



2007 State of the Market Report Midwest ISO

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Introduction

- The State of the Market report provides our annual evaluation of the Midwest ISO's markets and recommendations for improvements.
- The Midwest ISO introduced competitive wholesale electricity markets on April 1, 2005. These markets include:
 - ✓ Energy markets that produce transparent prices that vary by location to reflect the value of electricity throughout the network; and
 - ✓ Financial Transmission Rights (“FTRs”) that allow participants to hedge network congestion costs between various locations.
- These markets will soon be augmented by:
 - ✓ Ancillary Services Markets (“ASM”) that will be implemented in Fall 2008 to optimize the allocation of the Midwest ISO's resources between the ASM and Energy markets.
 - ✓ Clarified capacity requirements and enforcement that will ensure long-run economic signals support adequate supply and demand resources.



Benefits of the Midwest ISO Energy Markets

Midwest ISO markets produce substantial savings in the following areas.

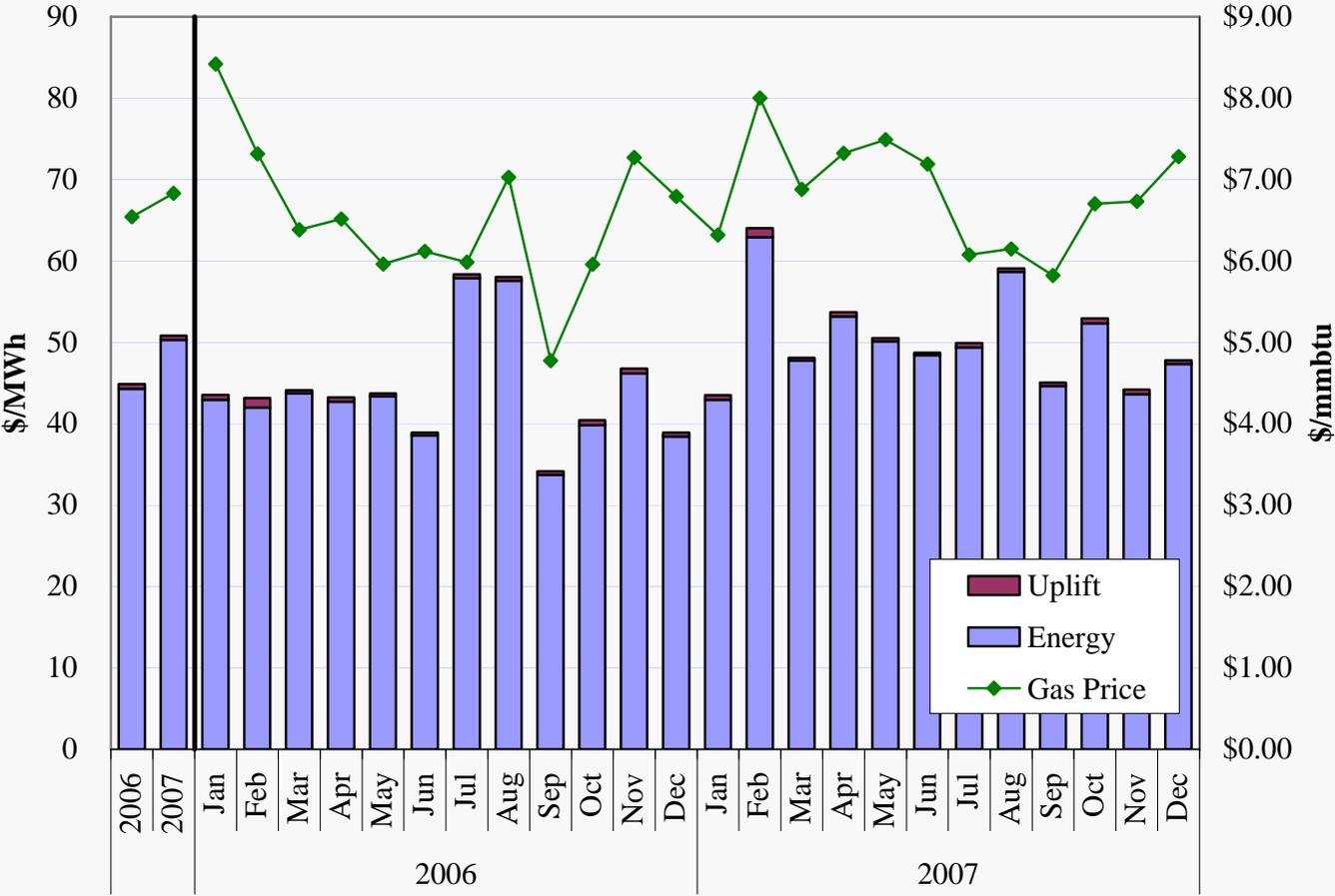
- Daily commitment of generation: Coordinated commitment of generation through the day-ahead market produces savings by:
 - ✓ Reducing the quantity of generation that is committed; and
 - ✓ Ensuring that the most economic generation is committed.
- Efficient dispatch: Dispatch costs are reduced by:
 - ✓ Producing energy from the most economic supply and demand resources and redispatching these resources in the lowest cost manner to manage network congestion; and
 - ✓ Much fuller utilization of the transmission capability in the region.
- Reliability: Improved because the 5-minute dispatch provides much more responsive and accurate control of flows on the network.
- Price Signals: The prices produced by the energy market provide a transparent economic signal to guide short and long-run decisions by participants and regulators.



Summary of Findings

- The Midwest ISO energy markets performed competitively in 2007.
 - ✓ Although certain suppliers in the Midwest ISO have local market power, there was very little evidence of attempts to exercise market power in 2007.
 - ✓ Hence, market power mitigation measures were not often used to address attempts to exercise market power to raise energy prices or other costs.
 - The most frequent mitigation occurred in Minnesota in a new Narrow Constrained Area (“NCA”) defined in January 2007.
- Average energy prices increased 13 percent in 2007 due primarily to higher fuel costs, which contributed to other cost increases as well:
 - ✓ A 26 percent increase in uplift costs associated with revenue sufficiency guarantee payments (“RSG”) that was due to higher fuel prices and use of high-cost peaking resources to manage network congestion.
 - ✓ A 28 percent increase in network congestion costs that was due to higher fuel prices and changes in flows on the network explained in the report.

All-In Price 2006 & 2007



Note: The All-In Price is computed by calculating a load-weighted average real-time energy price, plus a load-weighted real-time RSG allocation rate.



Review of Results

- Overall, we find that the Midwest ISO energy markets performed well in 2007 and continue to provide considerable benefits to the region.
- The addition of the ASM markets this fall will improve the markets by allowing them to more efficiently meet the system's reliability needs.
- However, our report includes eight additional recommendations designed to:
 - ✓ Improve the pricing of energy when demand resources or high-cost peaking resources are utilized;
 - ✓ Better facilitate economic imports and exports to and from the region;
 - ✓ Improve certain operational processes related to managing congestion and utilizing resources in the real-time market;
- New supply or demand resources will be needed in the next few years and market signals do not currently support the investment needed. Market changes underway should remedy this issue.