Energy Associates, L.P. (BEA), submitted a modified bid, proposing a 216 MW qualifying facility cogeneration project in the conventional supply-side category. Southwestern selected it as one of the winning bids.

Need

15. In the NOI proceeding, Docket No. 13827, the Commission reviewed and accepted Southwestern's load forecast and determined that it was reasonably likely that Southwestern had a capacity shortfall that created a long-term need for the 203 MW NOI project in 1998.

16. The QF contract will meet the need identified in Southwestern's NOI for the Phillips rate base cogeneration project.

17. For the NOI proceeding, Southwestern used a May 25, 1994 forecast.

18. Southwestern conducted two forecasts for this proceeding: the December 26, 1996 forecast filed with this case (1996 forecast) and its latest July 10, 1997 forecast (1997 forecast).

19. In developing all forecasts, including the NOI forecast, Southwestern used the Autoregressive Integrated Moving Average (ARIMA) model, which is based on historical energy usage to project future energy needs.

20. All forecasts include only firm retail and wholesale loads that SPS is contractually obligated to serve. Using the ARIMA forecast model, Southwestern makes assumptions such as growth rate, system load factors, and annual losses.

21. Southwestern currently includes a 15 percent planning reserve margin in its forecasts. This margin is required by the Southwest Power Pool (SPP).

22. The SPP allows a minimum reserve margin of 15 percent only if a probability study demonstrates that the expectation of load exceeding capability is not greater than one

occurrence in ten years. If a utility cannot so demonstrate. it is required to have an 18 percent reserve margin.

23. If Southwestern was required to have an 18 percent planning reserve margin, this would increase its generation capacity need by 115 MW.

24. Southwestern may not be able to meet its reserve margin if it does not acquire additional capacity and a single contingency occurs. The largest single contingency on Southwestern's system is the loss of its Tolk station, a 540 MW coal-fired plant.

25. Southwestern's 1996 and 1997 forecasts reflect the change in Golden Spread's contract with Southwestern from a full-requirements customer using approximately 620 MW to a partial-requirements customer using about 220 MW.

26. In response to Staff's testimony, Southwestern also produced modified 1996 and 1997 forecasts that adopted, for comparison, some of Staff's suggestions. Southwestern incorporated into both forecasts: (1) Golden Spread's updated July 1997 forecast; (2) the removal of 53 MW of post-2001 load related to Southwestern's wholesale partial-requirements contract with Texas-New Mexico Power Company; and (3) the removal of 10 MW of supplemental wholesale sales to Lubbock Power & Light Company. Even with these adjustments, the modified forecasts demonstrate a long-term need for additional capacity.

27. Southwest adjusted its 1996 forecast by exogenously adding 150 MW, based on the impact of new irrigation customers. additional center-pivot irrigation systems, and conversions from internal combustion engines to electric motors with the installation of new Low Energy Precision Application (LEPA) irrigation systems.

28. The 1997 forecast is a draft forecast, which has not been fully approved by Southwestern management.

29. In the 1997 forecast, SPS ran the ARIMA forecast model using only Southwestern's native system load, with a 66 percent load factor. For this forecast, Southwestern included a 100 MW exogenous irrigation load adjustment.

30. In the 1997 forecast, Southwestern's load data assumptions and adjustments to the ARIMA model appear reasonable.

31. Although the 1997 forecast predicts a need for future capacity, which increases in the long term, the need for the years 1999 through 2001 is less than that of the proposed project.

32. Although some variations exist in the exact MW shortfalls depicted in the 1996 and 1997 forecasts, both forecast show a long-term need for a capacity resource which the QF contract will provide.

33. Southwestern's import capability is declining from 100 MW to 59 MW in the Southwestern Power Pool (SPP) system, due chiefly to rising loads on the Southwestern system and in Oklahoma.

34. According to the data underlying the 1997 forecast, Southwestern has an interruptible load of approximately 480 MW for the year 1998, decreasing slowly to 240 MW by the year 2006.

35. Southwestern's interruptible load is available as a short-term resource to meet system peak needs.

36. Southwestern demonstrated a need for capacity that is reasonably consistent with the need shown in the NOI proceeding.

FERC QF Approval

37. According to Federal Energy Regulatory Commission (FERC) regulations, a facility qualifies as a QF if it meets FERC's operating and efficiency standards over the course of

the first 12 months of operation. It does not need to meet those standards on the first day of operation.

38. It is likely that BEA will obtain QF certification of the facility before the commercial operation date.

39. Southwestern's obligation to buy power from BEA is contingent on BEA securing QF certification from the FERC before commercial operation.

Solicitation and QF Selection

40. Southwestern conducted a solicitation to determine whether it could buy more cost-effective resources to meet its capacity needs.

41. In accordance with the NOI order in Docket No. 13827, before proceeding with its solicitation, Southwestern afforded the Commission's Staff an opportunity to review and comment on a draft of the solicitation. Staff proposed 12 revisions in response to its review.

42. After receiving Staff's comments, Southwestern revised the request for proposals (RFP), addressing all concerns raised by Staff.

43. The utility used an independent evaluator, Hagler Bailly, to assist in the solicitation's design, prepare the RFP bid package, screen the bids, recommend a short list of bidders, and conduct a detailed analysis of the best and final offers.

44. Hagler Bailly designed the solicitation to have five separate RFPs rather than a massive single request. Each RFP solicited a different resource type: supply-side, renewable, off-system purchase, demand-side management (DSM), and interruptible load.

45. On March 4, 1997, Hagler Bailly recommended the following short list bids: two supply-side proposals (Entergy and LS Power); one renewable resource proposal (Zond); one off-system transaction (Enron); seven DSM bids (Financial Energy Management,

NORESCO, Onsite Energy-baseload, Onsite Energy-peaking, Planergy/Quixx, Tamal Energy Services, and UCONS); and one interruptible load proposal (Planergy).

46. The low number of supply-side bidders may have resulted from Southwestern's low avoided costs, the short time frame for the development of resources, and an RFP issued by neighboring utility, Golden Spread.

47. Southwestern selected the short-listed bidders and then notified them that the solicitation would be delayed pending the outcome of Docket No. 15100, the Golden Spread proceeding pending before the Commission.

48. After a review of the Golden Spread settlement in Docket No. 15100, on December 16, 1996, Southwestern issued a revised request for a best and final offer through an addendum.

49. The addendum included the following information:

a) Southwestern would not pursue a certificate of convenience and necessity for the NOI units.

b) Southwestern's affiliate, Quixx, had teamed with LS Power and would be bidding in the best and final offer stage.

c) Southwestern required a January 10, 1997 deadline for best and final offers.

50. Neither Quixx nor LS Power viewed any bids before submitting its bid. All bids and reports from Hagler Bailly provided to Southwestern were confidentially maintained in Southwestern's Strategic Analysis Department.

51. The specific criteria used in the evaluation of resources was applied consistently and fairly to all bidders.

52. Quixx and LS Power did not receive preferential treatment.

53. Many provisions in the QF contract protect ratepayers. The limit placed on the capacity shortfall payments is reasonable given the other QF provisions that pressure BEA to deliver the committed capacity.

54. Phillips Petroleum Company (Phillips), the steam host, has a very substantial need for efficiently produced steam for its refinery operations and is entering a long-term contract with BEA to purchase steam. Phillips has been at the QF facility site for approximately 70 years with a remote possibility of moving.

55. In negotiating the QF contract with BEA, Southwestern sought to minimize the risk of losing the steam host by increasing Southwestern's ability to buy excess capacity beyond the contractual bid amount.

56. The QF cogeneration facility can produce 216 MW during the peak summer months; however, it is capable of producing up to 239 MW during the cooler off-peak months.

57. Under the QF contract, SPS is able to purchase any excess energy for a price equal to 95 percent of Southwestern's avoided energy costs until a $10 million escrow amount is funded. After reaching that amount, the price for energy above and below 216 MW is the same.

58. Some risk allocation between Southwestern and BEA is appropriate to the overall negotiation of the QF contract.

The QF Contract

59. The average total purchase price in 1999 under the QF contract is $0.0280 per kilowatt (kWh), which is 16 percent less than the NOI cogeneration unit cost of $0.0331.

60. The contract's payments are below SPS's avoided costs, as compared to the cogeneration plant approved by the Commission in the NOI proceeding.

61. The QF contract requires BEA to offer the facility to SPS for purchase in the event BEA does not want to retain ownership.

62. The QF contract has an initial term of 25 years. Southwestern is requesting Commission certification for 15 years.

62A. SPS is willing to accept an order certifying the QF contract with a limitation that the certification may not serve as a basis for recovery of stranded cost, if any, associated with the QF contract, if and when such recovery becomes appropriate.

Different Loads and Need

63. Southwestern is a fully integrated and multi-jurisdictional electric utility. It serves its retail and full-requirements and partial-requirements wholesale customers from its portfolio of resources.

64. The BEA QF contract will be used to serve Southwestern's overall needs.

65. Southwestern's customer mix is essentially the same as the mix that existed during the NOI proceeding.

PCRF

66. It is appropriate for Southwestern to recover the capacity and fixed operation and maintenance costs of the QF contract through its purchased power cost recovery factor (PCRF) and the energy payments through its fixed fuel factors.

67. Southwestern will allocate cost recovery through the PCRF to the various jurisdictions and classes in the same manner as it allocates the embedded costs of it's generation facilities.

Potential for Stranded Costs

68. The capacity contracted for in the QF agreement represents approximately five percent of Southwestern's total capacity.

69. The QF contract provides a guaranteed unit heat rate value of 7,000 Btu/net kWh. This guaranteed heat rate is more efficient than Southwestern's existing system average heat

rate of 10,000 Btu/kWh. Accordingly, Southwestern will be able to back off older, less efficient units.

70. The contract allows reduced capacity payments if the unit's rolling average availability falls below 95 percent at peak months or 92 percent for off-peak. This provision shifts the risk of unit performance to BEA.

71. Southwestern has the right to demand retests of the facility's capacity if it fails to operate at 80 percent of its capability for six consecutive weeks.

Long-Term and Short-Term Needs

72. Hagler Bailly evaluated the risks associated with long-term versus short-term resources in two ways. First, it used a resource optimization model, PROVIEW, which modeled "generic" future resources that could be built after short-term resources, thereby supplementing small resources in comparison to the larger ones when addressing Southwestern's capacity needs. Second, the analysis focused on near-term benefits in determining the resources that should be included in SPS' recommended portfolio.

73. Southwestern, through its independent evaluator, Hagler Bailly, adequately assessed the risks of long-term versus short-term supply-side resources.

Fuel Pricing Risks

74. Hagler Bailly performed natural gas and coal price sensitivities and concluded that the fuel pricing mechanisms included in the solicitation's final recommended portfolio had a reasonably low risk.

75. The natural gas price forecast presented by Southwestern is reasonable and should be adopted as the forecast used to evaluate the QF contract.

76. Southwestern's natural gas contract with GPM Gas Corporation is reasonable.

77. The QF contract's future fuel price risk is similar to the fuel price risk of other Southwestern plants fueled by natural gas.

Other Issues

78. Southwestern conducted an all-source solicitation for alternatives to the NOI units. One specific RFP targeted renewable resources and another DSM. An independent evaluator reviewed the bids and concluded that no renewable resources could cost effectively meet any portion of the need for capacity.

79. The QF contract between Southwestern and BEA is an affiliate transaction. BEA is a limited partnership comprised of Quixx and LS Power. Quixx is an affiliate of Southwestern.

79A. BEA is a single-purpose entity and, as such, will not provide electric power and energy to others. Therefore, the price to SPS is not higher than the prices charged by Quixx to its other affiliates or divisions or to a nonaffiliated person for the same item or class of items.

80. Based on the foregoing findings of fact, the QF contract is reasonable and necessary and should be certified.

B. Conclusions of Law

1. Southwestern is a public utility as defined in §31.002 of PURA.

2. The Commission has jurisdiction over this case pursuant to PURA §§ 14.001, 31.001, 36.007, 36.207, 35.062-35.066, 36.058, 36.208, 34.003-34.173, 36.008, and 36.204.

3. SOAH has jurisdiction over all matters relating to the conduct of a hearing in this proceeding, including the preparation of a proposal for decision with findings of fact and conclusions of law, pursuant to TEX. GOV'T. CODE ANN. §2003.049.

4. Southwestern provided notice that substantially complied with P.U.C. SUBST. R. 23.37(d) and 23.31(c) and P.U.C. PROC. R. 22.55.

5. Pursuant to PURA §35.065(b) and (c) and by agreement of Southwestern, the Commission must make a determination by October 31, 1997 or the QF contract certification is considered granted.[14]

6. Southwestern's solicitation substantially complied with P.U.C. SUBST. R. 23.31(c)(5)-(8).

7. All proposed utility resource additions are governed by the integrated resource planning (IRP) requirements of PURA §§ 34.003-34.173, 36.008, and 36.204. Accordingly, Southwestern's request for approval of the QF contract lies within the intent of PURA §34.153.

8. Southwestern has demonstrated that it has satisfied the criteria set forth in PURA §34.153, and that the QF contract is exempt from other IRP requirements found in PURA.

9. Southwestern's application to certify its QF contract, filed under PURA §35.062, meets the requirements of PURA §35.064.

10. Pursuant to PURA §36.208, a payment made to a QF under an agreement certified under PURA, Subchapter C, Chapter 35, is considered a reasonable and necessary operating expense of the electric utility during the period for which the certification is granted, to the extent such payment is consistent with the terms and conditions of the certified QF contract.

11. Pursuant to PURA §36.058, the Commission may allow a payment to an affiliate upon a finding that such payment is reasonable and necessary.

12. Having met the requirements of PURA §35.064, the Commission is required to certify the QF contract.

[14] In the Commission's open meeting on October 22, 1997, Southwestern agreed to extend the jurisdictional deadline from October 24, 1997 to October 31, 1997.

VI. Ordering Paragraphs

1. Southwestern Public Service Company's application for certification of a qualifying facility purchased power contract pursuant to §§ 35.061-35.066 and 36.208 of the Public Utility Regulatory Act is approved.

2. Southwestern shall file with the Commission proof of certification with the FERC at least 30 days before the date of commercial operation.

2A. In consideration of the position of Southwestern, as stated in Finding of Fact No. 62A, certification of the QF contract shall not serve as a basis for recovery of future stranded costs, if any, associated with the QF contract, if and when such recovery becomes appropriate.

2B. Southwestern's administration of the performance-based affiliate QF contract may be reviewed, consistent with the terms and conditions of the QF contract, in a future rate, fuel or other appropriate proceeding to ensure the reasonableness and necessity of the future payments to be made under the contract; however, the terms and conditions of the QF contract shall not be subject to future review.

3. All other motions, application, or other requests for relief not expressly granted in this Order are denied.

SIGNED AT AUSTIN, TEXAS the 30th day of October, 1997.

PUBLIC UTILITY COMMISSION OF TEXAS

PAT WOOD, III, CHAIRMAN

JUDY WALSH, COMMISSIONER