



Pearl Street

**MISO: OPPORTUNITIES AND PERILS
IN THE NEXT PHASE OF
ELECTRICITY MARKET DEVELOPMENT**

A Pearl Street Inc Multi-client Study

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IMPACT OF MISO REAL-TIME MARKET EXPECTED TO BE PROFOUND

While energy company executives and the investment community laud the success of “back to basics,” what’s really happening is that the industry is entering a second phase of electricity market development and competition. That’s the conclusion of a multi-client study by Pearl Street Inc, entitled, “MISO: Opportunities and Perils in the Next Phase of Electricity Market Development.”

“In a sense,” notes Jason Makansi, principal investigator and president of Pearl Street, “the Federal Energy Regulatory Commission’s vision for a national electricity market is coming to pass, only slower than originally envisioned and within geographical areas, MISO being the largest”

Over time, the MISO market will help to redraw the map with respect to utility merger and acquisition activity, power plant divestitures, and transmission assets. In addition, because MISO will operate according to locational marginal prices (LMP), the value of power plant assets participating in the market will be dynamic, and no longer static. This means that each plant asset must begin to understand its cost of doing business in real time, and match that cost to the real-time electricity prices in the market. “Most plants are not really well-equipped to do that,” concludes Makansi.

The report defines phase one in market development broadly as the period between the 1992 National Energy Policy Act and the collapse of the electricity trading market in 2001. This period was followed by four years of “back to basics” and a massive correction to the irrational exuberance in gas-fired capacity between 1997 and 2001.

This second phase is different, however. This time, we have a very high commodity price environment for fuels, normal to modest projections for electricity demand growth, high reserve margins in most parts of the country, and rising electricity prices resulting from continuing environmental capex, renewable subsidies, and a T&D infrastructure starved for investment. The hope is that rising electricity prices can be moderated by

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a functioning competitive wholesale market, leveraging costs across larger customer bases (utility mergers), and real production efficiencies across the production and delivery value chain.

On the other hand, MISO represents a disparate collection of states with varying degrees of deregulation and competition. Utilities in MISO have by and large not been required or encouraged to divest of their generating assets, unlike deregulation programs in California, New England, and New York. Ample discussion is devoted in the report to Indiana, a highly regulated state sandwiched between Illinois, which deregulated relatively modestly, and Ohio, which is described as a quasi-regulated state. Indiana's utilities are relatively small, while their neighbors are, for the most part, much larger.

While nuclear power is expected to be a big winner in this market (as it was in PJM and the Northeast), Makansi and report contributor Kemm Farney believe that coal and gas capacity will face interesting market dynamics. "In the end," notes Makansi, "it may not be the capacity that's as important as who owns it." Adds Makansi: Owner/operators with big MISO footprints and fuel flexibility are liable to do better than 'one-trick ponies,' who end up as price-takers."

The 26-page Pearl Street report sells for \$945.00. More information is available at www.pearlstreetinc.com. Early MISO pricing information from P&L Economics (www.poweroutlook.com) is included as an appendix.