Indiana may experience mild weather this winter, but businesses and consumers won’t be able to tell by their natural gas bills.

The weather conditions within the state are only one of a number of factors that contribute to the price tag associated with gas consumption. Many of those causes are beyond the control of anyone in Indiana. And the early signs related to those causes are not positive ones.

Here to discuss natural gas and issue an early warning on upcoming prices are:

**Price is wrong**

The IURC conducted July hearings with gas companies providing an earlier-than-usual forecast for the winter heating season. The news was good regarding supplies, adequate storage and access to additional gas.

McCarty describes the IURC viewpoint as “guardedly optimistic about supply and the availability of gas in Indiana this winter.” The second part of the equation, however, is “very concerned, very troubled, about what costs are going to rise to during the course of the winter.”

The initial ominous sign: summer prices that have run slightly lower or higher than $5 a million cubic feet – roughly twice the usual cost.

Ulrey confirms summer storage prices between $5 and $6. Longer-term advance purchases, up to 15 months ago, were in the $5 or lower range. The key point, one often misunderstood, is that a significant portion of the gas used in the winter of 2003-2004 is purchased well before that time of the year – a fact that typically helps mitigate higher in-season prices.

“Storage (accounts for) approximately 40% of the delivered supply to customers during the wintertime,” he explains. “Approximately 70% to 75% of our purchases will already have been made before the winter season arises.”

While the summertime prices are higher than normal, they will be significantly lower than the rates in place if the weather turns extremely cold. Thus, don’t be surprised at the big numbers on those gas bills in the coming months.

It may not affect the price, but Merritt believes one of the keys is to make people aware of what is coming.

“It’s very important that we continue discussions so that people aren’t caught unaware,” he says. Whether it’s locking in a rate or spreading payments over more months, “I think we need to look into ways to soften the blow.”

**Variety of reasons**

The prices are higher. But why?

Supplies are not growing nationally. Tracy says, “Rig counts are going up, but production levels are relatively stable, not moving in the direction that you would anticipate with the number of rigs that are out there. They just don’t have the capacity anymore in
of the reason for the IURC’s approval of primarily natural gas-fired plants. Concerns over environmental issues were part of the summer electricity shortages of a few years ago are competing with the need to export more to Mexico than we have in the past.”

Merchant power plants that came into vogue following the 1973 oil embargo have been a key factor in the growing demand for natural gas. With the increased production from Canada and Mexico, the price of natural gas has fallen in recent years – 60% depending on natural gas – “if it’s 105 degrees for 60 days in Texas, there’s a whole lot of natural gas being used up in the summertime.”

McCarty confirms that the number of (Canadian) wells that are being drilled and the productive capacity has been reducing, and that’s partly due to the price fly-up, according to Ulrey. “Imports from Canada have gone down because their production has gone down. Production in the United States has diminished somewhat. And, on top of that, we’re exporting more to Mexico than we have in the past.”

Merchand power plants are “creating a whole new added pressure on the demand side.” The problem, however, is not within Indiana, but elsewhere. While Indiana’s natural gas usage in generation of electric power is approximately 4%, the national average is about 26%.

“It’s a classic example of us being a victim of national trends,” McCarty summarizes, “and it’s a trend we didn’t participate in to a very large extent.” With Texas overbuilding its electric generation, 70% of its generation costs depend on natural gas, while in Indiana, natural gas usage in generation of electric power is approximately 4%, the national average is about 26%.

“The inherent nature of federal regulation pushes electric producers toward gas, but then we also restrict where we can look for new gas.”

— Bill Tracy
Citizens Gas & Coke

When the price drops precipitously, then production will drop off. It’s reasonable to argue for some type of price floor that makes it financially viable … to continue production at a certain level.”

— Bill McCarty
Indiana Utility Regulatory Commission

“We’ve been decreasing usage by 3% a year, while we were getting almost a 100% increase in cost,” he points out. How did the company realize the decreased usage? It was by looking closely with customers, commercial

Internal auditing and external assistance.

Winterrowd says he spends up to two hours a day evaluating conditions and making decisions, ones that Citizens Gas handled previously. “For us, it’s a lot more labor intensive. We can save a few nickels. If we do it incorrectly, we can lose a lot of dollars.”

The utilities are still there to assist, helping users with efficiency measures and other opportunities for cost savings. Their success is our success. We want them to be as efficient as they possibly can,” Tracy surmises. “What we really work toward is helping the customer analyze situations and reduce their costs.”

 vectren has similar programs. Industrial sales representatives work closely with customers, commercial

It’s very important that we continue discussions so that people aren’t caught unaware. I think we need to look into ways to soften the blow.”

— James Merritt
Indiana Senate

Merchant power plants are “creating a whole new added pressure on the demand side.” The problem, however, is not within Indiana, but elsewhere. While Indiana’s natural gas usage in generation of electric power is approximately 4%, the national average is about 26%.

“This is a classic example of us being a victim of national trends,” McCarty summarizes, “and it’s a trend we didn’t participate in to a very large extent.” With Texas overbuilding its electric generation in recent years – 60% depending on natural gas – “if it’s 105 degrees for 60 days in Texas, there’s a whole lot of natural gas being used up in the summertime.”

The American Gas Association suggests that gas-fired electric generators have a backup alternative fuel they can switch to in the event of gas prices rising above a certain level. Winterrowd notes, however, that the price of the alternate fuel “goes up at the same time that the gas price goes up.”
groups team with architects and builders on efficiency measures and the effort is ongoing to educate residential customers on weatherization and conservation efforts.

Ulrey says a Demand Side Management (DSM) proposal has been filed with the IURC. Vectren would fund and help promote the effort, with third-party providers guiding conservation and other measures focused on reducing demand.

Past DSM programs that cost more than they saved should not be a deterrent to new initiatives, according to McCarty.

“It’s the responsibility of the commission to be more aggressive about encouraging programs, getting them reviewed and putting them into place. We just need to find the right ones, the ones that are responsive, effectively contain costs and are not irrationally subsidized.”

Residential efforts

Merritt hopes something good comes of the August blackout, reminding people about electricity and natural gas issues before it’s too late. Citizens Gas will try to reach out to residents through an expanded advertising budget, focusing on the value of conservation.

“Many times large industrial businesses have resources to fall back on. Smaller commercial/industrial customers many times don’t,” Tracy reasons, “and certainly residential is last on the totem pole to really have the resources and understanding about conservation efforts. We really try to concentrate heavily on the residential folks.”

“Senior citizens,” Merritt adds. “I think that should be the focus.”

McCarty says the statewide averages are 50% of natural gas usage for industrial purposes and 30% for residential. There is no doubt, he believes, that the greatest educational challenge is at the residential level.

Although the Regulatory Flexibility Committee that he co-chairs with Rep. Dan Stevenson (D-Highland) is keeping a close watch on the issue, Merritt considers that group more of a monitoring body.

“I don’t believe there is a legislative answer to this right now, but it behooves us to be as knowledgeable about the issue as possible – so we can pass that along to our constituents so they’re not taken by surprise.”

McCarty agrees, but fears a “real, real shock come December.”

New technologies

One way of reducing natural gas demand is to make alternative sources more promising. Easing of Environmental Protection Agency restrictions on coal-fired generation could be a step in the right direction.

“The inherent nature of federal regulation,” Tracy claims, “pushes electric producers toward gas, but then we also restrict where we can look for new gas. The more electric generators that are out there using natural gas puts more and more pressure on the natural gas market.”

Merritt would like to see incentives in place for more efficient coal usage.

“A couple of years ago we had a bill, Senate Bill 29, dealing with coal and how we best can utilize the resource. We need to look at liquefying coal, gasifying coal, find any type of new technique to utilize one of Indiana’s greatest treasures,” he declares.

“One of the roles in government is to be open to new techniques. We just need to have an open mind about the whole industry.”

Low natural gas prices made it the “fuel of choice,” Winterrowd says, but now electricity and other sources are re-entering the picture. Big operations like Visteon, he believes, have taken “most of the low-hanging fruit,” although smaller companies can still realize savings with the proper assistance from state or federal sources.

Market breakdown

Residential conservation is important, as is industrial efficiency. But natural gas, as a whole, does not work like a typical supply and demand situation. If the price of oranges reaches exorbitant levels due to a Florida freeze, consumers have the option of substituting another fruit into their diet. If the price of natural gas surges and you’re sitting at home
with three sweaters on and the thermostat turned down, you can’t just choose to stop using the gas.

“We have to address this primarily on a national level,” McCarty proposes. “This is probably the utility issue that is the most beyond our control.” The IURC chairman advocates that the Federal Energy Regulatory Commission (FERC) be empowered to oversee pricing to a certain degree.

Although most people would infer that he is supporting price caps – and McCarty does think FERC should have some authority if prices soar too high – he says, “I think, more importantly, what I would argue for is a price floor. When the price drops precipitously, then production will drop off. It’s reasonable to argue for some type of price floor that makes it financially viable ... to continue production at a certain level.”

Tracy says that when the gas price goes below $2, it’s not economical for companies to continue drilling.

The wildly fluctuating prices impact the rig count, Ulrey adds. With technology improvements, the life span of wells is growing shorter. If prices drop, companies don’t see a return on their investment and production falls. A level of longer-term purchases, he says, “would provide producers with sufficient incentives to go ahead and drill.”

The price speculation that is part of today’s climate adds to the volatility, Winterrowd notes, placing it behind the weather as perhaps the biggest cost variable.

Looking ahead

Projecting beyond this winter season elicits the following observations:

Ulrey: “Prices will be somewhat higher, and they will continue to be volatile because I don’t see excess capacity coming back into the system anytime soon.” He thinks that prices will continue to be affordable, with it “incumbent on the utilities, the industrial customers and their marketers to find ways to hedge those prices and take out the volatility.”

Tracy: “Natural gas is still a good value. I think it will be the fuel of choice in the future. There is a certain amount all of us can do, but the greater good can come from the national energy policy and how the federal government looks at and works with natural gas over the next five years.”

Two unknowns, McCarty points out, are the long-awaited national economic recovery (which will increase demand and put additional pressure on pricing levels) and the summer of 2004 and its projected highest activity level for merchant plants in electric generation.

“I think we’ll probably see three years yet with fairly high prices, with pressure for them to be even higher,” he predicts. “Because of those prices, I hope it stimulates additional production. We have to be realistic about looking for new areas of production – we’re going to have to pursue new sites.”