

UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,  
U.S. Department of Justice  
Antitrust Division  
450 5<sup>th</sup> Street, NW, Suite 8000  
Washington, D.C. 20530,

*Plaintiff.*

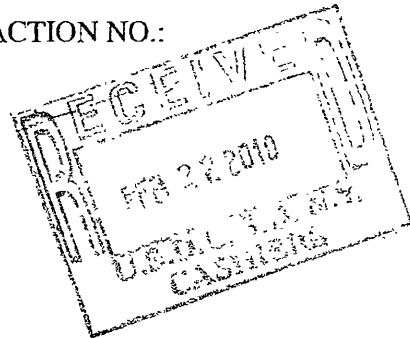
v.

KEYSPAN CORPORATION  
1 Metrotech Center  
Brooklyn, N.Y. 11201,

*Defendant.*

10 MAY 2010

CIVIL ACTION NO.:



**COMPLAINT**

The United States of America, acting under the direction of the Attorney General of the United States, brings this civil antitrust action under Section 4 of the Sherman Act, as amended, 15 U.S.C. § 4, to obtain equitable and other relief from defendant's violation of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1.

On January 18, 2006, KeySpan Corporation ("KeySpan") and a financial services company executed an agreement (the "Keyspan Swap") that ensured that KeySpan would withhold substantial output from the New York City electricity generating capacity market, a market that was created to ensure the supply of sufficient generation capacity for New York City consumers of electricity. The likely effect of the Keyspan Swap was to increase capacity prices for the retail electricity suppliers who must purchase capacity, and, in turn, to increase the prices

consumers pay for electricity.

## I. INTRODUCTION

1. Between 2003 and 2006, KeySpan, the largest seller of electricity generating capacity (“installed capacity”) in the New York City market, earned substantial revenues due to tight supply conditions. Because purchasers of capacity required almost all of KeySpan’s output to meet expected demand, KeySpan’s ability to set price levels was limited only by a regulatory ceiling (called a “bid cap”). Indeed, the market price for capacity was consistently at or near KeySpan’s bid cap, with KeySpan sacrificing sales on only a small fraction of its capacity.

2. But market conditions were about to change. Two large, new electricity generation plants were slated to come on line in 2006 (with no exit expected until at least 2009), breaking the capacity shortage that had kept prices at the capped levels.

3. KeySpan could prevent the new capacity from lowering prices by withholding a substantial amount of its own capacity from the market. This “bid the cap” strategy would keep market prices high, but at a significant cost – the sacrificed sales would reduce KeySpan’s revenues by as much as \$90 million a year. Alternatively, KeySpan could compete with its rivals for sales by bidding more capacity at lower prices. This “competitive strategy” could earn KeySpan more than bidding its cap, but it carried a risk – KeySpan’s competitors could undercut its price and take sales away, making the strategy less profitable than “bidding the cap.”

4. KeySpan searched for a way to avoid both the revenue decline from bidding its cap and the revenue risks of competitive bidding. It decided to enter an agreement that gave it a financial interest in the capacity of Astoria – KeySpan’s largest competitor. By providing KeySpan revenues on a larger base of sales, such an agreement would make a “bid the cap”

strategy more profitable than a successful competitive bid strategy. Rather than directly approach its competitor, KeySpan turned to a financial services company to act as the counterparty to the agreement – the KeySpan Swap – recognizing that the financial services company would, and in fact did, enter an offsetting agreement with Astoria (the “Astoria Hedge”).

5. With KeySpan deriving revenues from both its own and Astoria’s capacity, the KeySpan Swap removed any incentive for KeySpan to bid competitively, locking it into bidding its cap. Capacity prices remained as high as if no entry had occurred.

## **II. DEFENDANT**

6. KeySpan Corporation is a New York corporation with its principal place of business in New York City. During the relevant period of the allegations in this Complaint, KeySpan owned approximately 2,400 megawatts of electricity generating capacity at its Ravenswood electrical generation facility, which is located in New York City. KeySpan had revenues of approximately \$850 million in 2006 and \$700 million in 2007 from the sale of energy and capacity at its Ravenswood facility.

## **III. JURISDICTION AND VENUE**

7. The United States files this complaint under Section 4 of the Sherman Act, 15 U.S.C. § 4, seeking equitable relief from defendant’s violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

8. This court has jurisdiction over this matter pursuant to 15 U.S.C. § 4 and 28 U.S.C. § 1331 and 1337.

9. Defendant waives any objection to venue and personal jurisdiction in this judicial district for the purpose of this Complaint.

10. Defendant engaged in interstate commerce during the relevant period of the allegations in this Complaint; KeySpan’s electric generating units interconnected with generating units across the country, and KeySpan regularly sold electricity to customers outside New York.

11. One generation facility located in New Jersey supplies capacity to the New York City installed capacity market.

#### **IV. THE NEW YORK CITY INSTALLED CAPACITY MARKET**

12. Sellers of retail electricity must purchase a product from generators known as “installed capacity.” Installed capacity is a product created by the New York Independent System Operator (“NYISO”) to ensure that sufficient generation capacity exists to meet expected electricity needs. Companies selling electricity to consumers in New York City are required to make installed capacity payments that relate to their expected peak demand plus a share of reserve capacity (to cover extra facilities needed in case a generating facility breaks down). These payments assure that retail electric companies do not sell more electricity than the system can deliver and also encourage electric generating companies to build new facilities as needed.

13. The price for installed capacity has been set through auctions administered by the NYISO. The rules under which these auctions are conducted have changed from time to time. Unless otherwise noted, the description of the installed capacity market in the following paragraphs relates to the period May 2003 through March 2008.

14. Because transmission constraints limit the amount of energy that can be imported into the New York City area from the power grid, the NYISO requires retail providers of electricity to customers in New York City to purchase 80% of their capacity from generators in that region. The NYISO operates separate capacity auctions for the New York City region (also

known as “In-City” and “Zone J”). The NYISO organizes the auctions to serve two distinct seasonal periods, summer (May through October) and winter (November through April). For each season, the NYISO conducts seasonal, monthly and spot auctions in which capacity can be acquired for all or some of the seasonal period.

15. In each of the types of auctions, capacity suppliers offer price and quantity bids. Supplier bids are “stacked” from lowest-priced to highest, and compared to the total amount of demand being satisfied in the auction. The offering price of the last bid in the “stack” needed to meet requisite demand establishes the market price for all capacity bid into that auction. Capacity bid at higher than this price is unsold, as is any excess capacity bid at what becomes the market price.

16. The New York City Installed Capacity (“NYC Capacity”) Market constitutes a relevant geographic and product market.

17. The NYC Capacity Market is highly concentrated, with three firms – KeySpan, NRG Energy, Inc. (“NRG”) and Astoria Generating Company (a joint venture of Madison Dearborn Partners, LLC and US Power Generating Company, which purchased the Astoria generating assets from Reliant Energy, Inc. in February 2006) – controlling a substantial portion of generating capacity in the market. Because purchasers of capacity require at least some of each of these three suppliers’ output to meet expected demand, the firms are subject to a bid and price cap for nearly all of their generating capacity in New York City and are not allowed to sell that capacity outside of the NYISO auction process. The NYISO-set bid cap for KeySpan is the highest of the three firms, followed by NRG and Astoria.

18. KeySpan possessed market power in the NYC Capacity Market.

19. It is difficult and time-consuming to build or expand generating facilities within the NYC Capacity Market given limited undeveloped space for building or expanding generating facilities and extensive regulatory obligations.

## **V. KEYSpan'S PLAN TO AVOID COMPETITION**

20. From June 2003 through December 2005, KeySpan set the market price in the New York City spot auction by bidding its capacity at its cap. Given extremely tight supply and demand conditions, KeySpan needed to withhold only a small amount of capacity to ensure that the market cleared at its cap.

21. KeySpan anticipated that the tight supply and demand conditions in the NYC Capacity Market would change in 2006, due to the entry of approximately 1000 MW of new generation. Because of the addition of this new capacity, KeySpan would have to withhold significantly more capacity from the market and would earn substantially lower revenues if it continued to bid all of its capacity at its bid cap. KeySpan anticipated that demand growth and retirement of old generation units would restore tight supply and demand conditions in 2009.

22. KeySpan could no longer be confident that "bidding the cap" would remain its best strategy during the 2006-2009 period. It considered various competitive bidding strategies under which KeySpan would compete with its rivals for sales by bidding more capacity at lower prices. These strategies could potentially produce much higher returns for KeySpan but carried the risk that competitors would undercut its price and take sales away, making the strategy less profitable than "bidding the cap."

23. KeySpan also considered acquiring Astoria's generating assets, which were for sale. This would have solved the problem that new entry posed for KeySpan's revenue stream,

as Astoria's capacity would have provided KeySpan with sufficient additional revenues to make continuing to "bid the cap" its best strategy. KeySpan consulted with a financial services company about acquiring the assets. But KeySpan soon concluded that its acquisition of its largest competitor would raise serious market power issues.

24. Instead of purchasing the Astoria assets, KeySpan decided to acquire a financial interest in substantially all of Astoria's capacity. KeySpan would pay Astoria's owner a fixed revenue stream in return for the revenues generated from Astoria's capacity sales in the auctions.

25. KeySpan did not approach Astoria directly and instead sought a counterparty to enter into a financial agreement providing KeySpan with payments derived from the market clearing price for an amount of capacity essentially equivalent to what Astoria owned. KeySpan recognized the counterparty would need simultaneously to enter into an agreement with another capacity supplier that would offset the counterparty's payments to KeySpan, and KeySpan knew that Astoria was the only supplier with sufficient capacity to do so. KeySpan turned to the same financial services company that it had consulted about the potential acquisition of Astoria's assets. The financial services company agreed to serve as the counterparty but, as expected, informed KeySpan that the agreement was contingent on the financial services company also entering into an offsetting agreement with the owner of the Astoria generating assets.

## **VI. THE AGREEMENTS**

26. On or about January 9, 2006, KeySpan and the financial services company finalized the terms of the KeySpan Swap. Under the agreement, if the market price for capacity was above \$7.57 per kW-month, the financial services company would pay KeySpan the difference between the market price and \$7.57 times 1800 MW; if the market price was below

\$7.57, KeySpan would pay the financial services company the difference times 1800 MW.

27. The KeySpan Swap was executed on January 18, 2006. The term of the KeySpan Swap ran from May 2006 through April 2009.

28. On or about January 9, 2006, the financial services company and Astoria finalized the terms of the Astoria Hedge. Under that agreement, if the market price for capacity was above \$7.07 per kW-month, Astoria would pay the financial services company the difference times 1800 MW; if the market price was below \$7.07, Astoria would be paid the difference times 1800 MW.

29. The Astoria Hedge was executed on January 11, 2006. The term of the Astoria Hedge ran from May 2006 through April 2009, matching the duration of the KeySpan Swap.

#### **VII. THE COMPETITIVE EFFECT OF THE KEYSpan SWAP**

30. The clear tendency of the KeySpan Swap was to alter KeySpan's bidding in the NYC Capacity Market auctions.

31. Without the Swap, KeySpan likely would have chosen from a range of potentially profitable competitive strategies in response to the entry of new capacity. Had it done so, the price of capacity would have declined. By transferring a financial interest in Astoria's capacity to KeySpan, however, the Swap effectively eliminated KeySpan's incentive to compete for sales in the same way a purchase of Astoria or a direct agreement between KeySpan and Astoria would have done. By providing KeySpan revenues from Astoria's capacity, in addition to KeySpan's own revenues, the Swap made bidding the cap KeySpan's most profitable strategy regardless of its rivals' bids.

32. After the KeySpan Swap went into effect in May 2006, KeySpan consistently bid



its capacity at its cap even though a significant portion of its capacity went unsold. Despite the addition of significant new generating capacity in New York City, the market price of capacity did not decline.

33. In August 2007, the State of New York conditioned the sale of KeySpan to a new owner on the divestiture of KeySpan's Ravenswood generating assets and required KeySpan to bid its New York City capacity at zero from March 2008 until the divestiture was completed. Since March 2008, the market price for capacity has declined.

34. But for the KeySpan Swap, installed capacity likely would have been procured at a lower price in New York City from May 2006 through February 2008.

35. The KeySpan Swap produced no countervailing efficiencies.

#### **VIII. VIOLATION ALLEGED**

36. Plaintiff incorporates the allegations of paragraphs 1 through 35 above.

37. KeySpan entered into an agreement the likely effect of which has been to increase prices in the NYC Capacity Market, in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

#### **IX. PRAYER FOR RELIEF**

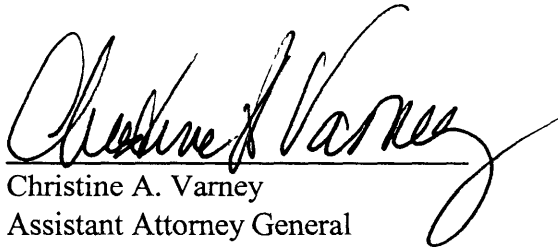
WHEREFORE, Plaintiff prays:


1. That the Court adjudge and decree that the KeySpan Swap agreement constitutes an illegal restraint in the sale of installed capacity in the New York City market in violation of Section 1 of the Sherman Act;

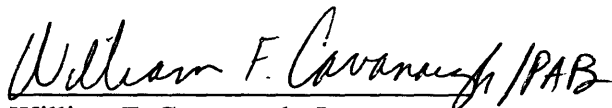
2. That plaintiff shall have such other relief, including equitable monetary relief, as the nature of this case may require and as is just and proper to prevent the recurrence of the alleged violation and to dissipate the anticompetitive effects of the violation; and

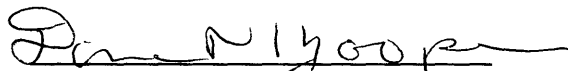
3. That plaintiff recover the costs of this action.


DATED this 22nd day of February, 2010.

  
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Respectfully Submitted,

  
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