

Why U.S. Natural Gas Bills Are Going Through the Roof

by Marsha Freeman

Over the past two months, citizens around the United States have seen their natural gas bills explode, due to the huge prices gouged by suppliers, and an unusually cold Winter. Public demonstrations against rate increases have been held in Philadelphia and Atlanta. Utilities report receiving thousands of phone calls a day from irate customers, who are facing the choice of paying their heating bills, or buying food and medicine.

Natural gas suppliers will tell you that the price increase is a function of the law of supply and demand: that there has been a shortage this Winter, which drove the price up. This is hogwash. The price of natural gas has nothing to do with supply and demand; the price is pegged to the price of oil. In 1997 and 1998, when oil prices fell, so did natural gas prices. In response, drilling for new supplies fell. So, for no objective reason at all, with demand certainly not diminishing, there was a slowdown in bringing new supplies on line, allowing the companies to threaten consumers with scare stories of shortages, and to jack up the price this year. The reason natural gas prices started climbing over the past year is that oil prices rose.

But while half the oil this nation uses comes from overseas, so OPEC is conveniently blamed if prices rise, more than 85% of the natural gas we use is produced right here in the United States. So why should the gas price be pegged to oil? The reason is simply that many of the same mega-conglomerates that control world oil prices also distribute natural gas. These stateless companies have been crying "shortage," and making a killing on both oil and gas "commodities."

For more than a decade, natural gas companies have known that increased supplies would be needed, while they

did little to increase capacity. Nearly all electric generating plants that are planned for the future, and those that have come on line in the past decade, have been fueled by natural gas.

Between 1986 and 1998, the proportion of new single-family homes being heated with natural gas rose from 46% to 70%. In total, 55% of all American homes are heated with natural gas. If there is a law of supply and demand, why weren't the gas companies drilling for new wells like mad?

By "gaming" the market, or withholding supplies to create an artificial shortage, and other manipulations that have become the hallmark of the energy industry, prices have risen in the futures market from about \$2 per million BTUs over as of a year ago, to more than four times that this Winter, as seen in **Figure 1**. Spot market prices, in many parts of the country, have spiked to six times last year's prices.

Only re-regulation of this crucial energy sector will squeeze out the speculators, and restore long-range planning and proper infrastructure development, to ensure an adequate, reasonably priced supply of natural gas in the future.

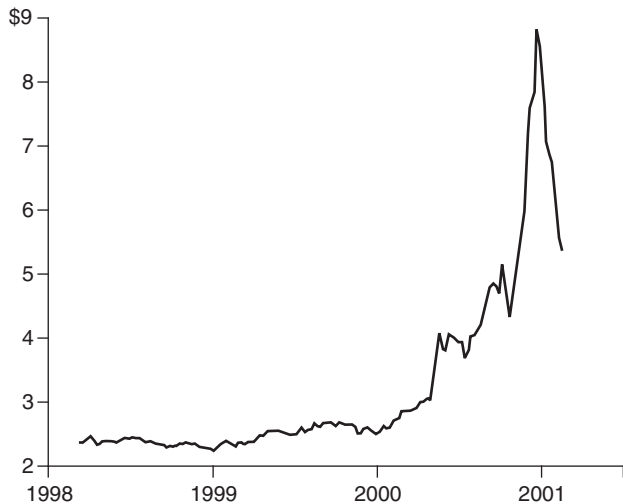
California: A Case Study

California has gained notoriety over the past six months, due to its near-fatal electricity crisis, thanks to deregulation. Electricity rates last Summer for the fully deregulated San Diego Gas & Electric utility in California rose from 10¢ per kilowatt-hour (kwh) in 1999, to 16¢ per kwh in 2000. The utility was purchasing electricity from wholesale suppliers, who jacked up the price as high as they could, claiming that the heat spell created a "distortion" in supply and demand.

Yet, when the California Public Utilities Commission (PUC) released its report on California's electricity crisis on Aug. 2, 2000, it reported that even though peak power require-

FIGURE 1
Natural Gas Futures

(Dollars per Million BTU)



Source: Brock Associates.

ments on July 29, 2000 were actually slightly *lower* than July 29, 1999, the price had shot up from \$49.56 per megawatt-hour to \$522.55. The PUC concluded that the price being charged California utilities for power they had to buy, had virtually no correspondence to “supply and demand.”

Less publicized, but increasingly critical, is the similar profiteering and manipulation that the state is suffering at the hands of its natural gas suppliers.

Thanks to its anti-human “environmentalist” policies, most of the electric generating capacity built in the state for the last decade has been small-scale gas-fueled power plants. No nuclear or clean coal power plants have been allowed. Virtually all of the generating capacity that is planned for the state also relies on natural gas. Today, California is dependent upon natural gas for more than 50% of its power. So any companies that can control the price of natural gas in the state not only have a stranglehold on residential customers, but also inevitably heavily influence the availability and price of electricity.

Prices for natural gas have been in the \$8 per million BTU range throughout the Winter around the country. In California, however, the price peaked at nearly \$60 per million BTUs, in December. The state PUC has been investigating why. They found that in 1996, a group of gas pipeline executives met in a Phoenix hotel, to discuss the “opportunities” arising from California’s newly deregulated electricity market. Representatives from El Paso Natural Gas Company, and Southern California Gas and San Diego Gas & Electric (which

later merged to become Sempra Energy), agreed to kill new pipeline projects that would have brought more, and cheaper, natural gas into California.

El Paso, which owns the main pipeline transporting out-of-state gas to the California-Arizona border, is being sued by state regulators, electric utilities, and anti-trust attorneys for using its control of the market to drive up the price of natural gas for Californians.

Under Federal deregulation, El Paso is required to sell all of its pipeline space to utilities, gas marketers, and other users, and just function as a transportation link. But El Paso sold about 40% of that pipeline capacity to its own trading arm, El Paso Merchant Energy. This allows El Paso to hoard pipeline space, creating an artificial shortage. “What we are seeing is high gas prices that cannot be attributed to the cost of gas, but the ability of El Paso to exercise market power and manipulate prices,” PUC attorney Harvey Morris told the Feb. 4 *Los Angeles Times*.

The impact of this manipulation of the market is apparent in the “basis spread,” the difference between the price of gas at the California border, and the price at the Southwestern fields where the gas is drilled. The average spread, or transportation cost, over the past four years was 50¢. This year, the difference reached \$48.50!

According to filings by lawyers for Southern California Edison, every 10¢ increase in the price of gas at the California border raises its electricity costs by \$34.2 million per year. Edison stated that if the cost of gas in the last two months were annualized, the increase in electricity costs would be \$3.4 billion.

El Paso also owns interests in 25 “alternative” energy plants, which sell power to the California utilities. Since the prices charged by these small suppliers to the utilities are pegged to the price of natural gas, there lies another “incentive” for El Paso to manipulate the gas price.

While feigning innocence of the lawsuit charges of price manipulation, El Paso reports that its revenues have soared. El Paso Merchant Power’s revenues more than quadrupled in the fourth quarter of last year, in large part from its natural gas sales to California. Profits climbed to \$176 million from \$112 million the year before.

What Is El Paso Natural Gas?

Since 1996, the Houston-based El Paso has been on a buying spree, consolidating control over the oil and gas transport industry of the United States. On Jan. 29, El Paso announced that it had completed a \$24 billion merger with the Coastal Corp., bringing its value to over \$50 billion, making it the fourth largest U.S. energy company. El Paso currently owns 58,000 miles of pipelines in North America, and says it moves a quarter of this nation’s natural gas, to 70% of the American population—more than any other single company in the world. In five years, it has transformed itself from a \$2

History of Natural Gas Regulation

1938: Congress passes the Natural Gas Act, establishing Federal authority over interstate pipelines, after the Supreme Court ruled that the Constitution gives authority to the Federal Power Commission to regulate interstate transportation and wholesale sales of gas.

1954: U.S. Supreme Court rules that the Federal Power Commission has to regulate the price of natural gas at the wellhead, if the gas is sold in interstate commerce.

1978: Natural Gas Policy Act phases in decontrol of most natural gas prices at the wellhead, overturning the 1954 Supreme Court ruling.

1985: The Federal Energy Regulatory Commission, formerly the Federal Power Commission, issues regulations to establish a voluntary program for pipelines to become “open access,” to anyone who wanted to buy gas, to encourage “competition.”

1989: Congress passes the Natural Gas Wellhead Decontrol Act, which phases in the removal of price controls of all natural gas at the wellhead.

1992: FERC makes the “open access” rule mandatory, so all producers can compete directly for buyers. Interstate pipelines are required to “unbundle” services, to “open the market” to unregulated companies.

2000: Initiatives are under way in 20 states and the District of Columbia to allow residential customers to “choose” their natural gas supplier, rather than depend upon their local utility.

billion pipeline company, to a \$50 billion diversified international conglomerate.

El Paso, like other international energy conglomerates headquartered in Houston, such as Enron Corp., is branching out into the “opportunities” in the Ibero-American markets, where electricity is being privatized. Recent forays have been into Brazil and Argentina.

The company is moving into new trading activities, which will undoubtedly soon overshadow its business in the physical delivery of oil and gas. The “most advanced risk management technology in the energy industry” has been brought in to the company’s Merchant Energy Group, which will trade in weather derivatives, and other “commodities.”

It Will Only Get Worse

No one should have any illusions that the price of natural gas will drop down to where it was a year ago, after the Winter is past. Most analysts know that a price increase, at least double last year’s level, has now become institutionalized in the industry. At a conference sponsored by Cambridge Energy Research Associates (CERA) on Feb. 14 in Houston, El Paso president William Wise, said, “If we have a very hot Summer, I think you’re going to see prices spiking in the Summer, just like we did back in November and December.” He should know.

But Tom Robinson, CERA gas expert, described the way natural gas pricing actually functions, stating that gas prices could come down, if crude oil prices fell. (Out the door with the hoax of supply and demand.) The multiple increase in natural gas prices has been felt across the country, the result of speculation, manipulating the market, and collusion.

But, another crisis looms. Even were producers to crank out more natural gas over the next one or two years, as more wells are planned to come on line, (that is, if the oil price

doesn’t drop, causing a drop in gas prices, leading to a halt in new drilling activity), there will be bottlenecks in the physical distribution of the gas in parts of the nation.

On Feb. 5, the Independent System Operator of New England, which operates the bulk power transmission grid system for the region, announced the completion of a study to address concerns about the growing use of natural gas. The concern was caused by the expectation that within the next five years, gas-fired power plants could account for more than 40% of the region’s electric generation. The study revealed that as early as the Winter of 2003, constraints in natural gas delivery could affect 1,700 MW of generating capacity in the region. These constraints could intensify, the study found, by the Winter of 2005, such that shortfalls in gas delivery could affect 3,200 MW of capacity. The study recommends that New England expand its pipeline infrastructure. If that is not started soon, it will not improve the Winter 2003 situation.

The first step in the deregulation of natural gas was taken in 1978, after a natural gas shortage during the Winter of 1976-77 closed schools in the Midwest one month early, and shut down whole industries. The excuse for the shortage was that the government-controlled price of gas was so low, that there was no “incentive” for the gas companies to explore and develop new resources.

Natural gas, in the form of electricity, and as heat for homes, hospitals, and schools, is not a “commodity,” that people have a choice whether or not to purchase. The purpose and the outcome of natural gas deregulation was to hand mainly oil companies this multibillion-dollar per year energy business.

The fight for re-regulation of the electric utility industry must go hand-in-hand with the fight to re-regulate natural gas, before heating one’s home and having electricity become possible for only the few who can afford it.