

NATURAL GAS PRICES SURGING UP

Bob Rowe
Chairman, Montana Public Service Commission¹

All Montana natural gas users can expect to continue facing sharp increases in gas prices over the coming months. For NorthWestern Energy customers the requested increase in the gas portion of the bill is now expected to be fifty-seven percent, which would result in an average increase in the total gas bill to a residential NorthWestern customer of about forty-five percent. This will hurt individual customers, business customers, and the Montana economy as a whole.

This is part of a national crisis, which Federal Reserve Chairman Allan Greenspan says has received inadequate national attention. The compounding of wholesale natural gas prices has been compared to paying \$16 for a gallon of milk or \$9 for a gallon of gas. This article summarizes some of the reasons behind it, what consumers can expect, and what the Public Service Commission and consumers may be able to do.

Like most natural gas local distribution companies (LDCs), Energy West (formerly Great Falls Gas), Montana Dakota Utilities, and NorthWestern Energy own no natural gas production. Like most other LDCs they purchase gas for their customers in the wholesale gas market. What you pay for natural gas is directly linked to what the LDC pays for gas in the wholesale market.

What's Driving the Natural Gas Market?

Wholesale prices hit record highs in February, nearly \$12 per million BTUs, dropped down, and are now expected to climb back as high as the \$12 level. This is driven by declining production over time, less gas in storage, and strongly growing demand, and perhaps other factors.

Over the past few years, U.S. production has dropped as much as three percent a year, mainly due to diminished capacity in old fields. Some producers also say that lower prices in recent years made it difficult for them to extract the gas that was the most expensive to reach. This year, in response to increased prices, U.S. production may increase about one percent.

¹ The views expressed are the author's only, and do not reflect positions of the PSC. Last revised June 2, 2003.

Canadian gas, which makes up about fifteen percent of all U.S. supply and is especially important to Montana, is also declining, at the same time Canadian demand is increasing.

Normally, the off-season is the time to replenish storage, as prices are lower. This year, following an especially cold winter in many areas (but a warmer than average winter overall), gas in storage is half of what it was a year ago. There just isn't as much gas in reserve as there should be. If forecasts for summer demand (for example for cooling) are correct, it may be both difficult and costly to fill up storage capacity before the next heating season.

Demand for gas had been increasing for residential heating and cooling, industrial uses, and especially to generate electricity. As many as sixteen new gas-fired power plants are planned to come into service in the Western U.S. this year (likely, some projects will be postponed, due either to increasing gas prices or the damping effects of a weak economy on electricity demand). When demand exceeds supply, prices rise. That's what's happening now. Depending on how elastic demand is (how able or willing consumers are to reduce demand when prices go up), the response to increased prices is reduced consumption. Indeed, the federal Energy Information Agency has now revised downward its gas demand forecast, both as a result of a weaker economy than expected and decreased demand for natural gas. This may prove to be the best news for natural gas customers.

What Am I Paying The Gas Company For?

MDU and Energy Northwest file monthly "tracking" cases with the PSC, and their customers see an almost immediate change in commodity part of their monthly bill. If the wholesale market price goes down, customers' bills go down. If the wholesale market goes up, customers' bills go up. In February, 2001, MDU's customers saw their total natural gas bill peak at close to \$10.00 per decatherm, but then drop down over time.

NorthWestern is currently on a twelve month tracker, with the "tracker year" proposed to be moved from one that starts at the beginning of the heating season (giving customers an even bigger rate shock), to one that starts in the summer. The PSC had been able to insulate MPC/NorthWestern customers from the earlier price spike through requiring a "buy back" contract with Pan Canadian, for gas production that MPC sold, and by ordering \$60 million from the proceeds of the sale of gas-related properties to be credited to customers. The Pan Canadian

buy-back contract was well below the market price, and saved customers about \$45 million in direct gas costs (a total savings, by NorthWestern's estimate, of \$64 million factoring in a \$19 million value to storage utilization). NorthWestern is now filing a tracker requesting an increase of approximately forty-five percent in the total bill to reflect gas prices for the coming year. The last of the \$60 million credit to customers will be used at the end of this year, and NorthWestern will likely request an increase of over nine percent to make this up.²

Gas utilities are allowed to raise gas rates to cover their costs, and are required to lower them when the cost of gas goes down. (Yes, this actually happened a number of times in recent years.) Utilities are prohibited from earning any profit on the cost of gas they purchase. They earn their profit through a return on their capital investment, such as the gas distribution system, but don't earn a profit on their expenses, such as gas purchases. Gas utilities are also not allowed to include non-gas expenses in the gas tracker cases. It's also worth noting that NorthWestern's weak financial position does not appear to have affected the price at which they buy gas – they pay the same prices as do other utilities purchasing that gas.

Utilities' gas tracker applications are audited by the PSC and by the Montana Consumer Counsel (the ratepayers' attorney in utility cases), and are subject to "contested case" adjudications to make sure the utility used prudent practices in purchasing gas. Because gas costs are tracked, there is a true up at the end of the tracker period. If prices went down, customers get a refund in the form of an offset (with interest). If prices went up, customers make up the actual cost (along with any carrying cost the utility incurred for purchasing the gas some time before being paid).

²As a result of MPC's sale of its dams and coal plants, NorthWestern owns no electric generation either, and the cost of purchasing wholesale electricity is treated similarly to gas purchases. Indeed, the Montana electric restructuring law required MPC to remove its generators from rate base, and prohibited the PSC from blocking such a sale. Also like the gas commodity tracker, NorthWestern electric customers are benefiting from a \$30 million dollar credit related to the sale of the distribution system from MPC to NorthWestern. That credit was used to keep electric prices lower than they would otherwise have been, and expires on July 1. A typical residential electric customer, using 750 kWh per month, should expect an increase in the cost of electricity of about \$3.35 a month as a direct result of this credit being used up, along with other changes that NorthWestern may propose based on the cost of purchasing electricity. Previously, when MPC sold the dams and coal plants, the net gain on the sale was also credited to customers, and resulted in reduced electricity prices, approved by the PSC in February 2000.

Now What Do We Do?

The PSC and most Montanans have been focused for years on electricity. For many Montanans, natural gas prices are just as big a concern. For example, the Commission is closely examining NorthWestern's gas procurement practices, to ensure they produce both fair and reasonably stable prices.

During the PSC's recent hearing on the current NorthWestern gas tracker, the Montana Consumer Counsel's expert witness, George Donkin, concluded that the tracker was based on prudently incurred gas costs. He did not believe the market was being manipulated by gas suppliers. He recommended that the Commission order NorthWestern, and possibly the other Montana LDCs, to create a hands-on work group to examine a series of strategies that might help provide greater price stability. Specific strategies (for example, different kinds of "hedging") might or might not be a good idea, but I do expect the Commission to issue an aggressive order telling NorthWestern to stay on top of the gas market.

In addition to working on the NorthWestern natural gas tracker cases and other gas utilities' cases, the PSC has pulled together a work team to evaluate the factors driving wholesale natural gas prices; the relationship between gas and electric markets; how utilities should participate in those markets to best protect their customers; and, what steps the PSC, gas utilities, and customers could take to manage the swings in gas prices and the effect they have on customers. Commissioners and staff also share information, analysis and strategies with regulators from other states (who are facing the same problems) and with federal agencies. (In 2000, with gas prices rising, I worked with the U.S. Department of Energy to put together a toolkit for commissions, consumer advocates and others. Some of that work is still useful.)

Strategies to examine now might include risk management programs, increased investment in storage and transportation, and more robust wholesale market monitoring and enforcement. Apart from orders to specific utilities, the Commission is planning to convene a public meeting of experts and concerned parties this September, to examine a range of gas issues, from the wholesale market, to how rates are set, to issues of concern to particular kinds of customers.

I'll report back to you as this work takes shape.

If you have questions, call me at 406-444-6167 or e-mail me at browe@state.mt.us. The PSC takes public comments concerning cases at <http://psc.state.mt.us>.

PUBLIC MEETINGS SET TO EXPLAIN AND DISCUSS NATURAL GAS PRICES

KALISPELL

Tuesday, June 17, 6:00 PM
Old Gateway West Mall
(Use west parking lot entrance)

MISSOULA

Wednesday, June 18, 6:00 PM
County Commissioner Meeting Room
200 West Broadway, Room 201
2nd Floor Courthouse Annex (use Pine Street entrance)

PSC SUMMIT ON NATURAL GAS

Thursday, September 18 (*tentative date*)
Helena, *location to be announced*

The meeting will feature experts from the Federal Energy Regulatory Commission, the National Regulatory Research Institute, and the Gas Technical Institute as well as concerned Montanans

WHAT CAN I DO ABOUT MY NATURAL GAS BILL?

A. Conserve Energy.

- Turn down your thermostat – in the winter you can save as much as 3% of the energy your furnace uses simply by lowering your thermostat 1 degree F (if it's set between 65 and 72 degrees)
- Close off rooms that are not in use
- Use solar heat by opening curtains and drapes when the sun is shining
- Lower the temperature on the water heater to 120 degrees
- Install water-flow restrictors in showerheads and faucets
- Refrain from using hot water to wash clothes when possible
- Close the damper on the fireplace when not in use
- Replace/clean your furnace filter
- Replace aging appliances like water heaters and furnaces
- Use caulking or weather stripping to seal air leaks around doors, windows and other openings, such as pipes or ducts
- Check to see if your attic and basement (or crawl space) have enough insulation
- Get a home energy audit that points out ways to make your home more efficient

B. Choose a different supplier. NorthWestern and Energy West customers have the right to choose their own gas supplier. There are four competitive suppliers licensed by the PSC, but they are not marketing broadly at this time. It is possible that more competitive choices might be offered in response to the current gas price hikes. Licensed suppliers are listed at <http://psc.state.mt.us/scripts/gaslicense/gaslicensedisplay.asp>.

C. Budget Billing.

Budget billing can levelize your gas bills by spreading out your heating costs throughout the year. Contact your local gas company to learn more about their Budget Billing program.

D. Energy Assistance.

The Low-Income Energy Assistance Program (LIEAP) can help with winter heating bills if you qualify. Get a LIEAP application and more information by calling your local Human Resource Development office. LIEAP can also help qualified persons with weatherization during the summer months. Most gas utilities in Montana provide a rate discount of 10-15% to customers who are receiving LIEAP assistance.

E. Energy Share.

Energy Share of Montana provides emergency assistance with utility bills. Call 1-800-777-7589 for further details.