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July 8, 2003

Honorable Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Room 1-A209
Washington, D.C. 20426

Re: Docket No. ER03-647-000 – New York Independent System Operator, Inc.

Dear Secretary Salas:

For filing, please find the Answer of the New York State Public Service Commission in the above-entitled proceeding. Should you have any questions, please feel free to contact me at (518) 473-8178.

Very truly yours,

David G. Drexler
Assistant Counsel

Attachment

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.	) Docket No. ER03-647-000)

ANSWER OF THE NEW YORK STATE PUBLIC SERVICE COMMISSION TO THE MOTION FOR CLARIFICATION OF KEYSPAN-RAVENSWOOD, LLC

Pursuant to Rule 213 of the Federal Energy Regulatory Commission’s (FERC or Commission) Rules of Practice and Procedure, the New York State Public Service Commission (NYPSC) hereby submits its Answer to Keyspan-Ravenswood, LLC’s (KeySpan) Motion for Clarification.

INTRODUCTION AND SUMMARY

On May 20, 2003, the Commission issued an Order Conditionally Accepting For Filing Tariff Revisions (Order) that incorporates a Demand Curve into the New York State Independent System Operator Inc.’s (NYISO) Installed Capacity (ICAP) market. The Demand Curve sets a price buyers pay for ICAP, which varies with the amount of capacity available at a given price. As more or less capacity is offered, the price paid per kilowatt (kW) gradually decreases or increases accordingly. The Commission’s Order also eliminated the Supplemental Supply Fee, which would have paid generators a price above the Demand Curve if the NYISO experiences a deficiency.

In a Motion for Clarification (Motion) filed on June 23, 2003, KeySpan requested that the Commission clarify that "if the NYISO requires additional capacity" to meet the New York State Reliability Council's (NYSRC) 118% minimum reserve requirement, then the NYISO must "procure this capacity at prices in excess of the Demand Curve clearing price."[1] By requesting that payments during a deficiency may exceed the Demand Curve, KeySpan would have the Commission reverse its Order, which rejected the Supplemental Supply Fee.[2] As the Commission found, "[r]emoving the Supplemental Supply Fee will reduce the incentive for generators to withhold capacity from the ICAP auction."[3] KeySpan's proposal would allow the same potential for withholding to occur as the Commission found with the Supplemental Supply Fee.

KeySpan is incorrect in suggesting that payments above the Demand Curve will ensure reliability. In actuality, providing payments above the Demand Curve, no matter how high, will not address a shortage of physical capacity in a transmission constrained area, such as New York City, given the lengthy lead time necessary to build generation. Moreover, KeySpan suggests

[1] KeySpan Motion at 7.

[2] Order at ¶67.

[3] Id.

that such high payments are necessary to send a proper signal for new investment. However, the Demand Curve is based on the cost of financing new capacity, with appropriate offsets for expected revenues from energy and ancillary services markets, thereby sending proper signals to investors.

Finally, KeySpan inappropriately suggests that payments above the Demand Curve should be permitted when market abuse is not present. Not only is KeySpan's proposal void of any indication of what constitutes market abuse but it has the disadvantage of inviting potential disputes over when mitigation is warranted. The Demand Curve minimizes these shortfalls. As such, the Commission should deny KeySpan's Motion.

DISCUSSION

I. KeySpan's Proposal Would Encourage Generators To Withhold Their Capacity

Sellers exercise market power by withholding supply. Withholding is accomplished either via a reduction in the amount of capacity that participates in the market (physical withholding) or via the pricing of a portion of one's capacity so high as to price it out of the market (economic withholding). Either of these actions could drive the market price up enough to make it profitable for the withholding generator.

The Demand Curve approach features a slope that is gradual enough to mitigate the ability to profitably withhold capacity.

A sufficiently graduated slope can keep any such price rise small enough that generating firms, even large ones, will find it unprofitable to withhold. In other words, the extra revenues a generator would receive from its supply that remains in the market should not exceed the lost profits associated with its supply that is withheld from the market.

The minimum requirements established for reliability, however, provide sellers with an opportunity to profitably withhold, since the NYISO may be forced to purchase much of the withheld capacity anyway via supplemental purchases after the Spot Auction. KeySpan's proposal to give additional payments to generators would thereby reduce the protection that the Demand Curve provides against withholding. The Commission properly recognized "the potential for capacity withholding when the system does not clear to meet the 118% minimum" and thus rejected the Supplemental Supply Fee. The Commission should affirm its decision and reject KeySpan's proposal to provide payments above the Demand Curve if there is a deficiency.

II. The Commission's Order Will Not Sacrifice Reliability

The Commission properly determined that the Demand Curve price represents the maximum amount that loads should pay to achieve reliability. KeySpan's Motion argues that reliability may be sacrificed if the NYISO cannot purchase the "additional capacity required for reliability at above Demand Curve clearing prices," namely, at the deficiency charge.[4] However, the existence of a cap on ICAP payments is not new. In fact, KeySpan's proposal allows the same potential for obtaining less capacity than the minimum reserve requirements. If there is insufficient physical capacity to meet minimum reliability requirements in transmission-constrained localities, such as New York City, then there will be a shortage of ICAP. Higher capacity payments will not immediately resolve a shortage, due to the lengthy lead-time needed to bring new generation on-line. To avert shortages, new investments must be signaled well in advance of an actual shortage. The Demand Curve approach should help attract new investments by signaling reserve margin shortages in advance through gradually increasing capacity prices. KeySpan's proposal would not address reliability concerns, but rather, could provide a windfall to existing generators.

III. KeySpan's Proposal Incorrectly Suggests Payments Above The Demand Curve Are Necessary For New Investment

KeySpan's Motion suggests that the investments necessary to bring additional capacity, such as Special Case Resources, to the market "may cost in excess of the Demand Curve clearing price for a number of legitimate reasons but still be below the

[4] KeySpan Motion at 5.

Supplemental Supply Fee.[5] KeySpan further claims that prices above the Demand Curve are especially important to procure this capacity "during the first two years of the Demand Curve while it is artificially set at below the cost of entry to ameliorate potential rate impacts."[6] According to KeySpan, this capacity should be allowed to recover its costs over "a single six-month procurement period."[7]

Contrary to these claims, the Demand Curve's reference price is based on the cost of financing new capacity, with appropriate offsets for expected revenues from energy and ancillary services markets, thereby reflecting the costs of necessary investments. Contrary to KeySpan's assertions, the Demand Curve for the first two years is based on preliminary estimates that may be greater or less than the actual costs of new entry, accounting for offsets. This solution represents a maximum amount that loads should pay to achieve reliability, regardless of whether the source is new long-term supply or Special Case Resources. Moreover, given that the Demand Curve prices for New York City are greater than the cap currently in place for NE-ISO, PJM, and the rest of New York State, raising

[5] KeySpan Motion at 6.

[6] Id. at 7.

[7] Id.

the price would simply reward economic withholding in the tight New York City market.

IV. **KeySpan Incorrectly Suggests That Existing Market Monitoring And Mitigation Measures Are Adequate**

KeySpan suggests that "if the NYISO requires additional capacity to meet NYSRC requirements, and it is offered and available at a reasonable price and within the market monitoring and mitigation measures, *i.e.*, the offer does not represent the abuse of market power, then the NYISO should procure the capacity necessary to meet reliability requirements."[8] However, the existing market monitoring and mitigation measures do not contain any specific measures to address market power abuse within the ICAP market. Moreover, KeySpan does not provide any specific indication of what criteria should be used to determine whether a bid in excess of the demand curve is "reasonable" and not an "abuse of market power." Thus, KeySpan's proposal has the disadvantage of inviting potential disputes over ICAP reference levels, which would be used in determining whether mitigation is warranted. The Commission's Order properly resolves this issue by limiting payments to the level provided by the Demand Curve.

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[8] KeySpan Motion at 7.

CONCLUSION

For all the reasons above, the Commission should deny KeySpan's Motion for Clarification.

Respectfully submitted,

Dawn Jablonski Ryman
General Counsel

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of the State of New York
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Dated: July 8, 2003
Albany, New York

CERTIFICATE OF SERVICE

I, Jacquelynn Nash, do hereby certify that I will serve on July 8, 2003 the foregoing Answer of the Public Service Commission of the State of New York by depositing a copy thereof, first class postage prepaid, in the United States mail, properly addressed to each of the parties of record, indicated on the official service list compiled by the Secretary in this proceeding.

Date: July 8, 2003
Albany, New York

Jacquelynn Nash