STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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March 7, 2002

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

Re: Docket No. EL02-59-000 – <u>Complaint of KeySpan Ravenswood vs. NYISO</u>

Dear Secretary Salas:

For filing please find the Notice of Intervention and Protest 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) 486-2652.

Very truly yours,

Saul A. Rigberg
Assistant Counsel

Enclosures

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

KEYSPAN-RAVENSWOOD, INC.	)	
	)	
v.	)	Docket No. EL02-59-000
NEW YORK INDEPENDENT SYSTEM	)	
OPERATOR, INC.	)	

NOTICE OF INTERVENTION AND PROTEST OF THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK

Pursuant to Rules 211 and 214 of the Commission's Rules of Practice and Procedure[1] and a Notice of Complaint dated February 20, 2002, the Public Service Commission of the State of New York (NYPSC) submits this notice of intervention and protest objecting to the proposed modifications contained in the *Complaint of KeySpan-Ravenswood, Inc. Requesting Limited Changes* to *In-City Installed Capacity Mitigation Measures and Request for Fast-Track Processing* (Complaint).

The NYPSC opposes any weakening of the current protections against the exercise of market power because the Unforced Capacity (UCAP) Market[2] in New York City is not workably competitive. Three generation firms together control about 62 percent of the supply

[1] 18 C.F.R. §§385.211 and 385.214.

[2] With the Commission's approval, the NYISO has recently begun operating an Unforced Capacity (UCAP) Market as a replacement for the traditional Installed Capacity (ICAP) Market. For the purpose of comparing prices, the distinction has little bearing.

in that market.[3] With this degree of concentration, prices would not be “just and reasonable” without the existing price cap applied to those generators. The proposed modifications, moreover, would exacerbate market power concerns in New York City by providing a perverse incentive to those three companies to reduce availability of essential in-City generation in order to realize higher UCAP prices.

Copies of all correspondence and pleadings should be addressed to:

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KEYSPAN'S COMPLAINT

KeySpan-Ravenswood (KeySpan) requests the Commission to make two significant changes to the Open Access Transmission Tariff (OATT) administered by the New York Independent System Operator, Inc. (NYISO) in regards to the UCAP Market in New York City (in-City). First, KeySpan would have the Commission eliminate the price cap component on in-City UCAP sales that applies to the divested generation assets of Consolidated Edison (Con Edison), leaving only the bid cap component so that the three purchasers of

[3] 62% based on ICAP data; use of UCAP data would lead to a similar result.

these assets (KeySpan, Orion, and NRG; collectively, Divested Generation Owners) would be paid the market clearing price even if that price exceeds their bid cap.[4]

Second, KeySpan is seeking the elimination of the existing ban on bilateral sales of in-City UCAP by Divested Generation Owners to in-City load serving entities (LSEs). KeySpan asserts that these two modifications would reduce volatility, improve the efficiency of the in-City UCAP market, and ensure that "the appropriate resources" are constructed and maintained.

BACKGROUND

Buying and selling of a product in a market that is not workably competitive can result in unjust and unreasonable market power prices. Knowing that the companies that purchased the three bundles of Con Edison's generating assets would control about 5,700 MW of the approximately 8,500 MW New York City Locational ICAP requirement and that ICAP supplies are often tight, especially in the summer months, the NYPSC included mitigation measures in its order authorizing the sale of Con Edison's assets.[5]

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[4] The bid cap component sets the ceiling for all bids by owners of divested generation, whereas the price cap limits prices paid to those owners.

[5] *In the Matter of Consolidated Edison Co. of New York, Inc.'s Plans for (1) Electric Rate/Restructuring Pursuant to Opinion No. 96-12; and (2) the Formation of a Holding Company Pursuant to PSL §70, §108 and §110, Certain Related Transactions*, Case 96-E-0897 (July 21, 1998).

The Commission later approved these measures[6] to address concerns that the purchasers of the assets "might be able to exercise localized market power due to the current configuration of loads, generation, and transmission facilities in New York City and related in-City local reliability rules and transmission constraints."[7]

To ensure reliability, each LSE in the NYISO Control Area is required to procure UCAP in advance of each monthly Obligation Procurement Period in amounts equal to its UCAP requirement set by the NYISO. An LSE that does not satisfy this requirement is assessed a Capacity Deficiency Charge, which is currently $164.12/KW/year for UCAP.[8]

Because of this purchase requirement to ensure reliability, and in light of the dominant market position of the Divested Generation Owners as pivotal market players, carefully crafted mitigation measures are required to prevent the exercise of market power. First, KeySpan, Orion, and NRG must bid all of the UCAP resources they purchased from Con Edison into the NYISO

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[6] *Consolidated Edison Co. of New York, Inc.*, 84 FERC ¶ 61,287 (1998).

[7] Con Edison FERC Electric Schedule No. 199 at 1.

[8] The Capacity Deficiency Charge, which in ICAP terms is $150/KW/year, effectively serves as an upper limit on auction market prices in that no reasonable LSE would bid above the deficiency charge.

administered auctions. The purpose of this requirement is to formally prohibit physical withholding.

Second, the Divested Generation Owners are also subject to both a bid and price cap on UCAP sales. The price they receive is capped at the bid cap level, currently $112.95/KW/year, regardless whether the market-clearing price paid to non-mitigated generators is above the bid cap. The ICAP bid cap was initially based on a Capacity Reference Price of $105/KW/year, a figure derived from the average embedded cost of the four Con Edison bundles.[9] Since the most expensive bundle, comprising the Waterside Generation Station and the East River Generating Station assets were not sold, the $105 figure was about 15% above the embedded cost of the three bundles Con Edison did sell.

Whereas the bid cap is designed to prevent economic withholding, the price cap removes any incentive to seek loopholes in the bid requirement or bid cap. This is the case because the price cap removes the financial incentive from physical withholding on the part of the Divested Generation Owners that might have the effect of raising the market-clearing price above the bid cap. The Divested Generation Owners can receive no more than the capped price and thus may actually lose revenues if they

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[9] This amount was subsequently translated to $112.95/KW/year to accommodate the NYISO’s conversion to a UCAP market design.

physically withhold by, for instance, not maintaining units according to good utility practice.

Third, all LSEs pay to the NYISO the market-clearing price, which non-divested owners receive from the NYISO. The money above the cap that is not distributed to the Divested Generation Owners is rebated to all New York City LSEs in proportion to their UCAP requirement. Fourth, the Divested Generation Owners may not enter into bilateral contracts so as to avoid circumvention of the cap through ancillary arrangements.

In practice, because of the tightness of the market and the concentration of resources, the $112.95 annual price cap ($9.41 on a monthly basis) is not only a ceiling on the price the Divested Generation Owners can receive, but generally serves as a floor. Regardless of the time of year and the amount of UCAP needed, market clearing prices in the six-month strip auctions (which account for more than 80 percent of the auction sales) are at or very close to the $9.41 figure.

DISCUSSION

I. KEYSPAN'S PROPOSAL SHOULD BE REJECTED BECAUSE THE IN-CITY ICAP MARKET IS NOT WORKABLY COMPETITIVE.

KeySpan claims that the in-City ICAP market is workably competitive. Complaint at 5, 11. New entry has occurred, as KeySpan points out, and the NYISO does expect sufficient capacity for Summer 2002. However, such capacity is not a certainty and, in any event, the New York City Market continues to display non-competitive attributes.

According to a recent NYISO publication,[10] the current total in-City ICAP supply is 8,944 MW and the total in-City locational requirement is 8,532 MW, leaving a supply margin of only 412 MW. Suppliers include KeySpan with 2,149 MW accounting for a 24 percent market share, Orion with 2001 MW and a 22 percent market share, and NRG, holding a 16 percent market share with 1,457 MW. Thus, some of each of KeySpan's, Orion's, and NRG's capacity must be used to meet demand and each of the Divested Generation Owners is a pivotal market player as defined by the Commission in a recent order.[11] Absent mitigation measures, therefore, each of these owners would have the unlimited ability to set the market-clearing price.

Moreover, an analysis of the prices resulting from the NYISO's 2001 in-City ICAP auctions establishes that the UCAP market is not competitive even with new generation. The weighted average of six-month strip and monthly prices (using ICAP numbers) for the summer auctions was $8.81/MW/month. This average market-

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[10] "Locational Installed Capacity Requirement Study," dated February 28, 2002.

[11] *Order on Triennial Market Power Updates and Announcing New, Interim, Generation Market Power Screen And Mitigation Policy,* 97 FERC ¶ 61,219 (November 20, 2001). Again, each of these owner's capacity amount exceeds the supply margin.

clearing price was six cents above the $8.75/MW/month price cap of the Divested Generation Owners. For the winter 2001-2002 auctions, when cool temperatures create an increased supply, the weighted average of the six-month strip and monthly prices (using UCAP numbers) was $9.01/KW/month, just $.40 below the cap. Until there is a significant excess of UCAP greater than the amount of mitigated ICAP controlled by KeySpan, Orion, or NRG, so that the cap does not function as a price floor, each one of these pivotal players, absent appropriate mitigation, is in a position to exercise market power.

II. KEYSPAN'S MODIFICATIONS WOULD HARM THE UCAP MARKET, INCREASE PRICES, AND JEOPARDIZE RELIABILITY.

A. Eliminating The Price Cap Could Encourage Physical Withholding And Discourage New Capacity Investment By KeySpan, NRG, and Orion.

KeySpan is incorrect for several reasons in claiming that a bid cap coupled with a requirement to bid, but without a price cap, would provide complete protection against the exercise of market power. First, the proposal would allow the pivotal players to receive up to $164.12/KW/year, the level of the Capacity Deficiency Charge, as compared to $112.95/KW/year, as that higher number becomes attainable by the divested generators.[12]

[12] This would occur because, as explained above, there is a cap on the Capacity Deficiency Charge, assessed on LSEs that do not satisfy their ICAP requirements set by the NYISO, above which no LSE would pay.

Second, eliminating the price cap and relying on only a bid cap does not preserve protection against the exercise of market power. While the bid cap prevents economic withholding, it does not prevent physical withholding, which can be just as effective in raising prices. Merely requiring the units to bid does not ensure against physical withholding in the new UCAP market. Because the amount of UCAP each generator can sell depends on that generator's availability, UCAP quantity is subject to manipulation by suppliers. Suppliers with market power have a perverse incentive to reduce availability (for example, by more forced outages and slower repairs, situations almost impossible for the NYISO or the Commission to monitor, as was learned in California); the lower availability will translate into less UCAP supplied, thus driving up the market price.

Similarly, at the current, very high UCAP prices in both summer and winter, which are the highest prices for ICAP/UCAP in the country, there is a strong incentive for KeySpan, Orion, and NRG to add capacity. However, if the price cap were eliminated, this incentive would be severely restricted or even reversed for incumbents with generation already taking advantage of these prices. Indeed, if the rules permitted the market-clearing price to be obtained for all of their UCAP, the Divested Generation Owners would have an incentive not to add new capacity in order to keep supplies tight and preserve high UCAP prices.

B. Allowing Bilaterals Under Current Market Conditions May Lead To Negative Unintentional Consequences.

The NYPSC restricted ICAP bilateral contracts at the time of the sale of the Con Edison assets because of the concern that the price cap feature of bilateral could be circumvented. Because LSEs were required to purchase a set amount of ICAP supply that was constrained and likely to clear at prices well above the price cap, we were concerned that if LSEs entered into private negotiations with one of the Divested Generation Owners for ICAP both parties would have incentive to circumvent that cap. For instance, in a tight or deficient market, in which ICAP obtained via the auction process would be expected to cost an LSE $164.12 (the deficiency charge under UCAP), rational LSEs would be willing to enter a bilateral with a UCAP provider at any price lower than $164.12.[13] Therefore, both the divested owners and the LSEs realize the divested owners have the upper hand in the $112.95 to $164.12 range because the UCAP is worth about $164 to the LSEs.

The result may be that ancillary transactions would be entered into that may provide for, as an example, the purchase of energy at an inflated price as part of an implicit arrangement by which the LSE would purchase UCAP from KeySpan, Orion, or NRG in a

[13] This is the case because the LSEs’ alternative to a bilateral is to buy UCAP in the in-City UCAP auction, which would likely clear at $164.12 in a deficient market.

bilateral for $112.95, so as not to appear to exceed the cap.[14] This is an unstable environment that invites improper behavior on the part of both buyers and sellers as a way of sidestepping the $112.95 cap on bilateral sales.[15]

III. KEYSPAN PROVIDES NO SUPPORT FOR ITS CLAIM THAT UCAP REVENUES ARE INADEQUATE.

Implicit in KeySpan's observation that by lifting the price cap "Divested Generation Owners will be better able to recover fixed costs from ICAP revenues" (Complaint at 12) is the suggestion that ICAP revenues have been inadequate. KeySpan provides no factual support for its claim that it cannot recover its fixed costs under the current rules. With regard to this claim, the NYPSC urges Commission staff to analyze both sales and revenue data for KeySpan, Orion, and NRG in the possession of the NYISO and cost data in our possession.

Moreover, the Divested Generation Owners factored these very rules, which were known to all at the time, into their calculation of the value of the Con Edison assets at auction. The rules served to limit the forecast of potential net revenues that could

[14] Without the price cap, of course, under tight market, conditions the bilateral price would rise towards $164.12 deficiency charge.

[15] In a workably competitive market, KeySpan is correct that permitting bilateral transactions would provide greater price certainty and reduce the volatility of UCAP auctions. Complaint at 13. The NYPSC agrees that modifications may be appropriate regarding the prohibition against bilaterals once market-clearing prices are observed to occur at prices that consistently are below the bid cap.

be received by the purchaser of the assets, and because a purchaser would factor that limitation in its purchase offer, Con Edison's shareholders and ratepayers received less for the assets than they would have without that limitation. Removing the price cap at this time, would, therefore, provide a windfall to the Divested Generation Owners while reducing their incentive to building new generation, as noted above.

CONCLUSION

For all of the reasons expressed above, the NYPSC objects to the proposals of KeySpan to modify the Mitigation Measures while the in-City UCAP Market remains non-competitive.

Respectfully submitted,

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Dated: March 7, 2002
Albany, New York

CERTIFICATE OF SERVICE

I, Karen Houle, do hereby certify that I will serve on March 7, 2002, the foregoing Notice of Intervention and Protest 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: March 7, 2002
Albany, New York

Karen Houle