

Issues with Keyspan Proposal to Apply the \$105 Revenue cap on an Annual Basis

The proposal is complex to administer and could create disincentives to Generators. Because there are multiple auctions that a Divested Generation Owner (DGO) can sell their capacity into, the Monthly Revenue Cap mechanism would depend on each owner's individual bidding strategy. The decision of how to bid generation into individual auctions can greatly impact the revenues that a generator receives. If the owner had built up a credit in prior months (because they had already sold capacity in an auction with a clearing price higher than the Revenue Cap), they may no longer have an incentive to maximize subsequent revenues (since they would be entitled to a credit if their subsequent revenues were less than the cap). Consider the April 2002 capacity market that had clearing prices ranging from \$9.40/kw/month down to \$4.25: a generator with enough credits banked from the summer would be indifferent whether they sold at \$4.25 or \$9.40 because the difference would be paid by all NYC LSEs.

The funding mechanism for the Monthly Revenue Cap Adjustment would make it impossible for an LSE to hedge their capacity positions. When the Monthly Revenue Cap Adjustment provides additional payments to DGOs, all NYC LSEs would pay for it through what amounts to a capacity uplift charge. Since this charge would be assessed on all LSEs (not just those that purchased capacity from the DGOs), it would discourage LSEs from hedging their capacity positions. Consider an LSE that entered into a physical bilateral contract from unmitigated generation (e.g. Special Case Resources) or a CFD with a DGO at a fixed price: the capacity uplift charge would increase the LSE's costs and make the hedge ineffective.

The Monthly Revenue Cap Adjustment would lead to inefficient economic decisions – In months when the Monthly Revenue Adjustment was applied, it could lead to uneconomic selection of capacity suppliers because, including the capacity uplift cost, LSEs would be paying a rate higher than the posted clearing price even though they may have had more cost effective alternatives.

In-City LSEs would not know their capacity costs until after the capability year was over – Under the second Keyspan example (labeled “Starting negative revenue month”), an LSE that purchased capacity in an auction for less than the revenue cap would be at risk for paying an additional uplift charge later in the year. This creates uncertainty for LSEs which will ultimately result in higher retail costs and could even encourage retail LSEs to return customers to the utility whenever the Monthly Revenue Cap Adjustment was expected to result in capacity uplift in the upcoming months.

The Monthly Revenue Cap Adjustment proposal does not address other related market rules – The existing mitigation rules are applied to an LSE that purchase mitigated capacity in a strip or multi-month auction and then resells that capacity in a subsequent auction. It is unclear how to provide comparable treatment to an LSE that makes a forward purchase of mitigated capacity and subsequently resells it.

The Monthly Revenue Cap Adjustment proposal will create new financial incentives for DGOs and could create new Market Monitoring concerns – The shape of the in-City demand curve presumes that the DGOs have no incentive to withhold capacity since they have a revenue cap. However, if they under-collect relative to the revenue cap in one month, the Monthly Revenue Cap Adjustment would provide additional compensation if a subsequent auction clears above the price cap. This means that, on an incremental basis, a DGO can benefit if an auction clears above the price cap and therefore may have a financial incentive to withhold capacity and/or decreasing availability.