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California Energy Markets Stable and Competitive Four Years in A Row *While Challenges Remain, Prices are the Lowest Since 1998 When Normalized for Fuel Costs*

(Folsom, California) The short-term electricity markets run by the California Independent System Operator Corporation (California ISO) were stable and competitive for the fourth full year in a row, according to the ISO's state-of-the market report filed with the Federal Energy Regulatory Commission (FERC) today. The 2005 Annual Market Issues and Performance Report also found that the cost for managing local bottlenecks on the grid fell 52 percent from 2004 to 2005, and total wholesale electricity costs dropped significantly when normalized for the price of natural gas. However, the report encourages continued investment in new power plants.

"I am pleased by the sharp decrease in intrazonal congestion costs," said President and CEO Yakout Mansour. "This indicates to me that the additions and upgrades to the transmission grid built by transmission owners in coordination with the ISO are paying off as wise investments." The cost to manage locally overcrowded lines (intrazonal congestion) decreased from \$426 million in 2004 to \$203 million in 2005.

Natural gas fuels more than 40 percent of the power plant capacity in California. Prices for gas have been on the rise for several years and peaked at more than \$12.00 per million British Thermal Units (mmbtu) at the end of 2005 in the wake of hurricanes Rita and Katrina. Currently, gas prices are in the \$6.00 per mmbtu range.

Due primarily to higher natural gas prices, total estimated wholesale energy costs increased slightly in 2005 to \$13.6 billion, compared to \$13.1 billion in 2004. However, with the fuel cost increase taken out of the equation, the average annual wholesale cost of providing energy (cost per megawatt-hour) continued to decline in 2005.

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For example, with gas prices normalized, the average megawatt-hour in 1998 cost \$75.78, compared to \$45.26 in 2005. That's the good news. However, the report points out that the low spot market prices may not provide enough revenue to spur investment in new generating units. Long-term contracts, typically outside the ISO purview, are needed to guarantee a return on investment sufficient to encourage power plant development. For more details on price trends see Page 2-20 of the report <http://www.caiso.com/17d5/17d59ec745320.pdf>.

“When adjusted for increases in natural gas prices, our report shows a significant downward trend in other costs associated with generating and transmitting electricity in California,” said the ISO Director of Market Monitoring, Keith Casey. “This indicates that competitive energy markets can provide lower costs. And it makes the case for replacing old power plants with new ones that are more fuel-efficient.”

In spite of continuing investment in generation, a combination of healthy economic growth and the retirement of older, inefficient power plants means construction of new facilities is important. “Proactive investment in new power plants and transmission infrastructure is critical to meeting California's growing demand for electricity in a cost effective and reliable manner,” said Casey. “Fuel diversity is also important. Too much reliance on power plants fueled by natural gas can create significant cost exposure to higher natural gas prices. Renewable energy sources can play an import role in reducing this risk.”

One important measure of market competitiveness involves comparing the actual market price to an estimation of what the cost-based price would have been. A 12-month rolling average of this comparison is called the Market Competitive Index (MCI.) A MCI of between \$5.00 and \$10.00 per megawatt-hour is reflective of a workably competitive market. The MCI for 2005 was well within that range.

The California ISO is a not-for-profit public benefit corporation charged with managing the flow of electricity along California's open-market wholesale power grid. The mission of the California ISO is to safeguard the reliable delivery of electricity, and ensure equal access to 25,000 circuit miles of “electron highway.” As the impartial operator of the wholesale power grid in the state, the California ISO conducts a small portion of the bulk power markets. These markets are used to allocate space on the transmission lines, maintain operating reserves and match supply with demand in real time.

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