessary, acted upon to reduce exposures.

The following table provides information related to PNMR's credit exposure as of September 30, 2012. The table further delineates that exposure by the credit worthiness (credit rating) of the counterparties and provides guidance as to the concentration of credit risk to individual counterparties. The PVNGS and EIP lessor notes are not exposed to credit risk, since the notes are repaid as PNM makes payments on the underlying leases. Other investments (Note 4) have no significant counterparty credit risk.

Schedule of Credit Risk Exposure  
September 30, 2012

Rating <sup>(1)</sup>	Credit Risk Exposure <sup>(2)</sup>	Number of Counter-parties >10%	Net Exposure of Counter-parties >10%
	(Dollars in thousands)		
External ratings:			
Investment grade	\$ 3,567	2	\$ 1,448
Non-investment grade	—	—	—
Internal ratings:			
Investment grade	—	—	—
Non-investment grade	410	—	—
Total	\$ 3,977		\$ 1,448

The rating "Investment Grade" is for counterparties with a minimum S&P rating of BBB- or Moody's rating of Baa3. (1) If the counterparty has provided a guarantee by a higher rated entity (e.g., its parent), determination is based on the rating of its guarantor. The category "Internal Ratings - Investment Grade" includes those counterparties that are internally rated as investment grade in accordance with the guidelines established in the Company's credit policy.

The Credit Risk Exposure is the gross credit exposure, including long-term contracts (other than full requirements customers), forward sales, and short-term sales. The exposure captures the amounts from receivables/payables for realized transactions, delivered and unbilled revenues, and mark-to-market gains/losses (pursuant to contract (2) terms). Gross exposures can be offset according to legally enforceable netting arrangements but are not reduced by available credit collateral. Credit collateral includes cash deposits, letters of credit, and parental guarantees received from counterparties. Amounts are presented before the application of such credit collateral instruments. At September 30, 2012, PNMR held no credit collateral to offset its credit exposure.

The Company provides for losses due to market and credit risk. Net credit risk for the Company's largest counterparty as of September 30, 2012 was \$5.3 million, which is due from a full requirements customer.

### Interest Rate Risk

The Company has long-term debt which subjects it to the risk of loss associated with movements in market interest rates. The majority of the Company's long-term debt is fixed-rate debt and does not expose earnings to a major risk of loss due to adverse changes in market interest rates. However, the fair value of PNMR's consolidated long-term debt instruments would increase by 4.5%, or \$94.0 million, if interest rates were to decline by 50 basis points from their levels at September 30, 2012. In general, an increase in fair value would impact earnings and cash flows to the extent not recoverable in rates if all or a portion of debt instruments were acquired in the open market prior to their maturity.

TNMP has long-term debt of \$50.0 million that bears interest at a variable rate. However, TNMP has also entered into a hedging arrangement that effectively results in this debt bearing interest at a fixed rate, thereby eliminating interest rate risk. At October 26, 2012, PNMR had \$106.4 million of consolidated short-term debt outstanding under its revolving credit facilities, which allow for a maximum aggregate borrowing capacity of \$775.0 million. These facilities bear interest at variable rates, which averaged 1.97% for PNMR borrowings outstanding on October 26, 2012, and the Company is exposed to interest rate risk to the extent of future increases in variable interest rates.



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The securities held by PNM in the NDT had an estimated fair value of \$186.8 million at September 30, 2012, of which 48.9% were fixed-rate debt securities that subject PNM to risk of loss of fair value with movements in market interest rates. If interest rates were to increase by 50 basis points from their levels at September 30, 2012, the decrease in the fair value of the fixed-rate securities would be 3.1%, or \$2.8 million. The PVNGS and EIP lessor notes, described above, are not exposed to interest rate risk. PNM and TNMP do not directly recover or return through rates any losses or gains on the securities, including equity investments discussed below, in the trusts for nuclear decommissioning. However, the overall performance of these trusts does enter into the periodic determinations of expense and funding levels, which are factored into the rate making process to the extent applicable to regulated operations. PNM is at risk for shortfalls in funding of obligations due to investment losses, including those from the equity market risks discussed below to the extent not ultimately recovered through rates charged to customers.

### Equity Market Risk

The NDT and the trust for post-term reclamation of the coal mines serving SJGS hold certain equity securities at September 30, 2012. These equity securities expose PNM to losses in fair value should the market values of the underlying securities decline. At September 30, 2012, these equity securities were valued at \$95.2 million. A hypothetical 10% decrease in equity prices would reduce the fair values of these funds by \$9.5 million.

## ITEM 4. CONTROLS AND PROCEDURES

### Evaluation of disclosure controls and procedures

As of the end of the period covered by this quarterly report, each of PNMR, PNM, and TNMP conducted an evaluation under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based upon this evaluation, the Chief Executive Officer and the Chief Financial Officer of each of PNMR, PNM, and TNMP concluded that the disclosure controls and procedures are effective.

### Changes in internal controls

There have been no changes in each of PNMR's, PNM's, and TNMP's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, each of PNMR's, PNM's, and TNMP's internal control over financial reporting.

## PART II – OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

See Notes 9 and 10 in the Notes to Condensed Consolidated Financial Statements for information related to the following matters, for PNMR, PNM, and TNMP, incorporated in this item by reference.

- ☐ The Clean Air Act – Regional Haze – SJGS
- ☐ The Clean Air Act – Regional Haze – Four Corners
- ☐ The Clean Air Act – SJGS Operating Permit Challenge
- ☐ The Clean Air Act – Citizen Suit Under the Clean Air Act
- ☐ The Clean Air Act – Navajo Nation Environmental Issues

¶The Clean Air Act – Four Corners New Source Review

¶Endangered Species Act

¶Santa Fe Generating Station

¶Coal Combustion Byproducts Waste Disposal – Sierra Club Allegations

¶VNGS Water Supply Litigation

¶San Juan River Adjudication

¶Begay v. PNM et al

¶Transmission Issues

¶PNM – Renewable Portfolio Standard

¶PNM – Energy Efficiency and Load Management – Disincentives/Incentives Adder

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- PNM – 2010 Electric Rate Case
- PNM – Emergency FPPAC
- PNM – Transmission Rate Case
- PNM – Firm-Requirements Wholesale Customer Rate Case
- TNMP – Interest Rate Compliance Tariff
- TNMP – Advanced Meter System Deployment and Surcharge Request
- TNMP – Remand of ERCOT Transmission Rates for 1999 and 2000

See also Climate Change Issues under Other Issues Facing the Company in MD&A. The third, fourth, and fifth paragraphs under State and Regional Activity are incorporated in this item by reference.

#### ITEM 1A. RISK FACTORS

As of the date of this report, there have been no material changes with regard to the Risk Factors disclosed in PNMR's, PNM's, and TNMP's Annual Reports on Form 10-K for the year ended December 31, 2011.

#### ITEM 6. EXHIBITS

- |      |      |  |
|------|------|--|
| 3.1  | PNMR | Articles of Incorporation of PNMR, as amended to date (incorporated by reference to Exhibit 3.1 to PNMR's Current Report on Form 8-K filed November 21, 2008)                                      |
| 3.2  | PNM  | Restated Articles of Incorporation of PNM, as amended through May 31, 2002 (incorporated by reference to Exhibit 3.1.1 to PNM's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002) |
| 3.3  | TNMP | Articles of Incorporation of TNMP, as amended through July 7, 2005 (incorporated by reference to Exhibit 3.1.2 to TNMP's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005)        |
| 3.4  | PNMR | Bylaws of PNMR, with all amendments to and including December 8, 2009 (incorporated by reference to Exhibit 3.1 to PNMR's Current Report on Form 8-K filed December 11, 2009)                      |
| 3.5  | PNM  | Bylaws of PNM with all amendments to and including May 31, 2002 (incorporated by reference to Exhibit 3.1.2 to PNM's Report on Form 10-Q for the fiscal quarter ended June 30, 2002)               |
| 3.6  | TNMP | Bylaws of TNMP, as amended effective June 26, 2011 (incorporated by reference to Exhibit 3.6 to TNMP's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011)                     |
| 4.1  | PNM  | Tenth Supplemental Indenture, dated as of September 1, 2012, between PNM and Union Bank, N.A. (ultimate successor as trustee to The Chase Manhattan Bank), as Trustee                              |
| 12.1 | PNMR | Ratio of Earnings to Fixed Charges   |
| 12.2 | PNM  | Ratio of Earnings to Fixed Charges   |
| 12.3 | TNMP | Ratio of Earnings to Fixed Charges   |

31.1	PNMR	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	PNMR	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.3	PNM	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.4	PNM	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.5	TNMP	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.6	TNMP	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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32.1	PNMR	Chief Executive Officer and Chief Financial Officer Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	PNM	Chief Executive Officer and Chief Financial Officer Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.3	TNMP	Chief Executive Officer and Chief Financial Officer Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	PNMR, PNM, and TNMP	XBRL Instance Document
101.SCH	PNMR, PNM, and TNMP	XBRL Taxonomy Extension Schema Document
101.CAL	PNMR, PNM, and TNMP	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	PNMR, PNM, and TNMP	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	PNMR, PNM, and TNMP	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	PNMR, PNM, and TNMP	XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrants have duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized.

PNM RESOURCES, INC.  
PUBLIC SERVICE COMPANY OF NEW MEXICO  
TEXAS-NEW MEXICO POWER COMPANY  
(Registrants)

Date: November 2, 2012

/s/ Thomas G. Sategna  
Thomas G. Sategna  
Vice President and Corporate Controller  
(Officer duly authorized to sign this report)