SUMMARY OF FINDINGS REGARDING PROPOSED CHANGES TO THE NYISO IN-CITY CAPACITY MARKET

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Background: Mitigation History

- New York City LSEs must buy capacity in the City equal to 80 percent of peak load
- In 1998, Con Ed sold the majority of in-City generation to three DGOs
- Prior to sale, ConEd Requested DGO mitigation that required that all capacity be offered into the NYISO auction market, with price and bid caps of $105/kW-year (based on existing rate base value); bilateral physical sales were banned. FERC approved the mitigation, recognizing that a purpose was to provide value to ConEd and revenue certainty to buyers
- In 2003 the demand curve was introduced. For the City, the demand curve is very steep – going to zero with a surplus of about 1500 MW

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Background: Market Performance

- As expected by all parties and the Commission, the ability of DGOs to bid at the cap has resulted in capacity prices near the $105/kw-year cap
- Because the cap price is below the cost of new entry, virtually no new merchant capacity has been built for the market and, until this year, the NYC capacity situation has remained very tight
- ConEd and NYPA added over 1,000 MW of new capacity via self-build or long term PPA, which came on line this year. Despite the increase in supply, the capacity price has stayed near $105/kW-year

ConEd/NYPSC Proposals

- These parties proposed, and the BIC approved, a modification to the existing mitigation that effectively would require all in-City generators (not just DGOs) to bid at "reference prices" of going-forward cost net of energy and ancillary service margins
- Because such net prices are low or negative, the result would be that the demand curve sets the price where total physical capacity crosses it. In 2006, this price would be about $31/kW-year compared to the deemed cost of new entry of $126/kW-year.
- Other DGO mitigation (e.g. the price cap and sales restrictions) would continue
- The new proposal is simply to reduce the DGO bid cap to about $82/kW-year

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The Monopsony Problem

- **Large buyers who are relatively insulated from competitive pressure via the ability to pass through actual acquisition costs can save substantial amounts by acquiring capacity outside of the market and bidding it into the market as a price taker**
  - For example, if the demand curve sets the price, a 6,000 MW LSE can save nearly $60/kW-year for every kW that it purchases outside the NYISO NYC capacity market. This means that it can reduce its costs substantially even if it pays above-market prices to create entry
  - This results in a two-tiered market with contracted-for new capacity getting entry costs and existing capacity materially lower prices
  - No capacity will be built for the market; all capacity will be bought outside the market by these few LSEs
- **This problem is not unique to the NYC market**

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Revenue Adequacy in the NYC Capacity Market

- **Even assuming that the deemed cost-of-new-entry is adequate, the existing demand curve market is not revenue adequate unless new capacity is added in small amounts timed with precision to meet bare bones need**
  - DGO's current ability to bid at $105 only partially mitigates this inadequacy (albeit to a declining degree since the cap is fixed and eroded by inflation)
  - The BIC-approved joint proposal would remove this floor to prices and result in revenue inadequacy
  - The more recent joint proposal to reduce the floor to $82/kW-year would still result in revenue inadequacy because it is still less than the current mitigation
  - Monopsony purchases, price discrimination and the inability of the market to support entry will remain indefinitely under these proposals

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KeySpan’s Proposal

- **The long term solution is a forward market that is both revenue adequate and deals with market power issues**
  - New York stakeholder processes can build on the studies and designs of PJM and ISO-NE
  - It should take no more than 12 months to develop and 18 months to implement a forward market
- **If the market is changed on an interim basis, such changes should:**
  - Deal with monopsony market power, perhaps by setting a bid floor for resources acquired after the implementation of the demand curve
  - Lengthen the demand curve to reduce incentives for market power (reduce the slope)
  - Maintain DGO bid caps and must-offer requirements, but eliminate discriminatory restrictions (*i.e.*, lesser of bid or market price caps and bilateral sales restrictions)
  - Contingent on this package, KeySpan has indicated its willingness to revisit the level of the DGO bid cap

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