March 25, 2002

platts

Power Markets Week

Markets—East, Midwest, South

PRICES SURGE AS WINTER TEMPERATURES, OUTAGES FUEL DAILY, LONG-TERM MARKETS

A late winter blast sparked daily prices across much of the Eastern Interconnection last week. The sudden drop in temperatures acted in concert with high gas futures prices and a deluge of outages, pushing up forwards as well as dailies.

The colder weather late in the week, following the loss of a few nuclear units and rumors that a large fossil unit went down, snapped New York dailies snapped out of the doldrums. Early in the week, a continuing rise in daily prices, despite warmer weather across the region, prompted trader to speculate that a large fossil unit went down, joining planned outages at Constellation's 1,143-MW Nine Mile Point-2 in Lycoming and Rochester Gas & Electric's 470-MW coal-fired Ginna unit in Ontario,.

Several traders said that the AES 675-MW coal-fired Somerset unit near Buffalo shutdown and could remain offline to early this week. However, AES denied any downtime at the unit and insisted it was operating normally.

As colder weather crept in late in the week, dailies and ISO-posted clearing prices reacted sharply, particularly in the state's western zones where the plant outages were located. For-Friday deals in western Zone A surged as

(continued on page 17)

INSIDE THIS ISSUE

Rankings

• Wholesale power sellers ranked by sales volume for Q4 and all of 2001 ..... **19-24**

Enron Fallout

• Previously popular debt triggers lose shine for power companies after Enron's fall **3**

Marketplace

• Davis-Besse puts spotlight on six nukes; traders doubtful NRC will shut plants **6**

• **Daily on-peak indexes** **2**
• **Daily off-peak indexes** **4**
• **Forward pricing page** **8**

TRANSMISSION NEWS

• FERC struggling to balance openness **25**
• Regulators not promoting grid expansion **25**
• Environmentalists sue DOE over new lines **26**
• Kentucky Senate approves siting authority **26**

DERIVATIVES VOTE TOO CLOSE TO CALL; MARKET TRIES TO SORT OUT REAL IMPACT

Market players continue trying to determine what the real impact would be of a Senate effort to regulate energy derivatives traded electronically—
whether the measure would kill online platforms, as opponents have charged, or shine a much-needed light on the over-the-counter market, as proponents claim.

The Senate is expected to vote on the amendment offered by Sen. Dianne Feinstein (D-Calif.) to the comprehensive energy bill, S 517, sometime after it returns from spring recess April 8. Industry sources said that as of last week the vote was too close to call and that eight or 10 undecided senators would determine the measure's fate. "At this point, I think it is a toss-up," said one industry insider.

Industry watchers said the lawmakers were weighing whether the measure would really resolve issues surrounding the Enron debacle or California's price spikes of last year as supporters purport, or whether it simply "messes with" the Commodity Futures Modernization Act that Congress approved less than two years ago.

One industry trading source said he expected the derivatives market to survive as a risk management tool for energy companies whatever Congress may decide. "The

(continued on page 28)

POWER SALES SHOW ROBUST GROWTH, BIG PLAYERS GAINING IN POST-ENRON ERA

Fourth-quarter and 2001 power sales data show just how easily the power market shrugged off the collapse of market-maker Enron and its dominant EnronOnline trading volume, as volumes continued to grow robustly even as Enron departed the market.

Traders said shortly after Enron left the market in December that trading had quickly returned to normal, and day-to-day trading volumes behind the daily power indexes also showed how quickly the market recovered from the loss of its dominant players (*PMW*, 28 Jan, 4). Not only did the market recover quickly, fourth-quarter and 2001 sales figures show continued solid growth in sales volumes.

For the year 2001, total market-based-rate sales grew an impressive 44.7%, to 6.729 billion MWh, over the previous year. In the fourth quarter, sales reached 1.966 billion MWh. That was 5.5% over the third quarter of 2001, but up 51.5% over the fourth quarter of 2000.

Going back to the fourth quarter of 2000, quarter-by-quarter the market made solid strides in terms of volume: 1 billion MWh sold in Q4 2000; 1.38 billion MWh in Q12001; 1.5 billion MWh in Q2; 1.86 billion MWh in

(continued on page 18)

million individuals and businesses in 45 Florida counties.

It has 1,800-MW of coal-fired and gas-fired capacity.

The trading deal with Aquila will cover all its off-system sales and purchases, which total over 500,000 MWH/year, a Seminole spokesman said. "Aquila is one of the leading gas and power marketers in North America, so our members will benefit from their trading and risk management know-how," said Tim Woodbury, Seminole vice president-strategic services.

SOLICITATIONS

MICHIGAN CITY ISSUES SOLICITATION TO REPLACE LONG-TERM COMED DEAL

Dowagiac, a city of 6,500 in southwestern Michigan, issued a solicitation last week for 15 MW of full-requirements power to replace an existing contract with Commonwealth Edison that is scheduled to expire Feb. 28, 2003.

ComEd, the Chicago-based subsidiary of Exelon, has supplied power to Dowagiac since 1998. Dowagiac provides electric service to fewer than 3,000 customers, including 2,100 residential, 301 commercial and 31 industrial. The city operates approximately 3.5 miles of 34.5-kV transmission lines, 2 miles of 12.5-kV distribution lines and 51 pole-miles of 4.6-kV distribution lines. The city also owns and operates two diesel generators with combined capacity of about 2.2 MW.

Proposals are due May 9, and Atlanta-based GDS Associations, the consulting firm running the solicitation, hopes to have a short list by Aug. 29 and commence negotiations by Sept. 5.

The new contract will take effect March 1, 2003,. The length of the contract is expected to be determined through negotiations.

For more information, contact GDS Associates at www.gdsassociates.com, or call (770) 425-8100.

STRATEGIES

UTILITIES SCRAMBLING TO 'SPIN BACK' MERCHANT AND TRADING AFFILIATES

Utilities that within the last two years have spun-off portions of their unregulated generation and marketing units are scrambling to bring those entities back under the parental umbrella.

Enamored with the prospect of attracting thousands of investors and millions of dollars fleeing the collapsing high-technology sector, the companies saw spin-offs as a way to capture new, growth-oriented investors while maintaining a core of long-time, dividend-loving, low-risk investors with their regulated transmission-distribution businesses.

Consultants and analysts were touting the pent-up need for more generation and the outlook was rosy.

"Two years ago, 'growth' energy companies were in," said Kyle Rudden, a vice president with energy consulting firm R.J. Rudden and Associates and a former J.P. Morgan energy analyst. "There was so much momentum money from investors coming out of the dot-com market and looking for somewhere to put their money."

But spin-offs have fallen out of favor. "The general idea of a spin-off is to maximize shareholder value," said Daniele Seitz, an energy analyst in New York with Salomon Smith Barney. "When generation assets are trading at 20 times earnings, it's a good idea to spin them off."

Thus, Southern Co. let go of what became Mirant; Xcel Energy spun NRG Energy; UtiliCorp United did an initial public offering with Aquila; and Reliant Energy did the same with Reliant Resources.

And there was talk of more spin-offs, including IPOs by Constellation Energy and Allegheny Energy Inc.

Since that time, the industry's dynamics changed dramatically; the nation's economy and thus energy demand substantially cooled, the California debacle temporarily sorted itself out and Enron Corp imploded. Combined with rating agencies that have forcefully determined to scrutinize everything by the book, investors want little to do with deregulated entities' equity or debt.

"Nobody wants trading companies; nobody wants generation companies. The perception is they are fraught with problems," said Susan Abbott, managing director of Moody's Investors Service's Power Group.

"Pure plays were more highly valued than integrated utilities," said Gerald Keenan, senior energy strategy partner for PwC Consulting, a unit of Big Five accounting firm PricewaterhouseCoopers. "Now, companies have discovered there is value in having an integrated strategy when you're in a commodity business."

Keenan likened the generation-only business to the oil refining-only business: Both are whipsawed by commodity price fluctuations.

As investors went looking for the next big winner, stock prices dropped precipitously. Spinoffs which had been trading at two, three, four times their IPO price, plunged 58%, 69%, even 84% from their highs within a year. Mirant is looking for a capital-rich partner to back its operations and Reliant Resources continues to struggle with a mark-to-market accounting problem that is causing both it and its parent a great deal of dismay.

In some cases parents have announced "spin backs," which are share repurchases of their unregulated offspring.

In November, UtiliCorp said it would reacquire the 20% of Aquila it had sold just six months earlier. The deal closed in January, with UtiliCorp taking the Aquila name.

NRG, already pulling back on its growth plan to shore up its financials after Moody's said in December it may cut to junk status its senior unsecured debt, is now evaluating a takeover offer from parent Xcel Energy Inc. NRG's outside directors and consultants mulled an offer of Xcel stock worth about $11.50 per NRG share, a 35% discount to NRG's $15 a share IPO price just two years ago. Xcel said, in effect, it is being proactive, that it basically is saving NRG from its own high-powered, highly capital-intensive self.

That capital has dried up and now, leveraged at some 70% to 80%, NRG is in a position to experience difficult

©2002 The McGraw-Hill Companies, Inc. Reproduction prohibited without permission.

times, according to Christopher Ellinghaus, an energy analyst with Williams Capital Group in New York.

"These companies just don't have the access to capital that they previously had when they were spun off," said Ellinghaus.

Parent companies also are acting out of self-preservation, said PwC Consulting's Keenan. If there is risk of the partially owned subsidiary doing badly, failing, perhaps entering bankruptcy, it reflects on the parent firm, certainly affecting its stock price and possibly its credit rating.

"Reacquiring a subsidiary also is a cheap way to buy capacity," Keenan said. "When you are in a down-side business cycle, it's cheaper to buy reserves in the market than it is to develop them yourself."

UtiliCorp bought back Aquila and took total control of its highly regarded energy trading operation. Should Xcel reacquire the 24% of NRG it spun off, even after following through on its plan to sell $1.9-billion of existing assets and cancel or defer some $1.6-billion of projects, it still integrates some 20,000 MW of capacity into its own regulated portfolio of 15,394 MW.

"Together, Xcel and NRG look like a massive, geographically diversified supplier," Salomon's Seitz said. "It features a diversified fuel base and is still getting massive earnings from its regulated businesses in Minnesota and Colorado."

The other partial spin-off remaining, Reliant Resources, is a question mark for analysts and industry watchers. There is disagreement as to whether or not Reliant Energy will reacquire the 18% of Reliant Resources spun off about one year ago.

Rudden and Associates' Kyle Rudden said he believes it probably makes sense for Reliant Energy to reacquire Reliant Resources because it was late entering the game.

Also, while being forthright with its accounting problems-and, in fact, expecting to add up to $130-million in additional earnings to its second- and third-quarter financials-Reliant Resources is being painted with the Enron brush and thus its stock is suffering.

However, Williams Capital's Ellinghaus said Reliant Resources, even with the $5-billion deal to acquire Orion Power Holdings Inc, doesn't have the extremely high total debt-to-capitalization ratio NRG does (peaking at roughly 47% this year, according to ratings firm Fitch Ratings), and thus is in a better position to get through tough times.

Looking long-term, PwC's Keenan believes the spin-off of generation units is dead because no rating agency will allow the high-debt leverages the NRGs, the Calpines and AES Corp's enjoyed in the past.

"The focus will be on integration, but not the old regulated utility model," said Keenan. "Companies like Duke, El Paso and Dominion have shown they can weather market ups and downs with an integrated model, but integrated along a value chain, a combination of deregulated and regulated units. How nice it is to have boring (regulated) assets throwing off cash."

"The question companies have to find an answer for is, what do you have to do if you do a spin off to make the balance sheet strong enough to weather the volatility of being in that [generation] business?" asked Moody's Abbott.

ENERGY POLICY

ELECTRICITY PROVISIONS DOMINATE FLOOR DEBATE ON SENATE ENERGY LEGISLATION

Electricity issues dominated floor debate on the Senate's broad energy bill last week, adding to the controversy that threatens to doom the whole package. An effort to kill the whole electricity section of the bill might have gained ground as diverse interests find less and less reason to support it.

Democratic senators succeeded in turning back challenges to their renewable energy mandates while other electricity provisions remained in the background, to be taken up when Congress returns from its spring recess, which ends April 5. Related to the fate of the electricity section of the bill is the fight over oil drilling in Alaska—if pro-drilling senators lose that battle, it is unclear what will happen to the rest of the bill.

The Bush administration badly wants the drilling, but it may not have the 60 Senate votes needed to beat back strong opposition. A bill passed by the House last year approves it, and if the Senate sends a package to a conference with the House, the conflict will reappear there.

In action last Thursday, senators defeated three attempts to kill the bill's renewable portfolio standard, which would require investor-owned utilities to generate a portion of their power using renewable energy sources.

In a mainly party-line 58-40 vote, the Senate rejected an amendment from Sen. Jon Kyl (R-Ariz.) that would have deleted the bill's existing renewable portfolio standard, which requires electricity providers to generate 10% of their electricity by 2020 using biomass, geothermal, solar and wind energy. Kyl's amendment would have made the renewable provision voluntary. Lawmakers also defeated, by voice vote, another Kyl effort against the standard.

The Senate later rejected an amendment from Sen. Frank Murkowski (R-Alaska) that would have exempted states that had adopted their own renewables mandate from the bill's 10% non-hydropower renewables mandate. The amendment failed by a 57-39 vote.

The final renewables provision, as amended by sponsor Jeff Bingaman (D-N.M.), is less burdensome to utilities than the original language in that it delays and escalates more gradually the percentage requirement for the amount of renewable resources required. The renewables exclude existing hydro resources.

The measure as passed would require a federal renewable portfolio standard beginning in 2005 for each retail electric supplier. The suppliers would have to submit by April 1 of the following calendar year renewable energy credits in an amount equal to the required annual percentage, which would increase at a rate of 1.2% or 1.5% each year.

Retail suppliers' base amount must be 1% for 2005-2006, rising to 8.5% in 2017-2018 and to 10% for 2019-2030, when the requirement expires.

The amendment also provides that the federal government would issue renewable energy credits. Each credit, with certain exceptions, would be equal to one kilowatt-

©2002 THE MCGRAW-HILL COMPANIES, INC. REPRODUCTION PROHIBITED WITHOUT PERMISSION.