



THE OUTLOOK FOR NATURAL GAS IN THE NORTHEAST FOR THE 2005-2006 WINTER HEATING SEASON

December 20, 2005 Update

KEY POINTS

- *The natural gas distribution companies serving the Northeast U.S. are prepared for winter, and have secured adequate natural gas supplies to meet their firm customers' needs.*
- *The regional natural gas delivery system, which relies on multiple supply sources, is operating well. The natural gas storage situation, both nationally and regionally, is in a better-than-average position at this time of the year.*
- *The prices for all fuels, including natural gas, are much higher this year than last. Natural gas utilities have programs in place to advise their customers on ways to help manage their projected higher bills.*
- *The U.S. natural gas market has been challenged this year by a tight supply and demand situation, a high commodity price, and two severe hurricanes that impacted many energy production facilities in the Gulf Coast. This winter, the U.S. natural gas supply market is projected to remain in balance, albeit tighter-than-normal, with expected reduced supplies from the Gulf area offset by steady (and potentially slightly increased) imports from Canada, industrial sector "demand destruction," and general market conservation in response to higher prices.*
- *Energy efficiency is a valuable and important part of any energy plan, especially at this time of high fuel prices. The region's natural gas utilities and government agencies have useful tips on ways to use energy more efficiently in the home and workplace throughout the winter and year.*

Regional Winter Supply Outlook: Supplies Are in Place for Firm Customers

The natural gas distribution companies serving the Northeast report they are ready for winter, and have adequate natural gas supplies to meet their firm service customers' needs in the region this winter. This includes all residential customers, and commercial, industrial and power generation customers with firm transportation and firm supplies.

Storage supplies are in strong shape, and the regional delivery system is operating well.

The local gas utilities plan carefully all year to ensure that they have enough natural gas supplies available to meet their firm customers' needs through the winter, especially on the coldest days.

The region's natural gas system is diverse in its supply mix, drawing natural gas not only from the Gulf Coast area, but also from western Canada, eastern Canada, liquefied natural gas (LNG), and, to a limited extent, propane.

National Impact of the Gulf Coast Hurricanes: A Continuing Challenge, but Market is Projected to be in Balance, and System Restoration in the Gulf Continues at a Steady and Positive Rate

There has been concern about the impact of the Gulf Coast hurricanes on the U.S. and regional natural gas markets. An early November report by the Interstate Natural Gas Association of America (INGAA) indicates that despite the reduction in total U.S. gas production because of the storms, the U.S. natural gas supply situation – despite challenges - should remain balanced throughout the winter.

Hurricanes Katrina and Rita caused significant damage to the Gulf Coast states, the center of U.S. oil and natural gas production, refining and processing facilities. The Gulf Coast area produces about 20% of U.S. natural gas supplies, an average of 10 billion cubic feet per day (Bcf/d) compared to the U.S. total of 50 Bcf/d. The U.S. also utilizes approximately another 10 Bcf/d in natural gas imports, mostly from Canada and also from LNG. In the wake of the two hurricanes, over 8 Bcf/d out of a total of 10 Bcf/d in the federal offshore waters was initially out of production, or shut-in. This situation has continued to improve in recent months, with major efforts by natural gas producers, processors and transporters. As of December 19, about 2 Bcf/d of Gulf Coast production was offline due to the impacts of the storms, representing about 4% of U.S. average daily production. Advances continue to be made in the Gulf Coast area regarding the restoration of energy systems.

On November 17, 2005, staff of the Federal Energy Regulatory Commission (FERC) reported that the key factor that will help the U.S. natural gas supply market remain in balance this winter will be conservation and demand side management. On December 15, FERC staff released an update, noting that “recovery in Gulf production continues to be steady and strong”; the restoration is “well ahead” of where staff thought it would be in its mid-November update. On December 6, the U.S. Energy Information Administration (EIA) noted in its December *Short-Term Energy Outlook* that “the interconnectivity of the natural gas gathering system has helped speed the recovery of shut-in production as suppliers reroute gas flow around damaged pipelines to active processing plants. Consequently, in this *Outlook* we have accelerated the recovery of the natural gas supply system from our November *Outlook* prediction.”

Regional Impact of the Gulf Coast Hurricanes: Utilities Have Secured Alternate Supplies to Offset Potential Lost Deliveries from the Gulf; Nevertheless, Likely a Tighter General Market

The Northeast region relies on natural gas from the Gulf Coast area for about 25% of its winter utility supply portfolio (with the rest comprised of supplies from Canada, market area storage, LNG and propane). The natural gas utilities in the region reported that from 5 to 10% of their winter supplies were initially disrupted by the Gulf hurricanes. Since then, the local gas companies serving the region have taken steps to confirm alternate supply arrangements and alternate supply routes to make up for potential lost supplies from the Gulf area. They report that they have secured sufficient supplies to serve their firm customers. And it should be noted that not all production in the Gulf region was impacted by the hurricanes.

The natural gas pipelines based in the Gulf that deliver natural gas to the Northeast region continue to work extremely hard and creatively to restore service to facilities impacted by the hurricanes; this includes in many cases trying to reroute supplies – either to other pipeline systems for delivery to the market or to alternate processing facilities. The pipelines report that they are confident that all firm service customers in the region will be served. This includes all customers with primary firm service, from local gas utilities to commercial, industrial and power generation facilities with primary firm transportation contracts.

Canadian pipeline deliveries to the region continue to operate well, from both western and eastern Canadian supply basins. As well, LNG imports into the region remain steady and essential.

The availability of natural gas for non-firm service customers, such as some industrial and power generation load, will depend upon system conditions and weather. Any interruptions in delivery would be similar to those anticipated by industrial and power generation customers who incorporate the expectation of interruptions in their gas supply and transportation contracts. Such interruptions have been a normal occurrence during peak winter periods. During peak cold weather days this winter, because of the Gulf situation, there may be a tighter supply situation in the secondary market, that is, less flexibility for non-firm customers.

In the New England region, the issue of gas supply for power generation is of particular interest since about 10,000 megawatts of new gas-fired generation have been added to the regional electric system in the last several years. Many of these new units have opted for interruptible service rather than firm transportation service; at the same time, the regional electric grid operator reports that about 4,500 megawatts of these newer natural gas-fired generating units do have firm transportation arrangements.

As noted above, the availability of natural gas for non-firm customers, such as some industrial and power generation loads that have chosen for economic or market reasons not to contract for firm gas transportation, will depend upon system conditions and weather (as well as electric market signals).

NGA notes that it continues to work cooperatively with the regional electric system grid operators in both New England and New York to help support energy system reliability to the fullest extent possible.

The Important Distinction Between Firm and Non-Firm Transportation Contract Arrangements

The issue of “adequacy of supply” comes back to the central issue of the type of natural gas transportation service that a customer enters into with a natural gas provider.

Natural gas is provided under contract terms between a supplier and a customer. The contract terms are considered “firm” or “non-firm”/ “interruptible.” Service to residential customers, for example, is firm. Larger commercial or industrial customers, such as a power generator, on the other hand, have the option of contracting for either firm or interruptible transportation service.

Primary firm transportation service is not subject to prior claim by another customer, is the highest quality service offered to customers, and is a service for which facilities (e.g., pipelines, storage facilities) have been designed, installed and dedicated to a certified volume. Primary firm transportation service takes priority over interruptible service and ensures delivery under almost all circumstances.

Interruptible transportation service is a service which is subject to interruptions when deliveries under such service would interfere with or restrict deliveries of transportation service having higher priority. Therefore, interruptible service (i.e., “non-primary firm” service) includes in its contract terms the possibility of interruption under certain operational and market conditions. Those customers who elect to take interruptible service in any form often have alternative fuel capability for their operation.

It should be noted that an inability on the part of some power generators, for example, to secure natural gas on any given day does not necessarily result from a shortfall in gas supply or gas transportation capacity but more likely reflects system capabilities as defined by contract terms. These are economic decisions of power market participants and do not reflect the adequacy or lack thereof of the natural gas infrastructure.

The Federal Energy Regulatory Commission (FERC), in a report on the New England natural gas system a few years ago, made the following general observation:

“The adequacy of the natural gas infrastructure is based on its ability to fulfill its contractual commitments. Natural gas may be contracted on a firm or interruptible basis. Interruptible contracts are typically less expensive because capacity is only paid for if used, and the supplier or transporter may interrupt service. The natural gas infrastructure is considered adequate if firm commitments are met and terms of the interruptible contract are satisfied.”

Important Role of Conservation and Demand Side Management

As noted above, conservation and demand-side management are considered pivotal to keeping the national natural gas market in balance during the upcoming winter in light of the impact of the hurricanes on national production levels in the Gulf. Both the American Gas Association (AGA) and NGA issued press releases in early October noting the importance of energy efficiency this winter, and the natural gas utilities in the region are communicating directly with their customers about practical steps they can take to conserve energy. At the end of this document is a box outlining several helpful websites, from government to industry, that provide suggestions on energy-saving ideas.

Regional Natural Gas Industry: Working Together to Support Reliability

The natural gas industry in the Northeast is committed to meeting the needs of its firm customers at all times, including during periods of peak demand. The system was designed, built and operates so that there will be no interruption to firm service gas customers.

For decades the natural gas industry in the region has worked together through joint committees to provide a network for mutual aid, should a supply interruption occur. NGA's Gas Supply Task Force provides a link between the companies involved in delivering natural gas in the region, from the interstate pipelines to the LNG importer and transporters, to the local gas utilities. Should there be an emergency situation on the natural gas system that might impact supply levels in the region, the Task Force could be called into action to assess the situation and to take any appropriate actions to help ensure delivery of natural gas. It also updates state regulatory commissions on developments or actions.

NGA's Gas Supply Task Force is in place again this winter to monitor the regional supply situation and to be prepared to coordinate supplies for the region as needed.

Planning for Future Supply Needs

The region's gas industry also works every day to strive to secure future supplies to meet the region's growing need for natural gas. The Northeast region has several pipeline projects and LNG terminal projects in development that would bring great benefits to the region, in terms of mitigating price volatility, meeting growing customer demand, and achieving regional environmental goals. NGA hopes that timely

action can be taken to move needed projects forward, to help secure a greater diversity of natural gas supply sources and a greater diversity of natural gas infrastructure locations.

The Weather Remains the Biggest Factor in Supply & Price Fluctuations

In a final point on the supply outlook before addressing the commodity price, the biggest factor in determining the ultimate supply and price dynamic remains the weather.

How cold the winter is will determine to a great extent how high the price for the natural gas commodity will be and how tight the supply market might be on a peak winter day. In its September 2005 winter outlook, the Natural Gas Supply Association observed: "The weather is the largest single factor affecting demand and customer bills, and it is also the most difficult to predict." The weather will determine a great deal, both nationally and regionally, for all energy sources. Colder weather would likely mean a tighter supply market and price spikes; warmer-than-normal weather would likely mean easing prices and reduced demand on the supply system.

The impact of Higher Commodity Costs on Customer Bills

Higher energy prices nationwide will likely result in higher heating bills for consumers this winter. High demand, a tight national supply situation, and the impact of the Gulf Coast hurricanes have challenged the entire U.S. energy marketplace. This has also caused greater pressure on the commodity price of natural gas and will lead to higher bills for customers.

The price paid for natural gas by consumers depends on the market price of the gas commodity itself, and the cost of transporting that gas from production areas to customers. The natural gas commodity price has been higher throughout this year owing to several factors, such as higher demand resulting from a stronger national economy, a hot summer that led to greater natural gas use in power plants, and a tight supply and demand balance for all fuels. The impact of the two major Gulf Coast hurricanes has further stressed energy prices, including natural gas.

Natural gas utilities work throughout the year to purchase a reliable, diverse and cost-effective supply of natural gas in advance of the winter heating season. Market conditions have been especially challenging this year. As a result, customers should be planning for higher monthly gas bills, even with normal temperatures this winter. The average monthly bill this winter could be substantially higher compared to last, and if the winter is colder than normal, the impact to bills could be higher (and conversely, if the weather is milder, the lower average consumption would help to ease the bill impact).

Many natural gas utilities in the Northeast have filed for rate adjustments with their state public utility or public service commissions that regulate rates for homeowners and many businesses. In some cases, these adjustments to gas costs are filed with state regulators monthly. It is important to note that gas utilities do not make any money on the adjustments in the cost of gas; it is a pass-through cost.

The U.S. Energy Information Administration (EIA) in its December 2005 winter outlook estimates that the average U.S. household will spend approximately 38% more this winter compared to last for natural gas home heating; its projection for Northeastern households is lower.

Steps for Customers on Ways to Manage Projected Higher Heating Bills

There are steps that customers can take today to manage the expected higher cost of energy this year. Customers are encouraged to contact their local gas utility for suggestions on budget-billing and bill payment plans. A budget-billing option allows customers to equalize monthly payments. For example, a customer's annual bill can be estimated based on past energy use and then divided into equal monthly payments.

The local utilities also offer tips and have programs in place to help customers reduce their bill through energy-efficiency and conservation measures (see below).

The higher energy costs will be a particular concern for lower-income citizens, who are the most vulnerable to high energy costs. They are encouraged to contact their utility to find out how to apply for state and federal energy assistance programs. In addition, many social service agencies and charitable organizations have begun accepting energy assistance applications for the winter heating season.

State Regulatory Oversight and Coordination Contributes to Customer Protection

State public service / public utility commissions have oversight over the distribution costs of natural gas utilities. Utilities submit cost of gas adjustments to the commissions during the year as appropriate, to reflect different seasonal costs of the gas commodity. If the cost of gas itself rises or falls over a given period, that variation is reflected in the cost of gas adjustment provision. State oversight provides an additional measure of consumer protection.

Importance of Low-Income Home Energy Assistance Program (LIHEAP)

The Low-Income Home Energy Assistance Program – or LIHEAP – has been particularly important to the Northeast region, one of the coldest regions in the nation. This winter, with projected higher prices for all fuels, the value of the LIHEAP is even stronger. Initial funding for this year has been authorized, but

more funding is necessary in light of the significant rise in all energy costs. NGA strongly urges greater federal support for this important program.

Value of Energy Efficiency

Finally, the concern this year in all energy markets about supply levels and price volatility underscore the continuing value of energy efficiency.

Energy efficiency is an essential part of the national and regional strategy to meet the challenge of high prices and tight supplies this winter, but no less so for the future. In 2003, the National Petroleum Council (NPC), in a major forecast of North American natural gas supply and demand, focused on energy efficiency as one of the four key planks of the continent's natural gas future.

Utilities have made considerable investments over the years in offering to their customers more efficient equipment and technologies which have proven to be increasingly valuable.

Efficiency gains have been achieved. For example, on average, natural gas use per residential customer has been declining by about one percent per year since 1980. These gains have been achieved through enhanced appliance efficiency and more energy efficient home construction. The American Gas Association (AGA) projects that U.S. average residential gas usage will continue to reflect efficiency improvements. Continued progress in this area would help manage price volatility and contribute to a balanced supply portfolio.

FURTHER INFORMATION ON EFFICIENCY TIPS & CUSTOMER ASSISTANCE PROGRAMS

For further information, contact the following organizations, or visit their web sites.

Local Distribution Companies:

Contact your local natural gas utility by linking through the NGA web site. From www.northeastgas.org, go to the "Member Companies" link, and select the hyperlink to your local natural gas utility. The utility sites have information on specific programs that the companies offer, as well as, in many cases, links to other energy assistance agencies in their service areas.

Northeast Gas Association

The Northeast Gas Association represents the local natural gas utilities that serve customers in the six New England states, New York, and part of New Jersey. On the NGA web site home page is a link on "Supply & Price Info." that provides links to useful sites on the web. Visit www.northeastgas.org.

American Gas Association

The American Gas Association represents 195 local energy utility companies that serve customers in all 50 states. It has considerable information on its web site concerning the winter outlook. Visit www.aga.org.

New York State Energy Research and Development Authority (NYSERDA)

The New York State Energy Research and Development Authority (NYSERDA) has extensive information on energy efficiency and “smart energy” tips. Visit www.nyserda.org.

GasNetworks

Several natural gas utilities in the region have formed a collaborative that promotes natural gas energy efficiency and provides information to customers on energy-efficient equipment. The information is located at: www.gasnetworks.com.

U.S. Department of Energy (DOE)

The U.S. Department of Energy has a helpful web link providing energy-saving tips for homeowners and others. The information is located at: www.energysavers.gov.

U.S. Energy Information Administration (EIA)

The EIA is the statistical agency of the U.S. Department of Energy. Publications of particular interest include its “Short-Term Energy Outlook,” updated monthly, and its weekly “Natural Gas Market Update.” Its site is located at: www.eia.doe.gov.