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PROJECT NO. 40268

PUC RULEMAKING TO AMEND PUC SUBST. R. §25.505, RELATING TO RESOURCE ADEQUACY IN THE ELECTRIC RELIABILITY COUNCIL OF TEXAS (ERCOT) POWER REGION	**PUBLIC UTILITY COMMISSION OF TEXAS**

INITIAL COMMENTS OF DIRECT ENERGY TO THE PROPOSAL FOR PUBLICATION OF AMENDMENTS TO SEC. 25.505 AS APPROVED AT THE APRIL 12, 2012 OPEN MEETING

Direct Energy appreciates the opportunity to comment on the Commission's Proposal for Publication in this rulemaking, which is the most important rulemaking facing the Commission today in terms of its impact on the competitive wholesale and retail markets in Texas. Direct Energy fully supports the Commission's efforts to create a market design that will consistently provide adequate reserves while sustaining the viability of competitive wholesale and retail markets. A successful market design must consistently deliver adequate and reliable supply at a reasonable cost. The Brattle Group has provided a thorough study and report (Brattle Report), which going forward becomes an important resource in the discussions among market participants and other stakeholders on what actions are needed to achieve the Commission's resource adequacy objectives. Direct Energy continues to review the Brattle Report and Direct Energy's responses to the questions at this time will be brief. Direct Energy reserves the right to file reply comments addressing other parties' initial comments.

QUESTION 1: Should the sequence of changing the high system-wide offer cap (HCAP) increase at a different rate and over a different period? For example, are any of the following cases preferable to that proposed in the rule? Whatever is ultimately determined to be the appropriate HCAP, should the increase be in one or two steps, rather than three or four? Should the specific year for each increase or the specific date of June 1 for the increase each year be changed? If so, what should be the effective date of each change?

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	Raise the HCAP to:	Effective before the summer of:
Proposed Rule	$5,000	2013
	$7,000	2014
	$9,000	2015
Case 1	$4,000	2013
	$5,000	2014
	$6,000	2015
Case 2	$4,500	2013
	$6,000	2014
	$7,500	2015

RESPONSE:

In an energy only market structure, Direct Energy believes the primary compensation opportunity for generation comes from scarcity induced price signals. Scarcity pricing is a function of frequency, duration, and level of price. The regulatory changes implemented over the last several months have been primarily focused on the frequency and duration of scarcity pricing in the ERCOT market. The level of scarcity pricing also is a critical component of scarcity pricing and Direct Energy supports the Commission reviewing whether the current HCAP should increase. In determining the level of the HCAP, the Commission must balance the need to provide generation an opportunity to earn a return on investment and the need for the market to deliver competitive prices.

Direct Energy believes the HCAP may need to increase above $4500 per MWh in order to incentivize generation investment and demand response that will consistently meet the reliability target. However, Direct Energy is concerned that significantly higher HCAPs could expose retailers and consumers to unnecessary volatility that would lead to inefficient high prices for consumers and unstable wholesale and retail markets. Extreme volatility could lead to a high risk of default by market participants leading to cost exposure for ERCOT market participants and POLR risk for retail electric providers.

Direct Energy shares the concerns expressed in the Brattle Report in regard to the increased risk of default as a result of higher offer caps, and urges the Commission to address in separate proceeding(s) whether or not all Commission Substantive Rules adequately address the risk created by increasing the HCAP including the POLR rules. For these reasons, Direct Energy does not have a final opinion as to the appropriate increase to the HCAP at this time.

QUESTION 2: Is the use of the peaker net margin (PNM) method described in the rule the appropriate mechanism to measure resource adequacy in an energy-only market? If not, what should replace it? Should the PNM trigger amount be the cost of new entry (CONE) or a multiple of the CONE as determined by ERCOT? Should the trigger causing the system-wide offer cap to be reset to the low system offer cap be based on a calendar year or a rolling 12-month period, or should the use of the mechanism be based on hitting the trigger for a single year, or for multiple years? Should variability in the weather be taken into consideration in determining whether the PNM trigger is met?

RESPONSE:

Direct Energy believes the PNM trigger and the LCAP should increase, but does not have a final opinion as to the appropriate level. The PNM should be set at a level that does not interfere with the natural boom and bust cycle of revenue returns, and investors must have an expectation that recovering revenues from lean years is possible without hitting the PNM trigger. The PNM trigger should only serve as a protection from major market failures.

QUESTION 3: How long would it take market participants to adjust their financial exposure to the proposed amendments? Will these changes affect liquidity in the ERCOT market? If so, how? Will financial counterparties in hedging

arrangements continue to be willing to participate, and if so, at what cost, if the HCAP is increased significantly? Would there be any difference if changes were made over a shorter or longer period of time?

RESPONSE:

Direct Energy believes the answers to these questions are primarily driven by the level of regulatory certainty. The Commission needs to make the remaining decisions regarding resource adequacy this year and then allow the market an opportunity to transact with regulatory certainty. If market participants know the regulatory environment with certainty, then market participants can adjust their financial exposure to the proposed amendments quickly. If the ERCOT market knows the regulatory environment with certainty, then liquidity likely will follow.

QUESTION 4: Should the HCAP ultimately go to $12,000 or $15,000, and if so, over what time period? If the HCAP is raised to these levels, should the energy from the various ancillary services deployed by ERCOT be priced at the same amount, or should ERCOT procure different amounts of these services?

RESPONSE:

As stated in the response to Question 1, Direct Energy is concerned that a significant increase in the HCAP level may actually have an adverse affect by increasing the risk profile to a level that requires capital that the industry can't consistently support. Inadequate capital resources in a market with extreme volatility could lead to under-collateralized risk that exposes market participants to cost exposure due to market participant defaults. Direct Energy believes the Commission should direct ERCOT to examine the level of capital necessary to participate in a market design with a significantly higher HCAP and determine whether or not ERCOT's current credit policies adequately collateralize the risk due to a significantly higher HCAP.

CONCLUSION

Direct looks forward to continuing to work with the Commission, ERCOT, and other stakeholders to develop and implement the necessary changes needed to achieve the Commission's resource adequacy objectives.

Respectfully submitted,

By: ______________________

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