Exhibit VII-1
Residential Rate Comparison[25]

Month	CRE (per KWH based on 1,000 KWHs)	TXU Energy (per KWH based on 1,000 KWHs)
January 2007	$0.1272	$0.1427
April 2007	$0.1151	$0.1297
July 2007	$0.1152	$0.1302
September 2007	$0.1150	$0.1384

B. OBJECTIVE

In this area, we made a review of Cap Rock Energy's Customer Service functions including:

- Customer relations,
- Customer accounting,
- Billing and collection, and
- Service quality.

C. EVALUATIVE CRITERIA

In conducting the review in this area, we used the following criteria:

- Does a positive relationship exist between Cap Rock and its customers?
- Does Cap Rock have an effective and accurate customer accounting system?
- Does Cap Rock have effective customer service policies and procedures?
- Do Cap Rock's meter reading, billing, credit and collection procedures meet the needs of its customers?
- Are Cap Rock's billing and collection policies in compliance with PUCT requirements?
- Are policies and procedures effective in reducing bad debt write-offs?
- Does the Customer Information System (CIS) make cost-effective use of available technology?
- Does Cap Rock have effective procedures for measuring the quality of service

[25] Many commercial and industrial customer rates are negotiated making a simple comparison unrealistic.

it provides to its customers?

D. WORK TASKS

We reviewed the policies and practices and metrics to manage its customer service operations. In conducting this review, we interviewed managers and customer service personnel at each division, observed each division's operations, prepared and submitted data requests, and reviewed and analyzed the Company's responses to interview questions and data requests. We focused on the goals and objectives, organization, work responsibilities, staffing, policies and procedures, and training of the personnel having responsibility for managing customer service. We also reviewed the metrics employed to measure customer service and the associated results.

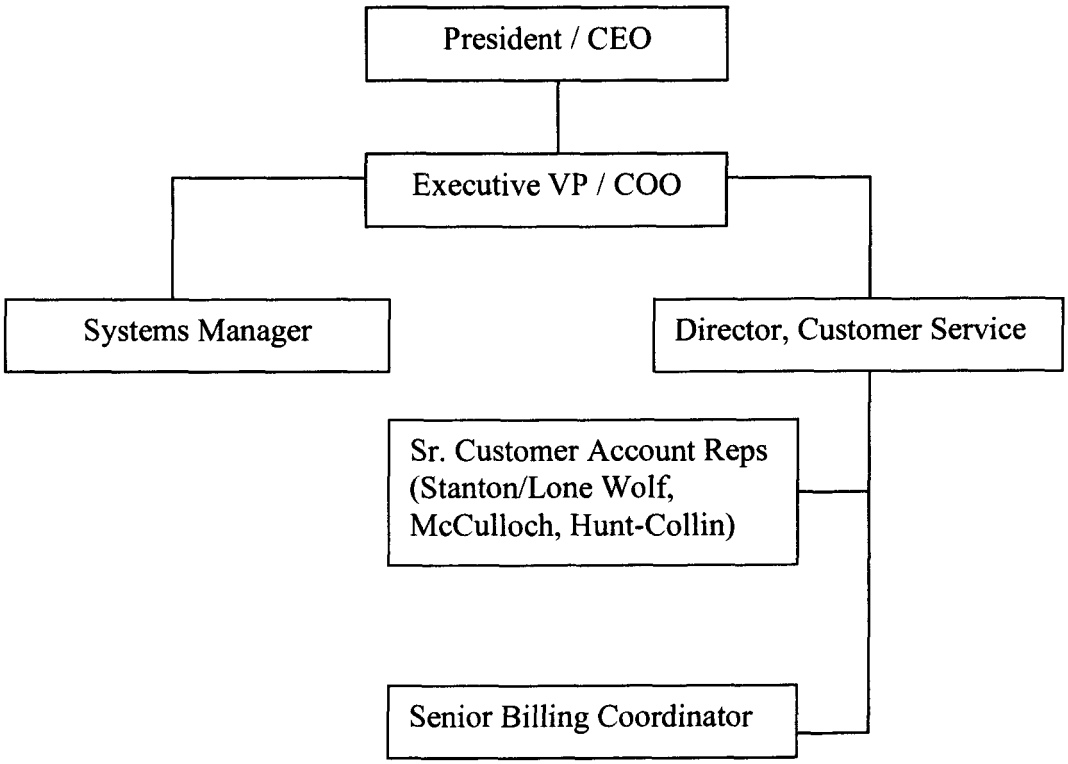
E. FINDINGS AND CONCLUSIONS

1. The Company's customer service organization and its roles and responsibilities are clearly identified.

   - The Company's Chief Operating Officer (COO) is responsible for overall customer service. Over the years the COO has directly managed the Stanton/Lone Wolf division and was also responsible for overseeing the other operating divisions. He has a good knowledge of the service territory as well as the Company's infrastructure.
   - The Company has over 40 employees engaged in customer service functions. There is significant value of local knowledge inherent in the decentralized structure for customer service representatives.
   - In October 2007, CRE reorganized its customer service functions and assigned one director responsibility for the customer service functions in all the divisions. The new customer services director reports to the COO. The senior customer service representatives in the Stanton/Lone Wolf, McCulloch and Hunt-Collin Divisions and the senior billing coordinator also report to the customer services director. The other customer service personnel in Stanton/Lone Wolf, McCulloch and Hunt-Collin Divisions report to the senior customer representatives.
   - **Exhibit VII-2** provides an overview of the new organization structure implemented in October 2007. The structure is "logically structured" with operating roles and responsibilities clearly identified.

Exhibit VII-2

Customer Service Organization Structure



2. While the CRE customer service function has few **written** standard policies and procedures, service practices meet major PUCT requirements.

   - Each division has its own mostly unwritten policies which are fairly consistent across the company. These informal policies and procedures balance PUCT requirements with the flexibility to try to meet individual customer needs.
   - The following major PUCT requirements are being met:
     - ***Deposits {Section 25.24 (c)[26]}*** – Deposits are waived if customers have no more than two late payments in a twelve-month period based on verification from the prior service provider.
     - ***Bill due dates {Section 25.28 (a))*** – The bill due date is at least sixteen calendar days after bill issuance.
     - ***Payment Arrangements/Deferred payment plans {(Sections 25.28 (h-i))*** – Arrangements are made and/or payment plans are established for qualifying customers which request such assistance. CRE

[26] Section numbers refer to the PUCT's rules.

customer service personnel are diligent in establishing financial arrangements which keep customers in service.

- ***Disconnects {Section 25.29}*** – Proper notice is given for disconnects; the Company notice period is sixteen business days from the bill due date which should always exceed ten calendar days.

- The informal approach to policies and procedures allows the use of subjective judgment to avoid collecting deposits or disconnecting service. For example, follow up calls or technician premise visits are sometimes made to try to collect payment prior to disconnecting service. However, the informal processes tend to be more lenient than the PUCT's rules require which may increase costs and slow collection times. It is unclear whether collections are adversely affected by the informal approach to policies and procedures. In addition, the informal nature of the policies does not ensure consistent treatment of customers.

3. The recently revised customer service organization provides more emphasis on customer account management while addressing regulatory opportunities and challenges.

   - The Company has identified two major market segments – commercial accounts and residential developments. CRE is experiencing significant growth in both these areas due to the resurgence of oil exploration and drilling in the Permian Basis area.

     - A manager for each segment will address revenue opportunities through new service growth as well as regulatory requirements and processes.

     - Stronger and consistent lines of communications with customers in these two segments will be established to express CRE's appreciation for its customers and obtain feedback on customer service levels.

   - The two managers who have significant customer service experience now report to the director, resource and regulatory administration.

4. Customer service training is largely informal and "on the job."

   - Training is based on observing other employees and not on formal program(s) or document(s). Customer service representatives and meter readers "shadow" existing employees for several weeks before being released to work on their own

   - While significant system documentation for the Customer Watch (customer service) system is available electronically to all customer service representatives, customer service representatives have learned to use the system largely on their own.

5. The development of a comprehensive customer communications plan to assess customer service requirements is underway.

- Standard project planning tools are being employed to keep the plan on target.
- Increasing communication is an objective of the plan.
- The plan includes tools to increase energy efficiency and help manage seasonable usage fluctuations.
- Increased communication often improves efficiency as customers receive information pro-actively and unnecessary calls to Company personnel are avoided.

6. Few customers are "surveyed" about their opinions of CRE service.

   - Letters to solicit feedback are sent to customers with recent "right of way" work; responses are largely positive.
   - Written surveys related to the customer service contact experience were discontinued due to the use of a retired employee's name in the survey document.

7. While CRE provides good customer service quality, call handling results are not tracked by employee.

   - CRE customers have not filed any formal service-related complaints with the PUCT in recent years.
   - Individual customer service representative call handling times are not tracked. However, tools are in place in the Stanton work center to notify reps when calls are waiting.
   - Overflow calls in the Hunt-Collin and McCulloch work centers receive busy signals.
   - Call center overall service results are as follows:
     - Over 95 percent of service requests are handled with one call; most call backs are due to the customer not having all the required information.
     - 99 percent of appointment times are met (June 06-June 07)
     - 97 percent of calls are answered (June 06-June 07)

8. CRE's customer complaint level is low, but it has increased recently due to a lengthy period of cold weather which resulted in high bill complaints due to greater energy use and higher bills.

   - While only 20 informal complaints were filed with the PUCT in 2006, 2007 levels were tracking higher as of the end of May. This is principally due to a period of unusually cold weather through April which caused greater use of electric heat and higher bills which results in more informal complaints. The number of complaints has declined since the acquisition by Lindsay Goldberg.

- All informal PUCT complaints or inquiries to date were resolved informally.

9. While the meter reading process addresses both timeliness and accuracy, "no-reads" have increased during 2007 due to wet weather experienced in the spring.

   - Prior to April, 2007, meter reading was outsourced. Since it was brought back in-house, reader turnover has decreased. Training is "on the job". Usually, the reader accompanies and learns from the "best" reader.
   - Routes are assigned geographically, sized based on density (e.g., urban vs. rural) and tied to bill cycles. Meter readers have the tools and flexibility to maximize efficiency. New meters are added to the end of the appropriate route, but the reader can adjust the order.
   - The reading process is automated with "audits" to flag potential entry errors at the time the meter is read. The data from the hand-held devices is automatically entered to the billing system when the reader determines that a route is complete.
     - Billing and customer service personnel get "High and Low Read" reports which identify meter reads which do not trend with prior months and missed reads; this data helps identify reader errors and potential fraud situations.
     - In many cases meters can be reread and adjustments made prior to finalizing a billing cycle.
     - Estimation can also be used to bill customers in a timely and accurate manner.
   - "No-reads" appear to fluctuate widely from month to month, and are increasing overall during 2007. The wet weather in the spring of 2007 made it difficult to read meters in rural areas where many meters are only accessible over dirt roads and through fields. However, a new reporting system for tracking accuracy, estimates and no-reads is being implemented which should provide increased information to manage meter reading.
   - Meter readers are trained to conduct a visual inspection to look for tampered or inoperative meters and help spot potential fraud situations.

10. CRE has implemented a new customer accounting system (Customer Watch) which requires some modifications.

    - The new system has reduced customer confusion in general. However, some changes are still required.
      - Multi-meter customer bills do not show the prior balance and payment unless there is a past due amount which creates confusion for some customers and drives inbound call volume up.
      - For multiple meter/account customers, the system applies payments to bills in account number order. If a customer's account has a credit

amount for one or more accounts, those accounts may still have a payment posted. While the overall account may be paid properly, some accounts will appear as overpaid (i.e., a credit balance) and some accounts will show a past due balance. Manual adjustments are required to redistribute the payments.

- Billing adjustments made after the bill statement is printed, but prior to payment, are not automatically reflected in the bank draft amount. Customer service personnel must manually cancel the original bank draft and re-establish a new draft to avoid the wrong amount being drafted.
- Level-pay billing is being phased out due to the PUCT requiring CRE's tariff to allow only one adjustment (i.e., true up) per year. Depending on the timing for the one adjustment, customers can have large unpaid balances due or the company could have to make large credits at the time of the adjustment.
- Average-pay billing is available as an alternative to provide customers a better and more accurate way to pay their bills. The bill amount fluctuates month to month, but not significantly.
- Internet account access for establishing service or account maintenance and billing is not available.
- No individual customer service representative performance statistics are generated;

- The system provides several options to access accounts facilitating the reps' ability to find an account with minimal information provided by customers.
- No formal system training is provided. New customer service representatives observe for one to two weeks and then go live under the supervision of a seasoned rep.

11. Customer billing is managed effectively for all CRE divisions following unwritten but regular procedures.

- Although no written policies or documentation for the billing process are maintained, CRE personnel follow specific procedures for managing billing.
  - While the vendor supplied system documentation, the documentation is not used on a regular basis.
- CRE has 22 bill cycles each month (at least one cycle per business day). Bill timing is tied to the meter reading schedule. The senior billing coordinator conducts a quality audit for each cycle.
- CRE has several hundred meter reads by mail-out requests to customers, and responses are taken by mail, email or phone. These meter readings are verified twice per year by a meter reader premise visit.

- An unwritten, but formal communication process is followed between the customer service representatives, billing coordinator and service technicians to limit service order and billing errors for new accounts. Accounts cannot be set up for billing without a technician providing the initial meter read.
- An external bill print vendor prints and mails the bills. CRE receives an electronic file with all bills which is available to customer service representatives to respond to customer inquiries. Customer service personnel have an opportunity to review bills and the authority to hold or adjust bills. Standard billing reports are available to customer service personnel and provide adequate information to manage customer accounts. Customized reports can be requested by customer service personnel.
  - Customer service representatives can adjust bills for up to $1,000 without approval.
- Service for each meter can be billed on separate bills or customers with multiple meters can choose to receive one bill. No-read meters are estimated by the billing system based on the most recent two months and same month in the prior year usage.

12. Though not formalized or written, CRE's policies and practices for bill payments provide significant flexibility for customers and are designed to minimize disconnects.

- Bill payment policies and practices are not written, but are followed informally by customer service personnel.
- Multiple options for bill payment are provided:
  - Check by mail to a lock box,
  - Check, cash or credit card at a company facility in each division,
  - Check, cash or credit card at payment agent locations,
  - Recurring credit card,
  - Recurring bank draft,
  - Credit card by phone, or
  - "Check by phone" (bank draft over the phone)

  A convenience fee is assessed to the customer's account for credit card and bank draft options; the convenience fee is charged to the customer on the next bill which delays recovery of the costs associated with these options. Cash is deposited in the bank daily and payments, cash and deposits are reconciled daily.
- Recurring credit card payments are stored in the billing system, but posted manually each month by customer service personnel. Credit card data is kept in files at the division office which are open during business hours. No

instances of any fraud have occurred.

- Bank account information is taken over the phone without bank account documentation required. No instances of any fraud have occurred
- Bills may not be paid over the internet. EDI billing/payment as an option for commercial accounts is being investigated.

13. While CRE's collections process provides significant opportunity for customers to pay past due invoices, un-collectibles and write offs do not appear to be a problem.

- While collection policies and procedures are not written; unwritten/informal processes are in place.
- A past due notice is sent to customers prior to disconnect. Attempts are made to contact customers by phone or sometimes in person prior to disconnect. Prior to issuing a disconnect order; a subjective evaluation of the account is made by customer service personnel.
- Once disconnected, two final bills are issued prior to sending a final collection letter.
- Formal outside collection efforts begin after all other avenues to contact the customer are exhausted (approximately ninety days after the account initial becomes past due). Outside collectors invoice CRE for their services (fees are not based directly on the amount recovered).
- CRE uncollectibles are relatively high and increasing faster than revenues:[27]

2005	$215,955
2006	$260,071

  - Uncollectibles increased over $44,000 or 20 percent in 2006.

- CRE Revenues increased only 11.5% for the same period:[28]

2005	$77,037,577
2006	$85,916,914

- Uncollectibles as a percentage of revenue also increased slightly:

2005	2.8 percent
2006	3.0 percent

- However, for the same period write offs decreased suggesting an overly conservative approach to uncollectibles[29]

[27] Response to data request FWL-73.

[28] Response to data request JFJ-34.

[29] Response to data request FWL-73.

2004	$56,755
2005	$33,743 (41 percent decrease)
2006	$5,811 (83 percent decrease)

- Write offs also decreased as a percentage of revenues:

2005	0.04 percent
2006	0.007 percent[30]

F. RECOMMENDATIONS

1. Formalize the existing informal customer service policies and procedures to ensure consistent treatment for all customers regardless of the division or customer service representative. (Refers to Findings VII-2, VII-11, VII-12 and VII-13.)
2. Develop and implement a formalized training program for customer service representatives. (Refers to Finding VII-4.)
3. Implement a formal customer survey process. (Refers to Finding VII-6.)
4. Implement a system that provides automated quality of service results for call handling by the customer service representatives. (Refers to Finding VII-7.)
5. Make appropriate modifications to the customer accounting system. For example, implement internet based account setup and billing and EDI billing to provide customers electronic payment options which meet their specific needs. (Refers to Finding VII-10.)
6. Review opportunities to automate the bill collection process. For example, consider automating the processing of recurring bank drafts and credit card payments to eliminate human intervention and the need to maintain paper files with credit card and bank data. (Refers to Finding VII-12.)
7. Study un-collectibles to determine whether the level should be reduced to be more consistent with CRE's write-off experience. (Refers to Finding VII-13.)

[30] The low amount of write offs in 2006 suggests the Company had a revenue recovery or some sort of revenue and/or uncollectible true up.

A. BACKGROUND

The power procurement function obtains power for the Company's three divisions (Stanton/Lone Wolf, Hunt-Collin and McCulloch). The Company does not own any generation, so all of its power requirements are obtained through wholesale power agreements with third parties. All associated power costs are passed on to the Company's retail customers through the Power Cost Recovery Factor ("PCRF") and the Energy Charge.

The Company receives power for the Stanton/ Lone Wolf division, located in the Southwest Power Pool (SPP), from Southwestern Public Service Company (SPS). The contract with SPS was entered into in 1992 after the Company switched grids from the Electric Reliability Council of Texas (ERCOT) to the Eastern Grid of which SPS was on the far west side of the grid. The SPS transmission system is now part of the SPP which provides reliability for the region. Power began to flow to the division's customers in 1994 upon completion of the 138 kV transmission system. Along with the generation of the demand and energy used by the Company, SPS schedules energy for delivery to the SPP portions of the Company's transmission system. The contract is cost-based and can be cancelled by the Company or by SPS if either party gives a five-year notice of cancellation which can be given for the first time in 2008. The Company is currently negotiating a new agreement/extension with SPS.

The Company receives power for its McCulloch division, located in ERCOT, from Lower Colorado River Authority (LCRA). The McCulloch division's contract with LCRA originated in 1977 and had an original term of 22 years. The contract was renegotiated to continue through 2041. LCRA's goal is to maintain its wholesale rates at or below other full requirement wholesale power costs in Texas. LCRA schedules the delivery of energy to the McCulloch division through ERCOT on behalf of the Company. Under the new contract, the rates are cost-based and are applied through a formula rate.

The Company receives power for its Hunt-Collins division, also located in ERCOT, from Garland Power and Light (GP&L). GP&L's current contract with the Company for the Hunt-Collin division began in April 2002 with power flowing by May of that year. The contract will expire in September 2008 and Cap Rock plans to submit a Request for Proposal (RFP) for power to serve the Hunt-Collin division. The RFP will also cover the power needs for the City of Farmersville which the Company currently serves through a management contract. GP&L also handles all scheduling of energy to Hunt-Collin. GP&L is also one of ERCOT's lowest cost providers. Both LCRA and GP&L have expressed interest in serving the Hunt-Collin load.

In 2006 the Company purchased 896,651,075 kWhs for resale to its retail customers. SPS supplied 700,255,140 kWhs to the Stanton/ Lone Wolf Division which comprised 78 percent of the kWhs purchased by the Company. The Hunt-Collin division purchased nine percent of the Company's total kWhs or 82,027,586 kWhs from City of Garland and LCRA provided 114,368,349 kWhs or 13 percent of the total kWhs used by

the Company[31].

B. OBJECTIVE

In this task area, we addressed the following objectives which were identified in the PUCT's RFP):

- The management and planning of power procurement.
- Review of prior Purchase Power Agreements (PPAs).

C. EVALUATIVE CRITERIA

In conducting the review in this area, we used the following criteria:

- Does the Company have a well-defined organizational staffing structure and are operating roles and responsibilities clearly identified?
- Has the Company negotiated power contracts that ensure that it will meet its customer demand cost effectively?
- Does the Company have an effective process to forecast its future purchased power needs so that it can negotiate contracts that will meet its customer needs?
- Does the Company appropriately account for power purchase costs?
- Does the Company keep current with the issues in the evolving Texas market?
- Does the Company effectively manage all the data and information typically analyzed in this area for optimal power purchase planning?

D. WORK TASKS

To complete the review in this area, we performed the following tasks:

- Interviewed executives responsible for this function.
- Prepared and submitted data requests and analyzed the Company's responses to these requests.
- Reviewed the efforts made by the Company to retain external assistance over the last two years to perform specific studies and/or support with this function.
- Reviewed the reasonableness of the assumptions and process that the Company has in place to analyze the various options for power procurement going-forward.
- Reviewed the existing Power Purchase contracts to ensure that they are

[31] Notes from interview with Director of Resource Planning on 09/25/07.

meeting customer demand cost-effectively.

E. FINDINGS AND CONCLUSIONS

1. Cap Rock's power procurement function has the necessary expertise and it has achieved a reasonable level of performance.
   - The Resource Planning and Regulatory Administration (RPRA) function which is responsible for power procurement reports to the General Counsel. In July 2007, an individual who was in the Wholesale Account Management Group with SPS was hired as the RPRA director. He is responsible for power supply procurement. SPS consented to the individual's involvement in power supply negotiations with SPS and he has led such negotiations since his employment with the Company.
   - The Company's General Counsel and Chief Operating Officer (COO) are also actively involved in supporting the Director with this function as they both possess institutional knowledge of the methods, processes and assumptions used to analyze PPAs in the past.
   - The RPRA director is an experienced and qualified individual with over 19 years of experience working for SPS, a key power supplier for the Company. In this capacity, he has an unusual mix of market intelligence as well as SPS business knowledge that should benefit the Company.
2. From July, 1998 to July, 2007, the Company relied on Vision Energy Consultants (VEC) to perform various power procurement services.
   - VEC provided the following services:
     - Assisting in negotiation of PPAs,
     - Analyzing power brokering opportunities,
     - Providing market information, and
     - Assisting staff in all areas of power supply and resource planning.
   - VEC's principal owner performed the various services for Cap Rock. At times, other employees of VEC provided analysis and training for the Company and its staff at the owner's direction.
   - Through the years, VEC assisted Cap Rock in negotiating and securing several power supply agreements for the Hunt-Collin Division. In 1999, an agreement was negotiated for Dynegy to supply power to that division. VEC worked with the Company's General Counsel in negotiating and entering into that agreement. Prior to the end of that agreement, VEC developed an RFP) that was issued for the Hunt-Collin load. VEC, working with the Company's General Counsel, led negotiations which ended with a contract being signed with GP&L to serve Hunt-Collin and the City of Farmersville. VEC also negotiated two separate extensions to this agreement. The last extension

expires in September 2008.

3. Cap Rock carefully considers all potential issues in structuring its PPAs.

- PPAs are complex documents and each PPA has its own peculiarities and specialties. However, there are several main features that more or less, remain the same in all the PPAs. These include, but are not limited to, the following:
  - Preamble
  - Definitions and interpretations
  - Power supply services agreement
  - Term definition
  - Transmission, ancillary and qualified scheduling entity services, and regulatory fees
  - Metering procedures
  - Pricing methodologies
  - Billing procedures
  - Default provisions
  - Limitation of liability and indemnification
  - Audit protocols.
- PPAs also contain a number of schedules which may include the following:
  - Description of specific generating facilities
  - Interconnection and transmission facilities
  - Delivery points and charges
  - Metering standards and testing
  - Dispatch procedures
  - Capacity payments
  - Energy payments.
- The Company has considered all of the issues typically analyzed in PPA negotiations as well as has taken into account special circumstances that are either specific to the Texas market or to a particular supplier, such as:
  - Development of a nodal market in Texas
  - Divestiture of generation by a supplier
  - Demand-Side management provisions
  - Option for conversion to partial requirements service.

4. While the Company has an appropriate process for evaluating PPAs, it could analyze additional components to determine the full effects that distortions in key input variables might have.

   - Discussions with senior management indicated that the Company considers all potential options for procuring power to service its load requirements. These options include:
     - Negotiating/ extending the agreement with a current suppliers
     - Considering a new supplier
     - New Generation Build Options.
   - An analysis of the transmission situation indicates that SPS or another power provider in the SPP would be the preferred supplier for the Stanton/ Lone Wolf Division.
   - The December 2001 RFP for Power Supply issued for procuring power for the Hunt-Collin Division provides the framework that Cap Rock has used to procure power when various suppliers are invited to submit their respective bids.
   - Power contracts are evaluated by looking first at the supplier reliability and then comparing the price with the prices available from other power providers.
   - The Company needs to improve its analytical skills by recruiting individuals with advanced analytical and modeling capabilities. While Cap Rock has performed certain sensitivity analysis in the past, it needs to more fully analyze the full effects that distortions in key input variables might have on a PPA.

5. Historically, Cap Rock also relied on the services of VEC to assist with its resource planning process.

   - VEC attended numerous meetings with key suppliers, on behalf of, or with the Company to assist in PPA-related discussions. VEC also participated at FERC various proceedings involving the Company.
   - The Company does its best to calculate the rates of the power supplies currently and during the term of the contract. In the past, it retained VEC to run sensitivities on key input variables and to perform independent market assessments to determine the effect of potential market changes on existing PPAs.
   - VEC prepared annual forecasts on gas prices and provided reports to the Company on the status of the power markets. VEC also educated staff of the Company and taught them how to forecast load requirements and other things necessary for power supply needs.
   - By hiring an experienced individual to serve as the RPRA director, the Company expects that much of the "external knowledge," previously provided

by VEC, will now to be resident within the Company. Cap Rock is also considering adding staff to this area.

6. The Company appropriately accounts for purchased power costs.

- The Company purchases electricity from wholesale providers under long-term contracts. These wholesale costs, along with any wheeling charges, are recorded in FERC account numbers 555 and 565, respectively. These costs are recovered from customers through billings in base rate and a PCRF as allowed under the PUCT Substantive Rule No. 25.238.
- Under Rule No 25.238., the Company projects the monthly costs and the monthly kWh sales over which to collect those costs and then estimates the factor need to recover those costs. A true-up of estimates is made two months following billing. The difference in the true-up is netted with the projected estimates to be included in that month's PCRF calculation. Each month the true-up reconciliation, as well as the estimated PCRF is filed with the PUCT. The PCRF is on a system-wide basis, as are the Company's rates.
- The two-month delay in true-up is due to the timing of receiving the actual power bills. Each power provider's billing and accounting is described below:
  - SPS bills the Company on a monthly cycle through the end of the month and the invoice is received approximately five days after the month end.
  - LCRA bills the Company on a monthly cycle through the 25th of each month. Based on the monthly bill, an accrual is made for the remaining five days of the month, to record and project the 30 day monthly cost.
  - GP&L bills the Company on a monthly cycle through the end of the month. However, the bill is received more than a month following the cycle. The Company accrues an estimate each month for the expected cost. This estimate is determined by the system engineering department which monitors the substation meter readings and contacts GP&L as to the appropriateness of its estimates.
- As per the Company's approved rates, $0.042097 per kWh is billed to the customer for recovery of the base rate power costs. In addition to the base rates, customers are billed the PCRF which is calculated each month and billed on a per kWh basis prior to the first billing cycle. Differences in estimated PCRF calculations and revenues collected are determined in the month after month-end and adjusted in the following month's PCRF.
- Each month the over/ under collection of PCRF revenues is recorded as a payable/ receivable on the balance sheet with an offsetting revenue entry recorded to FERC account 407. The effect of these entries results in revenue neutralizing the power costs.

7. Cap Rock has not performed a "Market Analysis" of its service area.

- The Texas electricity market is in a state of flux with infrastructure challenges as well as regulatory and legislative rules contributing to an uncertain environment that will have a bearing on the Company's long-term acquisition of power supply. Some of the key issues relevant to the Texas market include, but are not limited to:
  - Development of a zonal market
  - Capacity adequacy issues
  - Generation inter-connection
  - Transmission planning
  - Market power issues
  - Retail restructuring
- The Company has relied upon VEC to keep it informed of key market development issues and trends. VEC has done this by participating in ERCOT, SPP and PUCT meetings regularly to educate Company staff on key issues.
- The Company has not conducted a focused Texas electricity market assessment that would include developing model(s) for capacity analysis, transmission constraints, forward price curve forecasting, fuel price analysis and formula rate effects. Given the recent and projected volatility in the energy market, it would assist the Company to develop skills that would enable it to perform such sensitivity analyses.
- Another area that the Company has paid limited attention to is the effect of Renewable Portfolio Standards and Demand-Side Management strategies of its suppliers, although it has introduced language in contract negotiations that discusses them.

8. The Company can improve its power procurement information management processes.
   - The Company does not have an integrated database that identifies power supply billing determinants by various components.
   - There is also not a clear linkage between analyzing retail customer usage information and power procured.

9. Cap Rock's power purchase expenditures appear reasonable when compared with the median value of power supply costs of all investor-owned utilities in the country.
   - **Exhibit VIII-1** shows the power purchase expenditures for the Company for the last three years across all of its divisions.

Exhibit VIII-1
Power Purchase Expenditures[32]

	Power Costs	Purchased kWh	Costs per kWh
2004 Stanton/Lone Wolf	38,926,535	638,309,655	0.0610
Hunt Collin	3,669,327	73,050,572	0.0502
McCulloch	4,937,043	104,964,826	0.0470
Farmersville	1,472,297	29,618,828	0.0497
	49,005,202	845,943,881	0.0579
2005 Stanton/Lone Wolf	37,133,530	653,676,289	0.0568
Hunt Collin	5,515,733	79,935,099	0.0690
McCulloch	5,830,847	111,328,656	0.0524
Farmersville	2,303,590	31,897,458	0.0722
	50,783,700	876,837,502	0.0579
2006 Stanton/Lone Wolf	35,460,433	700,255,140	0.0506
Hunt Collin	4,764,326	82,027,586	0.0581
McCulloch	6,579,315	114,368,349	0.0575
Farmersville	1,889,934	32,000,008	0.0591
	48,694,008	928,651,083	0.0524

- The costs per kWh across all divisions, on average, are approximately 5.79 cents for 2004 and 2005 and 5.25 cents in 2006.
- The median power generation costs throughout the country were approximately 7.05 cents, 7.30 cents and 7.64 cents for the years 2004, 2005 and 2006 respectively[33].

F. RECOMMENDATIONS

1. Add staff resources to the power procurement function to increase analytical capabilities. (Refers to Finding VIII-4.)
2. Perform a comprehensive market analysis of the electricity market situation in Texas and the implications it has for the Company. (Refers to Finding VIII-7.)
3. Develop databases that would allow the Company to analyze and match power supply and retail customer usage characteristics. (Refers to Finding VIII-8.)

[32] Cap Rock Date Response
[33] Huron SNL Benchmarking Analysis

A. BACKGROUND

The Company's distribution business is regulated by the PUCT and certain municipalities. All of the Company's operating revenues come from electric-related sales to commercial/industrial, residential and irrigation customers representing approximately 58 percent, 34 percent and eight percent respectively, of total electric sales. The Company does not own or operate electric generating facilities; rather it is a "poles and wires" (transmission and distribution) utility. The Company operates in a service territory that is 65 percent dually certified, that is, two utilities can provide services to the same customers.

The Company has three operating divisions which are each responsible for a specific portion of the Company's service territory as described below:

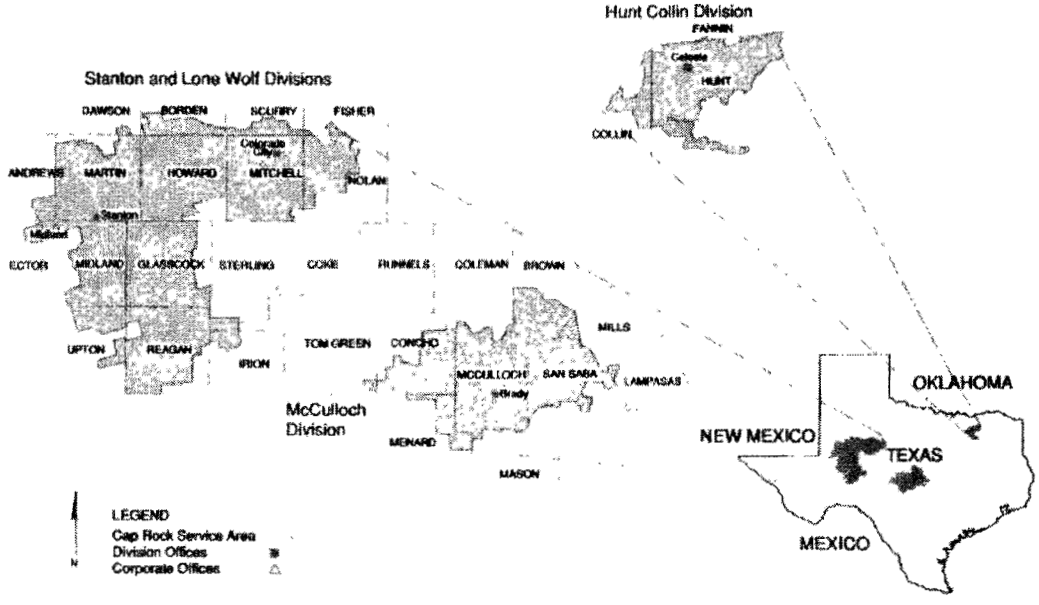
- Stanton/ Lone Wolf division covers rural Midland customers and portions of the oil-rich Permian Basin.
- Hunt-Collin division is an outer suburb of Dallas and manages the Farmersville system.
- McCulloch division in central Texas is a semi-rural area that includes residential and some commercial customers.

The Company's distribution system has more than 11,000 miles of primary and secondary distribution lines throughout 28 counties. The Stanton/Lone Wolf, Hunt-Collin and McCulloch divisions represent 75 percent, five percent and 20 percent respectively of the Company's total distribution system. **Exhibit IX-1** shows the three divisions and various counties served.

The Company's transmission system has 17 substations and 305 miles of single pole transmission line. The system provides a looped transmission line at 138 kV with two electric supply delivery points for power providers to tie into and deliver power. The Company owns real-estate related to its electric distribution and transmission business, including easements, rights-of-way and land where substations, as well as distribution and transmission poles and lines, are located. The Company also owns real estate and division office locations in Stanton, Colorado City, Brady and Celeste, Texas.

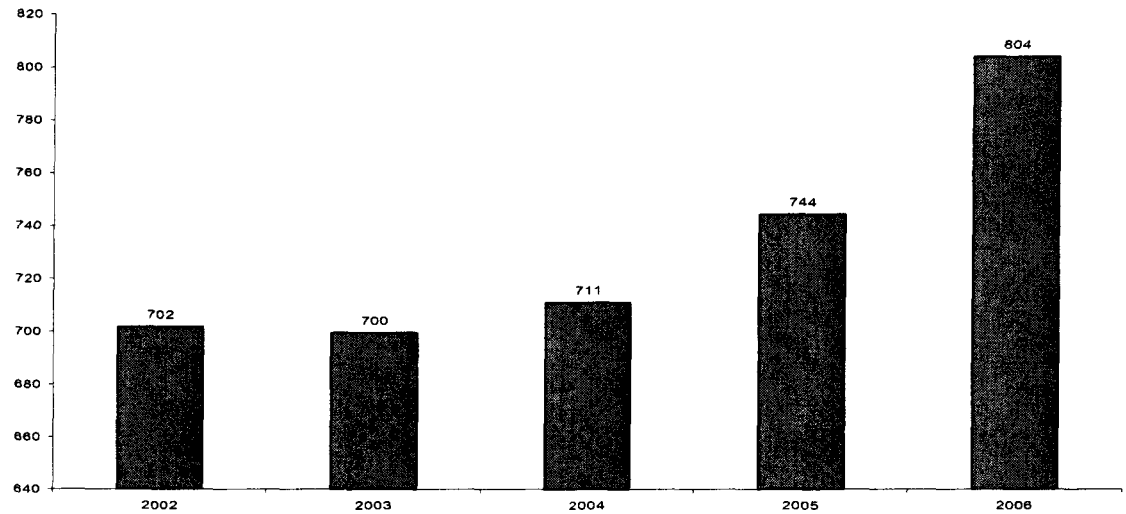
Exhibit IX-1
Company Service Area

CAP ROCK SERVICE AREA
MARCH, 2002



Over the past few years, the number of meters served by the Company has experienced an increase of approximately 1.5 percent compound annual growth rate (CAGR), driven by growth in the commercial/industrial and residential segments and an increase in irrigation in 2006 due to the hot dry spring and summer. Over the same period, total MWh deliveries grew at a rate of approximately two percent CAGR, reflecting overall increased usage per meter, primarily within the large and small commercial segments. **Exhibit IX -2** shows the load growth between 2002 and 2006.

Exhibit IX-2
Load Growth in 000's of MWh[34]
As of August, 2007



B. OBJECTIVE

Huron conducted an assessment of Cap Rock's distribution operational planning, procedures and practices, and reviewed its operational results to determine whether the Company was delivering electricity to its customers in a safe, reliable and cost-effective manner.

C. EVALUATIVE CRITERIA

In conducting the review in this area, we used the following criteria:

- Does the Company have a well-defined organizational staffing structure and are operating roles and responsibilities clearly identified?
- Is the distribution organization operational structure effective in helping the Company meet its goals and objectives for providing service to its customers?
- Is the Company adequately applying modern technology for monitoring and controlling its distribution system?
- Does the Company adequately measure system performance (SAIDI, SAIFI) in order to target areas for improvement?
- Does the Company have an effective capital project evaluation process? Have capital expenditures remained steady for the last three years?

[34] Cap Rock Energy Audit Kick-off Presentation

- How does the Company's operations and maintenance costs compare with other utilities in Texas?
- Does the Company maintain a comprehensive standardized documentation of operational processes and procedures across all divisions?
- Is the Company's emergency operations plan reasonable and adequate?
- Are the Company's engineering capabilities adequate and reasonable?
- Does the Company do an adequate and reasonable job of capital and O&M project development and execution with appropriate project controls?
- Does the Company rely on outsourcing for any particular job function or business process?

D. WORK STEPS

In conducting this review, we interviewed executives, managers and engineers in various electric distribution organizations, prepared and submitted data requests, and reviewed and analyzed the Company's responses to the data requests. We focused on the business plans, goals and objectives, organization, budgeting, staffing, policies and procedures, and training of the organizations having responsibility for operating the electric distribution system. We also reviewed the performance and reliability of the electric distribution system.

E. FINDINGS AND CONCLUSIONS

1. The Company has a well-defined electric distribution organization, and operating roles and responsibilities are clearly identified.

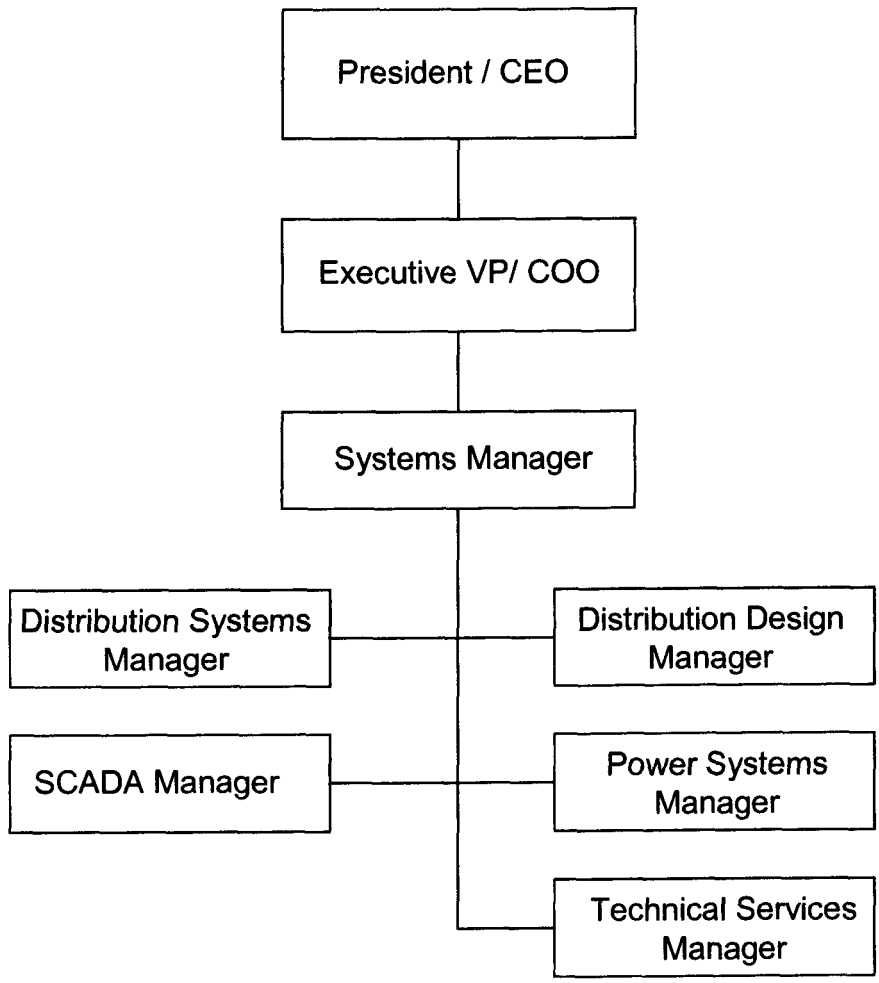
   - The Company's Chief Operating Officer (COO) is responsible for overall electric transmission and distribution operations as well as customer service. The COO joined the Company in 1974 and was promoted to Vice President and COO in June 1999. Over the years, he has directly managed the Stanton/ Lone Wolf division and was also responsible for overseeing the other operating divisions. He has a good knowledge of the service territory as well as the Company's infrastructure.
   - The COO is supported by a Systems Manager who reports directly to him and is responsible for all divisions of the Company. The Systems Manager has 18 years with the Company and a total of 36 years of experience in the electric utility business.
   - The Systems Manager has the following individuals reporting to him:
     - Distribution Systems Manager
     - Distribution Design Manager

- SCADA Manager
- Power Systems Manager
- Technical Services Manager

- Each of the individuals in the aforementioned positions have at least 20 years of electric utility experience, much of it with the Company, and hence have a very good understanding of cultural, operational, customer and infrastructure issues. The Company has 92 employees engaged in this function including meter readers.
- **Exhibit IX-3** provides the current organization structure in place which can be described as "logically structured" with operating roles and responsibilities clearly identified.

Exhibit IX-3

Electric Operations Organization Structure



2. The distribution organization operational structure facilitates servicing Cap Rock's customers.

   - Cap Rock's service are non-contiguous and the Company reports key statistics for each one of the three divisions as shown in **Exhibit IX-4** below:

Exhibit IX-4
Key Operating Statistics[35]

As of August, 2007

Division	Stanton/ Lone Wolf	Hunt-Collin	McCulloch	Total
# of Meters	24,591	4,410	6,356	35,357
% of Customer Base	70%	12%	18%	100%
MWH Deliveries	630,894	82,028	101,565	814,487

   - The operational organization structure facilitates the performance of core distribution operations by the respective divisions in a "de-centralized" manner. It also factors in the rural composition of the service territory.
   - Cap Rock has preserved the institutional knowledge of the service territory as well as the infrastructure as many of the field crews have over 20 years of service with the Company.

3. The Company's SCADA system monitors and controls its distribution system.

   - Cap Rock has a Supervisory Control and Data Acquisition (SCADA) system which is a monitoring system that allows supervisory, control and data acquisition from all of the substations in Company's system via various radio systems and numerous technologies.
   - SCADA was installed in 1987 in the Stanton division and implemented at each of the divisions as they came into the system. SCADA manages Power Factor and Load Shed, using radios in the field to control devices (capacitor banks or pumping units of oil field customers).
   - The Company receives the following benefits from the SCADA system:
     - Notification of a substation or feeder problem is prompt and does not rely on customers to report the problems. This is especially important when telephone lines are out, since customers without cell phones have no convenient means of notifying a utility of an outage.

[35] Cap Rock Audit Kick Off Presentation

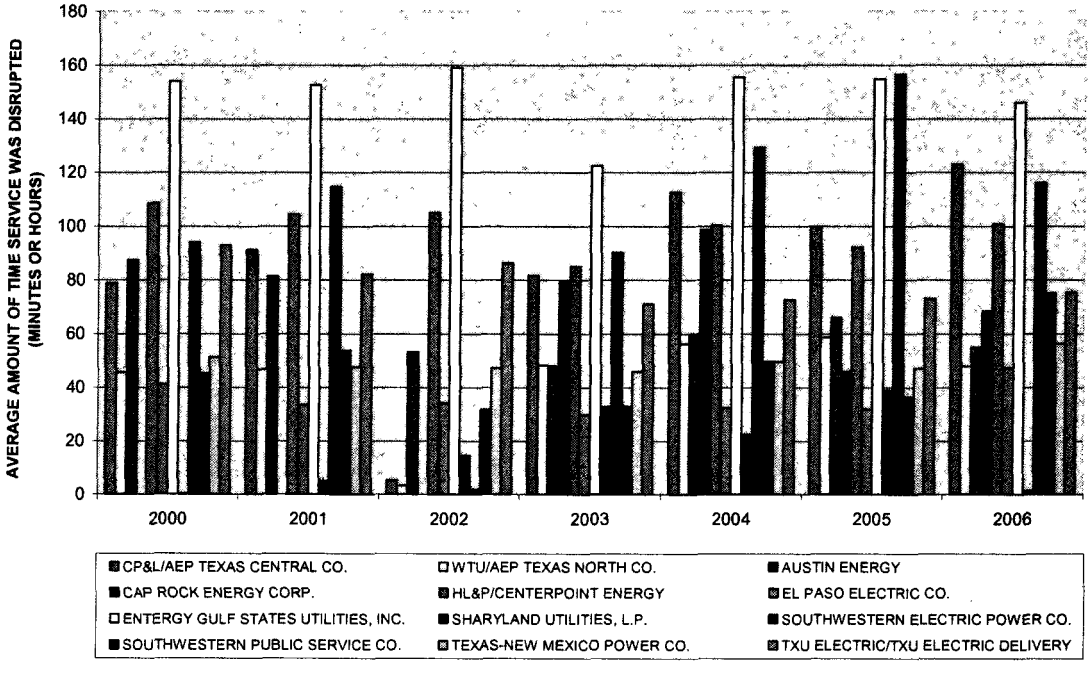
- Dispatch center personnel are immediately aware of the kind and extent of any substation problem and can dispatch the proper personnel to take care of the problem.
- Manpower costs are reduced, because the need to dispatch personnel to a substation to investigate and determine the cause and extent of the problem is reduced or eliminated.
- System reliability is improved when outage durations are reduced.
- Substation security is enhanced through the use of alarms on gates and fences.
- Safety is improved by eliminating the need for a person to be in the substation to carry-out switching orders.
- Real-time monitoring of the system is available on a continuous basis.
- Important system data can be automatically recorded and trended.
- During storms, loading on feeder breakers can be monitored to determine how much load was lost due to down stream feeder problems.

4. Cap Rock's SAIDI record is better than the national average and the median of Texas utilities in recent years.

   - System Average Interruption Duration Index (SAIDI) is the average outage duration for all customers in the system and is measured in units of time, often minutes or hours. It is usually measured over the course of a year, and according to IEEE Standard 1366-1998 the median value for North American utilities is approximately 1.50 hours. The Company's total system SAIDI has generally averaged about 73 minutes between 2003 and 2006 which is below the national average of 90 minutes.
   - As shown in **Exhibit IX-5**, the Company has had a better SAIDI than the median of other Texas utilities for the last two years.

Exhibit IX-5
SAIDI Metrics[36]

System Average Interruption Duration Index (SAIDI):
FORCED



5. Cap Rock's recent SAIFI record is better than the national average and slightly below the median for Texas utilities.

   - System Average Interruption Frequency Index (SAIFI) is an indication of the number of times per year that the average customer experiences an outage. SAIFI is measured in units of interruptions per customer. It is usually measured over the course of a year, and according to IEEE Standard 1366-1998 the median value for North American utilities is approximately 1.10 interruptions per customer

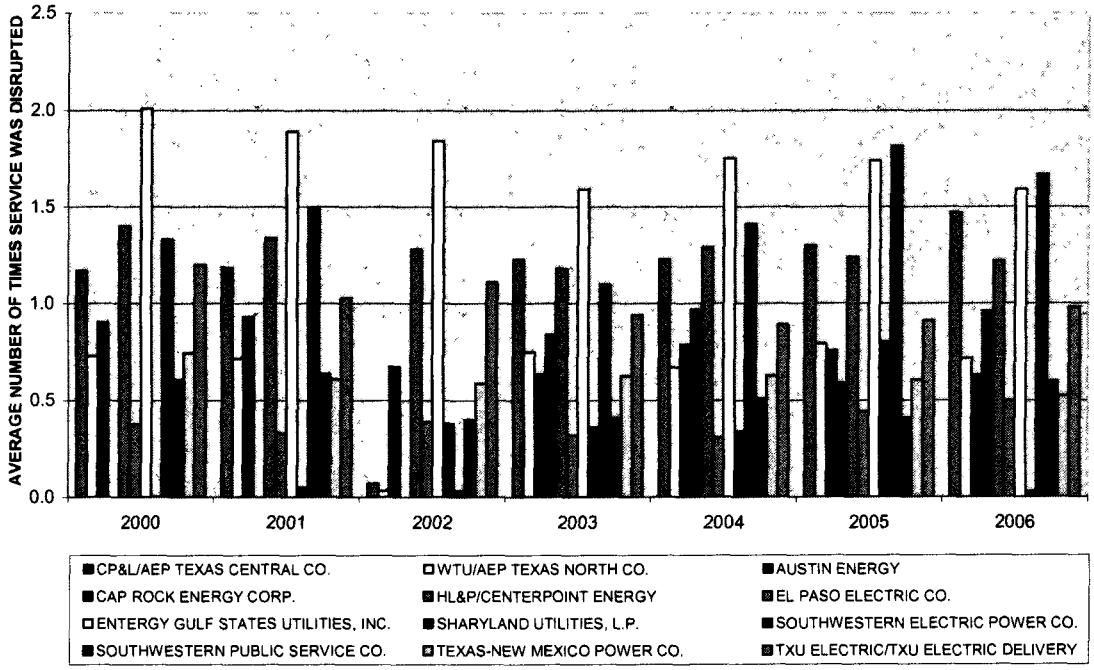
   - The Company's total system SAIFI averaged 0.84 between 2003 and 2006. The SAIFI value for 2005 was 0.59 since it was a mild weather year and the Company experienced lower than expected weather related outage events. The Company's four-year SAIFI average is better than the national SAIFI average and also for each year over the last four years.

[36] PUCT Website; Huron Analysis

- In comparison with other Texas utilities, as shown in **Exhibit IX-6**, the Company has a slightly worse SAIFI than the median SAIDI value over the four year period. The variance is within a reasonable bound and it should not raise any "red flags."

Exhibit IX-6
SAIFI Metrics[37]

System Average Interruption Frequency Index (SAIFI): FORCED



6. The Company's goal is to create a system to monitor SAIDI and SAIFI performance by circuit by month and use the data to formulate performance-based goals for 2008.
   - The Company has defined all elements that are to be monitored are and established and implemented data collection methods to meet the Company's "threshold" requirement.
   - The Company has not historically tracked the Customer Average Interruption Duration Index (CAIDI) since it was not required to be filed with the PUCT. However, with the implementation of a new computer system, the Company does have this data available for the first few months in 2007.

7. Weather and company-owned equipment are the principal causes of Cap Rock's service interruptions over the past two years.

[37] PUCT Website; Huron Analysis

- The causes of interruption for the two years are detailed in **Exhibit IX-7.**

Exhibit IX-7
Causes of Interruption[38]
As filed with the PUCT for 2005 and 2006

Causes of Forced Interruptions	2005 Percent	2006 Percent
Weather (Including Lightning)	42.54%	56.61%
Vegetation	2.26%	1.57%
Animals and Birds	5.79%	6.06%
People (Including cars and farm equip)	7.79%	8.33%
Utility-owned Equipment	35.73%	24.93%
Other	3.30%	0.69%
Unknown	2.58%	1.81%

- While it is difficult to discern trends that the Company is exhibiting based on two years of data, these metrics are in-line with acceptable utility performance. Forced interruptions caused by utility-owned equipment are down by almost 11 percent in 2006 compared with 2005.
- The Company has a vastly rural service territory compared with most utilities. Circuits in remote areas or those exposed to severe weather cannot be expected to offer the same level of reliability as circuits in urban areas or areas where weather conditions are milder

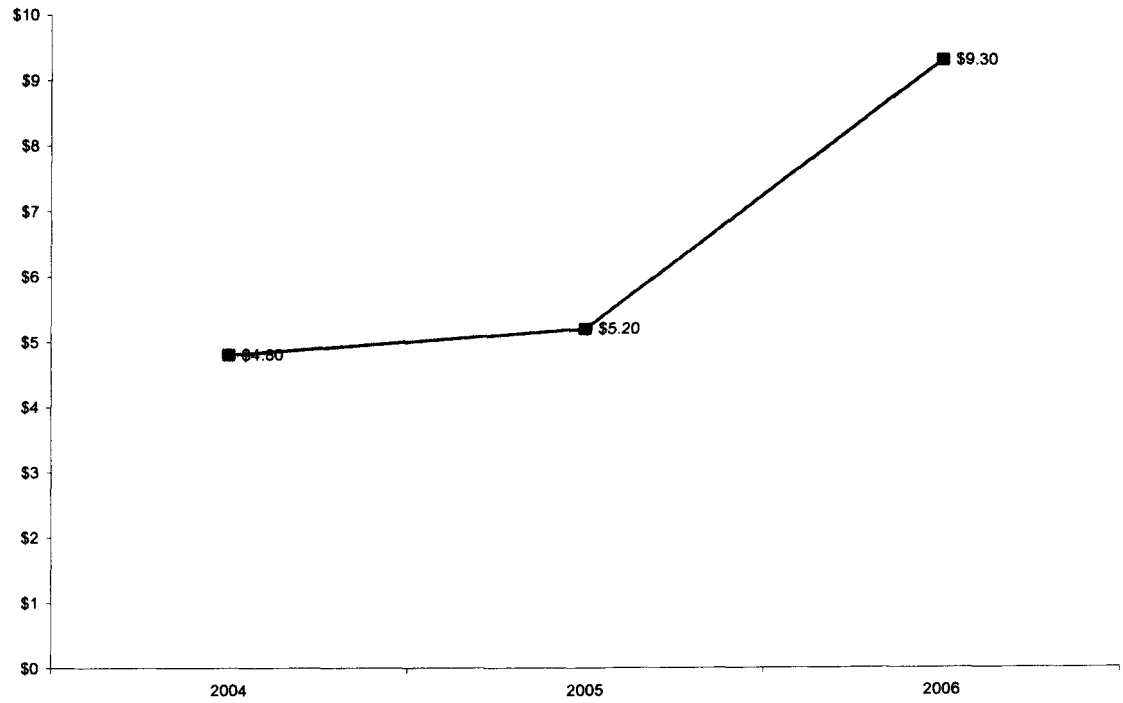
8. The Company has a good capital planning and budgeting process for its distribution operations.

- As part of the annual budgeting process, all capital items are reviewed and approved. Each item is assigned an amount, start date and a completion date and is tracked monthly by the division doing the work showing current cost to date and the projected cost for the next month.
- The Company's Board is provided with a quarterly report showing the status of each capital project and the budget is adjusted if required with Board approval.
- Capital items such as new construction are driven by past history and an estimate on the next year's growth. Repair and replacement capital items are driven primarily by storms. These items are evaluated each month and are also reported to the divisions and the Board.
- **Exhibit IX-8** shows the capital expenditure spending trend over the last three years. The Company's baseline capital expenditures were historically averaged around $4 to $5 million per year.

[38] Cap Rock Data Response

- The Company's initial capital budget for 2006 in January was $6.6 million, but the Company increased its capital spending to over $9 million. Once the acquisition was completed, Lindsay Goldberg provided the Company with more capital funds, than what it previously had access to, in order to operate more effectively. Some of the capital increases were $2.5 million more due to new services, $618,000 in unbudgeted costs for a 20-mile line, and cost increases in a substation project.

Exhibit IX-8
Capital Expenditure Spending Trend[39]



9. Cap Rock's distribution O&M costs per customer/meter are almost two and one half times higher than other utilities in Texas.

- **Exhibit IX-9** shows the approximate distribution expenses per customer for some of the other electric utilities that operate an electric distribution system in Texas.

[39] Cap Rock Data Response

Exhibit IX-9

Distribution Expenses per Customer[40]

Company	2006	2005	2004
CenterPoint Energy, Inc.	$ 75.45	$ 79.15	$ 66.09
El Paso Electric Company	60.00	52.73	47.74
Entergy Gulf States, Inc.	74.36	69.71	78.58
Entergy Louisiana Holdings, Inc.	55.44	58.41	72.44
Southwestern Public Service Company	64.61	55.47	62.16
Texas-New Mexico Power Company	70.49	73.07	66.41
TXU Corp. (Oncor Elec. Delivery)	65.15	66.97	61.12
Average	**$ 66.50**	**$ 65.07**	**$ 64.93**
Median	**$ 65.15**	**$ 66.97**	**$ 66.09**

- The Company's distribution costs per customer were $184 for 2004, $168 for 2005 and $207 for 2006. The reason that this metric is so high for the Company is because of the primarily rural terrain that Cap Rock operates in which results in fewer meters per mile. The Company has approximately three meters per mile of line while the IOUs that are listed above generally have between 60 and 100 meters per mile.

10. While electric distribution management and operations processes are appropriately defined and consistently performed, they are not fully documented across divisions.

- Executives and managers who are responsible for electric distributions management and operations functions have a common understanding of the processes and possess the knowledge and skills to fulfill their roles and responsibilities.
- To facilitate compliance with general corporate guidelines, the Company has rolled out various protocols to the divisions to consistently plan projects; to evaluate capital and O&M investment opportunities; and to prioritize, authorize, budget, and control project expenditures.
- Most of the staff have a good understanding of the infrastructure and have impressive "institutional" knowledge of good utility practices that ought to be followed and which are being followed. However, key processes are not fully documented

11. The Company's emergency operations plan is well-written and complete.

- One of the key indicators of the effectiveness of the management and operations practices during an emergency for any utility lies on how it plans to handle adverse situations. The written standards and specifications are

[40] Huron SNL Energy Benchmarking Analysis

comprehensive and well-written.

- The Company's emergency operations plan is a "living" document that is periodically reviewed and revised as determined necessary. The practice of periodically publishing updates as a need arises is also an indication that the Company is making a good effort to keep its distribution management and operations practices current with a changing industry.

12. Cap Rock's System Engineering Department utilizes established industry standards in determining the need for system upgrades and improvements.

- As part of its efforts to serve its customers, the Company develops a rolling work plan that addresses the major needs of the electric system. The plan focuses on providing adequate power delivery to its existing customers and having enough system reserves to ensure the ability to serve future growth. The Company established standards for the development of the work plan in 2002.
- Milsoft DisSPatch outage management software is utilized to model the Company's distribution systems to aid in improving response and restoration times.
- SCADA information is recorded per each substation on 15-minute intervals. This information is used to create a growth factor for each substation circuit. The load data spans 16 years and allows the Company to create reliable growth factors based on factual information.
- Operations personnel are also periodically requested to identify problem areas that can be addressed with the work plan.
- In addition to relying on internal review and assessment of the system, the Company also proactively conducts third-party reviews of its system which has experienced growth levels significantly above normal for the past two years. The Company has selected an engineering consulting firm to provide a five-year work plan of the Company's system.

13. The Company has a framework that provides effective technical and administrative oversight over capital projects.

- The Company's Technical Services Manager reviews the entire system once a year and runs system models to determine needs.
- The Company prioritizes and schedules jobs as to build dates. Jobs are presented in budget discussions with reason, cost, and benefits, reason if not constructed and scheduled construction time.
- The Staking Tech is usually the individual who is responsible for discussing requirements with the customer and identifying what is to be built, the cost and the date the customer requires service to be completed.
- The Staking Department sends staking sheet(s) to Line Superintendent and to

the warehouse to schedule construction based on customer completion date. Construction crew builds job and returns staking sheet to Line Superintendent after completion.

- The Line Superintendent inspects the job to determine that it was built to the Company's specifications.

14. Cap Rock uses outsourcing as an "option" to procure services where it makes sense.

- An example where the Company relies on outsourcing are situations were the Company has hired LCRA to provide maintenance services on substations or to construct substations for the Company.
- The Company displayed good business judgment when it "in-sourced" the meter reading function in March 2007. The Company had outsourced its meter reading several years ago and this had worked relatively well. However, for the past year or so, the external firm had trouble keeping employees and getting the meters read accurately and on time.
- The Company felt that by using its own employees, it could read the meters more efficiently and accurately. By Company employees performing this job, the Company had another opportunity to spot potential problems that had yet to advance to the critical stage. Company employees would be able to view most of the meter sites every month and could relay valuable information to line crews. This helps in maintaining and improving reliability. Also, by having employees read meters, the Company is able to develop these employees to fill vacant jobs that become available. They are also a valuable resource when there are major outages such as ice storms and tornadoes.

F. RECOMMENDATION

1. Formalize and document electric distribution business practices across all divisions. As some of the Company's workers start retiring, the Company will need to replace this expertise and it is imperative that it starts documenting and preserving their institutional knowledge. (Refers to Finding IX-10.)

EXHIBIT 7

PUC DOCKET NO. _____

BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS

PETITION OF
PNM RESOURCES, INC.
AND
CAP ROCK ENERGY CORPORATION
REGARDING PROPOSED PLAN OF MERGER

PREPARED DIRECT TESTIMONY AND EXHIBITS
OF
J. NEAL WALKER

ON BEHALF OF
PNM RESOURCES, INC.

MARCH 14, 2008

TABLE OF CONTENTS

I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND PLACE OF EMPLOYMENT.

A. My name is J. Neal Walker. I am Vice President, Operations for Texas-New Mexico Power Company ("TNMP"), a wholly-owned subsidiary of PNM Resources, Inc ("PNM Resources"). My business address is 4100 International Plaza, 8th Floor, Fort Worth, Texas, 76109.

Q. WHO DO YOU REPRESENT IN THIS FILING?

A. I represent PNM Resources and its subsidiary PNM Merger Sub, LLC ("PNM Sub").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. Exhibit JNW-1 describes my background and experience.

Q. WHO ARE THE APPLICANTS IN THIS PROCEEDING?

A. The applicants are PNM Resources and Cap Rock Energy Corporation ("Cap Rock"), collectively referred to as "Applicants".

Q. HAVE YOU PREPARED ANY EXHIBITS?

A. Yes. I am sponsoring Exhibits JNW-1 through JNW-4 which are attached to my testimony. Each of these exhibits was prepared by me or under my direction and control. The information contained in these exhibits is true and correct to the best of my knowledge and belief.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I will address the operational issues associated with the acquisition of Cap Rock Holding Corporation ("CRHC"). Specifically, my testimony will address:

1. A general description of the companies PNM Resources is acquiring in this transaction.
2. How PNM Resources will organize and operate the CRHC companies.

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3. The effect of the transaction on employees of Cap Rock, including employment and safety.

4. The effect of the transaction on electric service in the Cap Rock service territory, including availability, quality and reliability of service.

III. THE TRANSACTION

Q. WHAT COMPANIES IS PNM RESOURCES ACQUIRING IN THIS TRANSACTION?

A. As described by PNM Resources witness Terry R. Horn, PNM Resources is acquiring CRHC, which will survive as a subsidiary. CRHC in turn has three wholly-owned subsidiaries: Cap Rock Intermediate, Inc. (no assets), Cap Rock, and NewCorp Resources Electric Cooperative ("NewCorp").

Q. PLEASE DESCRIBE CAP ROCK.

A. Cap Rock is an electric utility headquartered in Midland, Texas. It is regulated by the Public Utility Commission of Texas. Cap Rock has distribution assets and operations in 28 counties in three separate divisions: the Stanton/Lone Wolf division (24,500 customers) in the rural Midland area and portions of the Permian Basin, the McCulloch division (6,700 customers) in central Texas, and the Hunt-Collin division (4,800 customers) northeast of Dallas. A map of the Cap Rock and TNMP service territories is attached as Exhibit JNW-2.

Q. ARE CAP ROCK'S OPERATIONS LOCATED ENTIRELY WITHIN ERCOT?

A. No. The McCulloch and Hunt-Collin divisions are located within ERCOT, but the Stanton/Lone Wolf division is in the Southwest Power Pool ("SPP"). As Cap Rock's witness Melissa D. Davis describes, 75 percent of Cap Rock's load is outside of ERCOT.

Q. PLEASE DESCRIBE NEWCORP.

A. NewCorp operates as a transmission company regulated by the Federal Energy Regulatory Commission ("FERC"). It owns 305 miles of looped 138 kV transmission line and 17 associated substations dedicated to serving Cap Rock's Stanton/Lone Wolf division. NewCorp operates under an Open Access Transmission Tariff for which Cap Rock is the only customer. NewCorp only operates in SPP.

IV. ORGANIZATION AND OPERATIONS

Q. HOW DOES PNM RESOURCES PLAN TO ORGANIZE AND OPERATE THE CRHC COMPANIES?

A. Cap Rock and NewCorp will continue to operate as separate companies under CRHC after the transaction is closed. As discussed in the testimony of Patricia K. (Vincent) Collawn, transition teams are presently evaluating how best to provide corporate services to Cap Rock and NewCorp after the close and some executive positions will be absorbed by PNMR Services Company. However, PNM Resources has no plans to make significant changes at the operating levels of these companies.

Q. DOES PNM RESOURCES PLAN TO COMBINE CAP ROCK AND NEWCORP OPERATIONS WITH TNMP?

A. No. TNMP is completely within ERCOT, is completely unbundled, and all of its customers participate in the Texas retail competitive market. Since Cap Rock procures power for its customers and renders bills to its customers, there are fundamental business and regulatory differences between TNMP and Cap Rock operations. PNM Resources intends to operate Cap Rock and NewCorp as separate companies.

V. EFFECTS ON EMPLOYMENT

Q. WHAT WILL BE THE EFFECT OF THIS TRANSACTION ON THE OPERATING EMPLOYEES OF CAP ROCK AND NEWCORP?

A. PNM Resources has no plans to make significant changes at the operating levels of these companies. Changes for corporate services are presently being evaluated as described in the testimony of Patricia K. (Vincent) Collawn. In addition, there will be some changes at the executive level. However, operating personnel will see no immediate changes as a result of this transaction.

As Cap Rock's new executive leadership evaluates how to best address the findings and recommendations of the Huron Consulting Group Management Audit and implement best practices, there will likely be changes in policies, procedures and organization. However, these changes are not known at this time.

Q. WHAT WILL BE THE EFFECT OF THIS TRANSACTION ON EMPLOYEEE SAFETY FOR CAP ROCK AND NEWCORP?

Attached as Exhibit JNW-3 is data on OSHA Recordable Incidents for the last 5 years for TNMP. Over time, we would continue expect Cap Rock and NewCorp to see contiued improvement in employee safety as a result of the propsoed transaction. For example, PNM Resources has a strong safety culture and will be able to share its culture, processes, and procedures with Cap Rock through executive management and corporate service personnel.

VI. EFFECTS ON ELECTRIC SERVICE

Q. WHAT WILL BE THE EFFECT OF THIS TRANSACTION ON THE AVAILABILITY OF ELECTRIC SERVICE?

A. As discussed by witness Terry R. Horn, PNM Resources plans a sound capital structure for Cap Rock and NewCorp, and plans to properly fund the capital requirements of these companies. In addition, as stated above, PNM Resources plans no immediate changes in the operational structure of Cap Rock and NewCorp. As a result, this transaction will not adversely affect the availability of electric service to Cap Rock customers.

Q. WHAT WILL BE THE EFFECT OF THIS TRANSACTION ON THE QUALITY AND RELIABILITY OF ELECTRIC SERVICE?

For the same reasons stated in response to the previous question, PNM Resources does not anticipate any significant changes in the quality or reliability of service as a result of this transaction. I have attached as Exhibit JNW-4 the System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI) for TNMP for the last 5 years. These figures show that TNMP has consistently had high reliability during this period. Over time, after applying best practices from PNM Resources and its subsidaries, Cap Rock and NewCorp should see continued improvement in reliability as a result of the proposed transaction.

TNMP is committed to bringing best transmission and distribution operating practices to Cap Rock and NewCorp to ensure that quality and reliability of electric service are as good as possible.

VII. CONCLUSION

Q. WHAT ACTION DO THE APPLICANTS PROPOSE THAT THE COMMISSION TAKE IN THIS PROCEEDING?

A. Applicants are requesting the Commission issue an order that approves the transaction, permit the merger of PNM Sub with CRHC, finds that the transaction is in the public interest, and gives Applicants authority to close the transaction after all other regulatory approvals have been received and the closing of the sale of PNM gas business has closed.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

J. NEAL WALKER

EDUCATION BACKGROUND AND BUSINESS EXPERIENCE

Neal Walker is currently the Vice President of Operations at Texas-New Mexico Power Company. Mr. Walker graduated from Texas Christian University in 1989 with a Bachelor's Degree in Business Administration. He graduated from LeTourneau University in 1995 with a Master's Degree in Business Administration. He has also completed executive education courses at Darden Graduate School, University of Virginia, and Texas Christian University. Mr. Walker has been employed by TNMP since 1990. He has worked at TNMP as a Contracts and Regulatory Projects Analyst, Pricing Analyst, Regulatory Affairs Specialist, Area Manager in Nocona/Olney, Business Unit Manager in North Texas and Lewisville, and Director of Customer Operations. In 2005, Mr. Walker was promoted to Vice President of Operations. In this capacity he is responsible for overall TNMP operations and engineering, Retail Electric Provider relations and customer service, and community relations.

TNMP and Cap Rock Service Territories

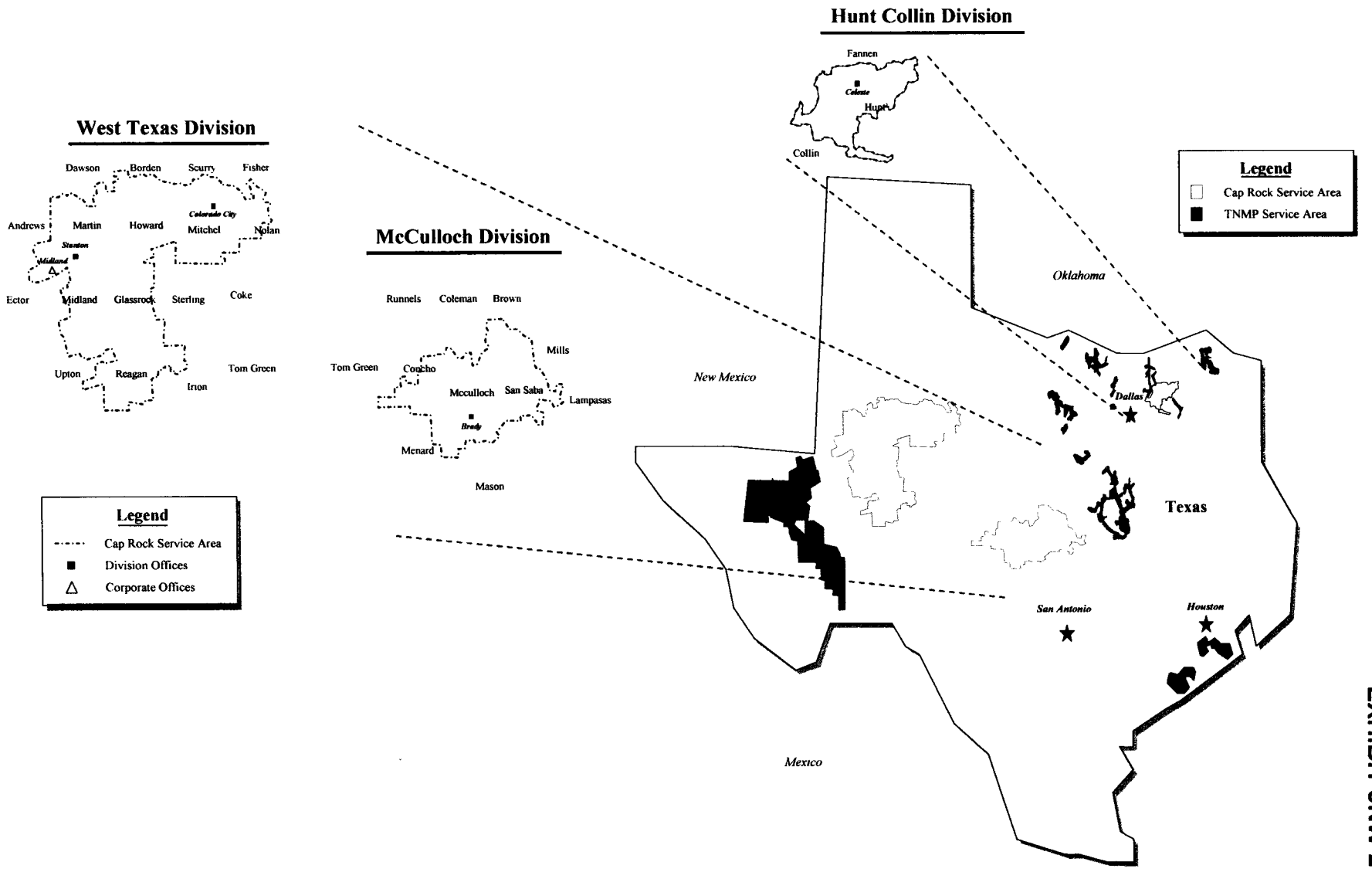
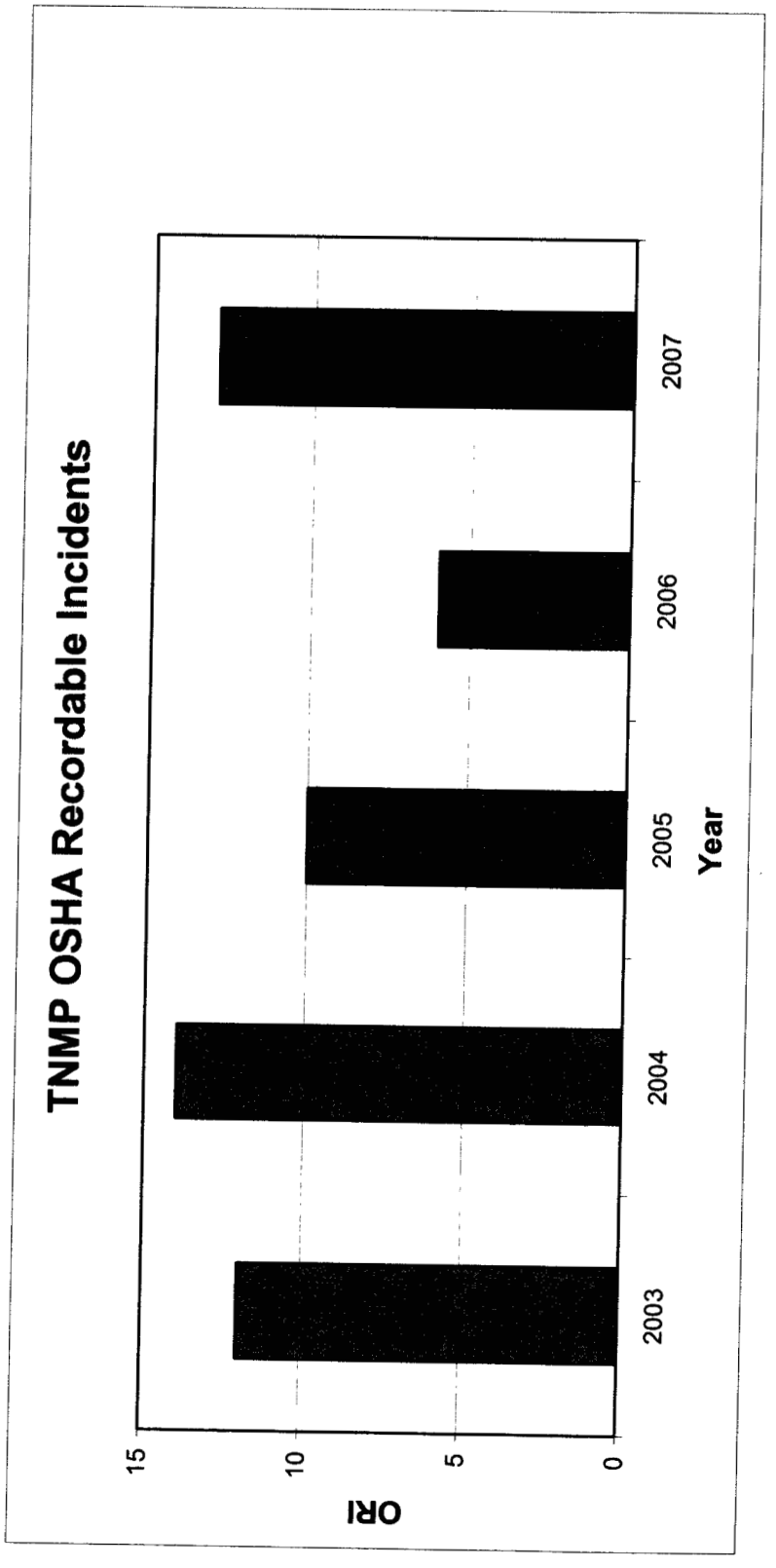
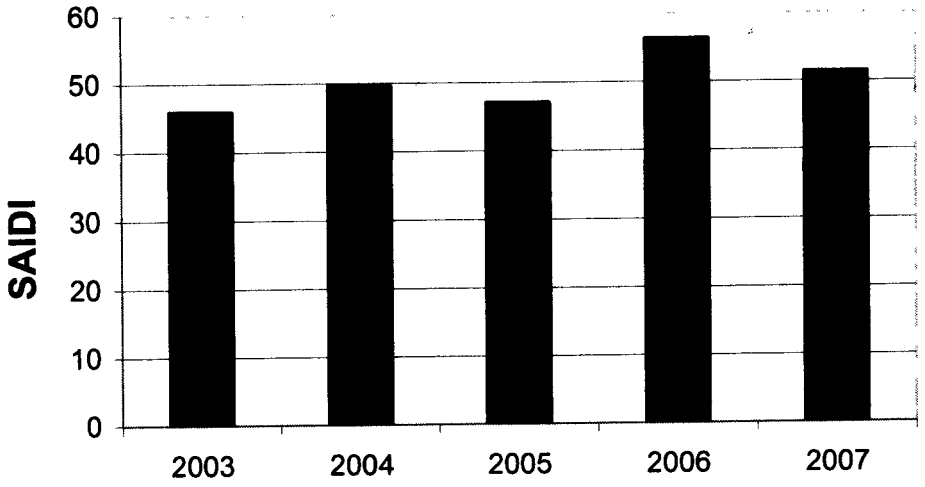


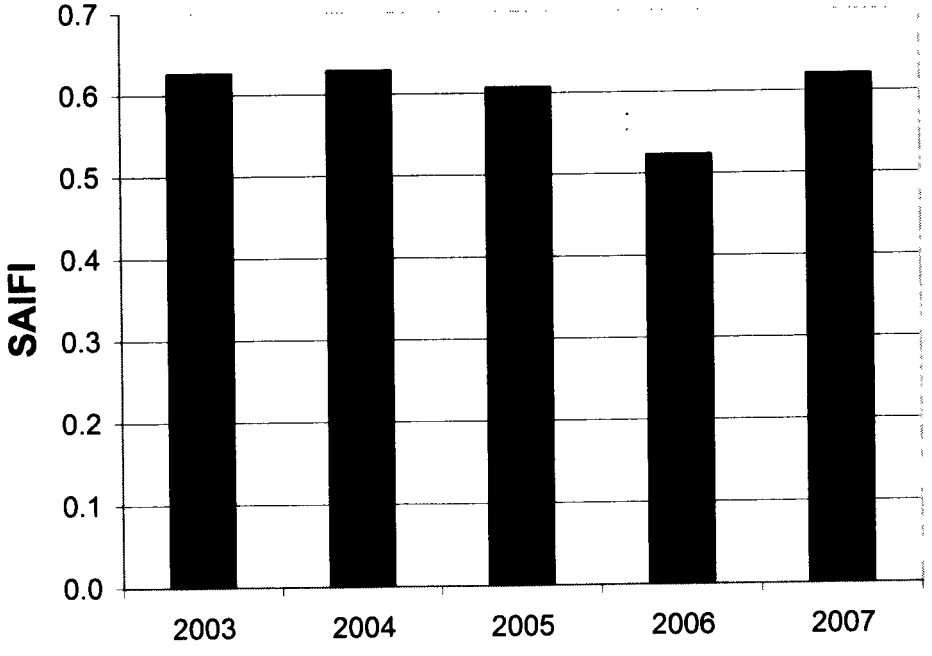
EXHIBIT JNW-2


TNMP OSHA Recordable Incidents
ORI
15
10
5
0
2003
2004
2005
2006
2007
Year

TNMP System Average Interruption Duration Index (SAIDI): FORCED



TNMP System Average Interruption Frequency Index (SAIFI): FORCED



SAIDI – Average amount of time service was disrupted
SAIFI – Average number of times service was disrupted

AFFIDAVIT

STATE OF NEW MEXICO §
§
COUNTY OF BERNALILLO §

BEFORE ME, the undersigned authority, on this day personally appeared J. Neal Walker, who, upon proving his identity to me and by me being duly sworn, deposes and states the following:

"My name is J. Neal Walker. I am of legal age, a resident of the State of Texas, and have never been convicted of a felony. I certify that the foregoing direct testimony and exhibits, offered by me on behalf of PNM Resources, Inc. and PNM Merger Sub, LLC, are true and correct and based upon my personal knowledge and experience."

J. Neal Walker
J. NEAL WALKER

SWORN TO AND SUBSCRIBED before me, Notary Public, on this 28th day of February, 2008, to certify which witness my hand and seal of office.

SEAL:

F. Celestina Blair
NOTARY PUBLIC in and for the
State of ~~Texas~~ New Mexico

Printed Name F. Celestina Blair
My Commission expires 04·06·08

EXHIBIT 8

PUC DOCKET NO. _____

BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS

PETITION OF
PNM RESOURCES, INC.
AND
CAP ROCK ENERGY CORPORATION
REGARDING PROPOSED MERGER AND ACQUISITION OF STOCK

PREPARED DIRECT TESTIMONY AND EXHIBITS
OF
TERRY R. HORN

ON BEHALF OF
PNM RESOURCES, INC.

MARCH 14, 2008

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I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND PLACE OF EMPLOYMENT.

A. My name is Terry R. Horn. I serve as the Vice President of Treasury for PNM Resources, Inc. My business address is Alvarado Square, Albuquerque, NM 87158.

Q. WHO DO YOU REPRESENT IN THIS FILING?

A. I represent PNM Resources, Inc ("PNM Resources") and its subsidiary PNM Merger Sub, LLC ("PNM Sub").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. Exhibit TRH-1 describes my background and experience, including proceedings in which I have provided testimony.

Q. WHO ARE THE APPLICANTS IN THIS PROCEEDING?

A. The applicants are PNM Resources and Cap Rock Energy Corporation ("Cap Rock"), collectively referred to as "Applicants".

Q. HAVE YOU PREPARED ANY EXHIBITS?

A. Yes. I am sponsoring Exhibits TRH-1 through TRH-4, which are attached to my testimony. Each of these exhibits was prepared by me or under my direction and control. The information contained in these exhibits is true and correct to the best of my knowledge and belief.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I will serve as the financial witness for PNM Resources in this proceeding. I will cover the following in my testimony.

1. I will discuss the transaction between PNM Resources and Cap Rock Holding Corporation ("CRHC").
2. I will discuss the valuation and reasonableness of the transaction.
3. I will discuss any tax consequences as a result of the transaction.

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III. THE TRANSACTION

Q. CAN YOU PLEASE DESCRIBE THE MECHANICS OF THE TRANSACTION THAT IS THE SUBJECT OF THIS PROCEEDING?

A. PNM Resources will acquire ownership of all outstanding common stock of Cap Rock. PNM Resources will pay $202.5 million in cash to Continental, the parent of CRHC and Cap Rock. The transaction is not a straight stock purchase, but is a business combination wherein PNM Resources' subsidiary PNM Merger Sub, LLC will merge into CRHC. Under the terms and conditions set forth in the merger agreement, CRHC will survive as a PNM Resources subsidiary and PNM Sub will cease to exist as a separate entity. CRHC will continue to hold 100% of the outstanding common stock of Cap Rock. Cap Rock will thereafter be a subsidiary of PNM Resources. The closing of the Cap Rock transaction is contingent upon the sale of Public Service Company of New Mexico's ("PNM") natural gas operations to New Mexico Gas Company, a newly formed subsidiary of Continental.

Q. PLEASE DESCRIBE HOW PNM RESOURCES WILL FINANCE THE TRANSACTION AND WHAT CAPITAL STRUCTURE CAP ROCK WILL HAVE AFTER THE CLOSE OF THE TRANSACTION.

A. The purchase price for CRHC, subject to adjustments at closing, is $202.5 million as negotiated in an arm's-length transaction between PNM Resources and Continental. PNM Resources will most likely use $202.5 million of its cash to consummate the purchase. This would temporarily result in a capital structure of 100% equity for CRHC and its subsidiaries. Shortly thereafter, Cap Rock would issue approximately $120 million of debt, or 60 percent (60%) of its capitalization. The proceeds of that debt issuance would be paid as a dividend to PNM Resources to compensate for the debt component of acquisition funding provided by PNM Resources. Once that transaction is complete, the resulting capital structure for Cap Rock would be 60 percent debt and 40 percent equity.[1]

Q. DO YOU BELIEVE THAT PNM RESOURCES HAS PAID A FAIR AMOUNT FOR CRHC?

[1] *Petition of Public Utility Commission of Texas (Staff) to Inquire into the Reasonableness of the Rates and Services of Cap Rock Energy Corporation,* PUC Docket 28813, Final Order dated August 5, 2005, FOF 62A – "It is appropriate for Cap Rock to move to a more balanced capital structure."

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A. Yes. The price was arrived at through arm's-length bargaining between unaffiliated parties. PNM Resources had access to valuation methods such as comparable sales, market comparables, discounted cash flow analysis, intrinsic value and other information we deemed appropriate to consider in order to arrive at the price we were willing to pay.

Q. DID PNM RESOURCES SEEK AN OUTSIDE REVIEW OF THE TRANSACTION?

A. Yes. JPMorgan reviewed the transaction and issued a letter which is attached as Exhibit TRH-3.

Q. WILL THE COMPLETION OF THE TRANSACTION HAVE ANY TAX CONSEQUENCES TO PNM RESOURCES, INCLUDING ANY ISSUES TO ANY OF THE AFFILIATED ENTITIES IN TEXAS?

A. No, the transaction will not have any tax consequences to PNM Resources or any of the affiliated entities. From a tax perspective, this transaction is similar to PNM Resources' acquisition of Texas-New Mexico Power Company.

IV. CONCLUSION

Q. WHAT ACTION DO THE APPLICANTS PROPOSE THAT THE COMMISSION TAKE IN THIS PROCEEDING?

A. Applicants are requesting the Commission issue an order that approves the transaction, permits the merger of PNM Sub with CRHC, finds that the transaction is in the public interest, and gives Applicants authority to close the transaction after all other regulatory approvals have been received and the sale of the PNM gas business has closed.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

EDUCATIONAL AND PROFESSIONAL SUMMARY

Name: Terry R. Horn

Address:
PNM Resources, Inc.
Alvarado Square MS 2702
Albuquerque, NM 87158

Educational Experience:
MBA - Finance, University of Houston - 1977
BBA - Finance/Economics, NMSU - 1974

Business Experience:

PNM Resources/Public Service Company of New Mexico

Vice President and Treasurer
January 2008 - Present

Vice President, Strategic Planning and Development
August 2007 – January 2008

Vice President, Customer and Market Services
February 2006 – July 2007

Vice President, Corporate Secretary & Acting CFO
August 2005 – January 2006

Vice President, Treasurer and Corporate Secretary
March 2005 – August 2005

Vice President and Treasurer
December 1998 – February 2005

Director of Financial Management and Assistant Treasurer
February 1991 – December 1998

Manager, Financing Projects
April 1990 - February 1991

Financing Project Manager
November 1985 - March 1990

Texaco, Inc.

Supervisor Information Systems/Staff Analyst
1984 through 1985

Senior Analyst - 1983 through 1984
Analyst - 1981 through 1983
Senior Accountant - 1980 through 1981
General Accountant - 1977 through 1980
Accountant - 1975 through 1977
Jr. Accountant - 1975

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