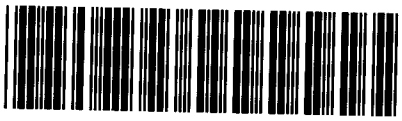

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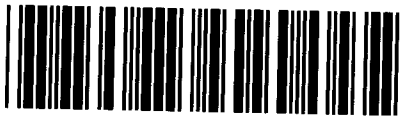

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PROJECT NO. 37897

PROCEEDING RELATED TO RESOURCE AND RESERVE ADEQUACY AND SCARCITY PRICING	§ § § §	**BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS**

COMMENTS OF TOPAZ POWER GROUP

Topaz Power Group ("Topaz")[1] hereby files these comments in response to the Public Utility Commission of Texas ("Commission") request regarding the proposed solutions to the pricing impacts of the deployment of reserve capacity in the ERCOT market.

The Commission has requested responses to specific questions. Topaz's comments herein, accordingly, will address all four questions.

1. Proposals to introduce an offer floor into the market for the procurement of NSRS have ranged from about $72 to $3000. How would the different offer floors on the Non-Spinning Reserve Service scenarios impact wholesale electricity prices?

There is broad consensus that an offer floor for NSRS awarded resources will help to mitigate the price reversals that have dampened real-time wholesale prices. During peak months, the price reversal timeframe became predictable as NSRS deployments generally occurred in the mid-afternoon as the ERCOT market approached peak and ERCOT operators saw available

[1] Topaz is the owner/operator of three Power Generation Companies in Texas: Barney M. Davis, LP; Laredo WLE, LP; and Nueces Bay WLE, LP. Topaz has 2,779 MW of generating capacity under management including the newly acquired 778 MW portfolio of gas-fired power generation facilities strategically located in northeast United States competitive power markets.

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capacity to meet increasing load rapidly declining. The predictability of the reversals also lead to day-ahead price suppression.

Correlating the price dampening impact of the NSRS deployments to pricing beyond day-ahead would be pure speculation, given all of the inputs to the derivation of those curves. However, because these price reversals happen during the peak hours of the day; the impact on generator revenues has been severe especially on peakers, since the reversals are most prevalent during the periods when peakers rely on consistent prices and are most needed for reliability.

With regard to the proposals, Topaz is in agreement with the consensus items: RUC for system capacity should be offered at the system wide offer cap ("SWCAP"); Responsive Reserve & Regulation Up service awards portion of the Energy Offer Curve should also be offered at the SWCAP; ERCOT should deploy NSRS in increments smaller than a 1000MW; prices should be at SWCAP when ERCOT deploys load resources or EILS; and online units and Quick Start Generation Resources ("QSGR") with NSRS awards should be offered in SCED and deployed by SCED.

However, when it comes to the floor for energy offers during NSRS award intervals, it is important to bear in mind that the options under review have impacts not just on prices but on revenues. Although often the price for energy prior to NSRS deployments was significantly higher than some of the scenarios under discussion, floors set too high may have significant negative impacts on revenues.

For example, a floor at the SWCAP exposes generators to extreme risk if a unit trips unexpectedly during an NSRS deployment. Replacement costs for the energy could be catastrophically high with no reasonable way for the generator to mitigate that risk.

Further, while the concept of an offer floor is a quick way to institute change, it may have a significant impact on online units and QSGR energy deployments during intervals when NSRS has been awarded. A higher floor would result in significantly less deployments than a lower floor, and these revenue impacts must be factored in the NSRS offer prices to reflect the opportunity costs.

Topaz would prefer a system change trigger rather than floors in the energy offer curve to enable more efficient energy offers while correcting the reversal during NSRS deployments. However, if the only option to correct the price reversal is a floor, then Topaz believes the floor should be high enough to reflect the true cost to respond to a projected shortfall in reserves, while preserving the pricing signals that preceded the NSRS deployment. The floor must strike an appropriate balance to set a price level that reflects the shortfall in reserves that necessitated the NSRS deployment. To enable immediate implementation, Topaz supports the compromise proposal, which proposes an energy curve for the online units and QSGRs from $250 to $1000, and $1000 to $3000 for the offline units.

However, given the potential revenue impacts of reduced energy deployments for QSGRs, an automatic system-wide price adjustment mechanism that triggers upon NSRS deployments to employ an energy-curve that increases from the last price before deployment to the SWCAP and

permits efficient energy offers is an important and necessary system change for future implementation.

2. Do the NSRS proposals address the price dampening impact of the current NSRS deployment methodology?

As long as the floor is sufficient to mitigate price reversals, Topaz believes that the proposals will address the price dampening when combined with the consensus items referenced above. Given the severity of the problem, Topaz believes that the compromise solution is a reasonable interim solution.

3. What impact would the NSRS proposals have on future contribution to the Peaker Net Margin?

Setting aside the other market impacts that influence the Peaker Net Margin, the NSRS proposals should increase the Peaker Net Margin. There are differences of opinion on the net contribution to Peaker Net Margin if the change had been implemented from the start of 2011 to the end of August 2011. Topaz concurs with the assumption that only considered the NSRS deployment for capacity hours where the NSRS capacity sets price and excluded the February 2nd event and 1st week of August. This would lead to an approximate additional contribution to Peaker Net Margin as follows:

Floor	NSRS deployment for capacity hours where the NSRS capacity sets price and excluded the February 2nd event and 1st week of August	Total PNM as of 10/13 with NSRS proposal implemented
$72	$2,815	$121,350
$180	$7,038	$125,573
$250	$9,775	$128,310
Compromise Curves	$23,104	$141,639
$650	$25,415	$143,950
$1,000	$39,100	$157,635
$2,000	$78,200	$196,735
Average	$26,492	$145,027

4. Is the Peaker Net Margin trigger working to incent new development? If not, why not?

The Peaker Net Margin is a retrospective determination of the revenue adequacy of the market in a given year. The Peaker Net Margin is not an indicator of future market performance. It is a report on the actual market results for the historical period. Developers, like Topaz[2], look to market fundamentals to determine the best investment opportunities. These fundamentals include fuels costs, capacity/demand, environmental conditions, regulatory stability, forward pricing, cost of construction and more. The ERCOT market has been significantly weaker than expected since 2008. It has not provided the stability, certainty or predictably needed to incent investment in capacity additions. In fact, given the extreme market conditions in 2011, it would have been reasonable to expect that the revenue adequacy for 2011 should have been closer to the $175,000 level.

Further, because the Peaker Net Margin is the determinant that resets the SWCAP from the HCAP ($3000) to the LCAP ($500); one could argue that after years of not meeting the threshold of $175,000 that a reset in a single "revenue adequate" year could exacerbate the long-term revenue shortfall. Although this can only be a theoretical argument, Topaz believes that the Commission should consider adjusting the mechanism to look at rolling five-year revenue adequacy so as not to impair long-term revenue adequacy.

[2] Topaz completed construction to build a new peaking facility in Laredo in 2008 and to convert two existing power plants in the Corpus Christi area to more efficient combined-cycle technology in 2010. The projects were financed and hedged in 2008 prior to the collapse of the financial markets.

It is important to note that new development is only one leg of the stool that ensures resource adequacy in a market. Maintenance of existing generation, creating economic opportunities for underutilized or mothballed capacity, load response and capacity additions, whether new plants or enhancements to existing plants, are all required to ensure long-term resource adequacy in a well-functioning market. In ERCOT, we have been seeing more capacity exit the market than enter; in a over-built market this could be a reaction to market fundamentals, but combined with the declining reserves in ERCOT, this would seem to be an indicator of a fundamental flaw in the revenue adequacy of the market.

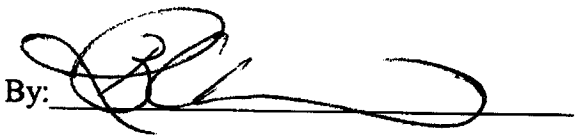
The energy-only market is great in theory, but has been uncertain in practice. The ERCOT market requires a developer to believe in the possibility of high price spikes. However, it is difficult to get banks to finance "possibility". The fundamental problem is cash flow volatility, which in the current financial market is untenable to investors. Tradable five year load obligations to meet prospective demand may be a long-term solution to correct the revenue adequacy problem and ensure a reliable future. Topaz believes five years should be considered to mitigate the problems in the eastern markets where some longer lead technologies like clean coal and nuclear have not been incented to enter. Clearly, this market change requires significant discussion but given the current conditions, Topaz believes that the time is right to open the dialogue.

5. What relationship does the Peaker Net Margin have to forward prices?

As stated above, the Peaker Net Margin is an indication of past performance and does not drive forward prices. Rather expectations regarding weather, capacity/demand, fuel costs and how the

operators, regulators and market participants will react to expected conditions drive forward prices.

Respectfully submitted,

By: 

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