

# Price Volatility and LDCs

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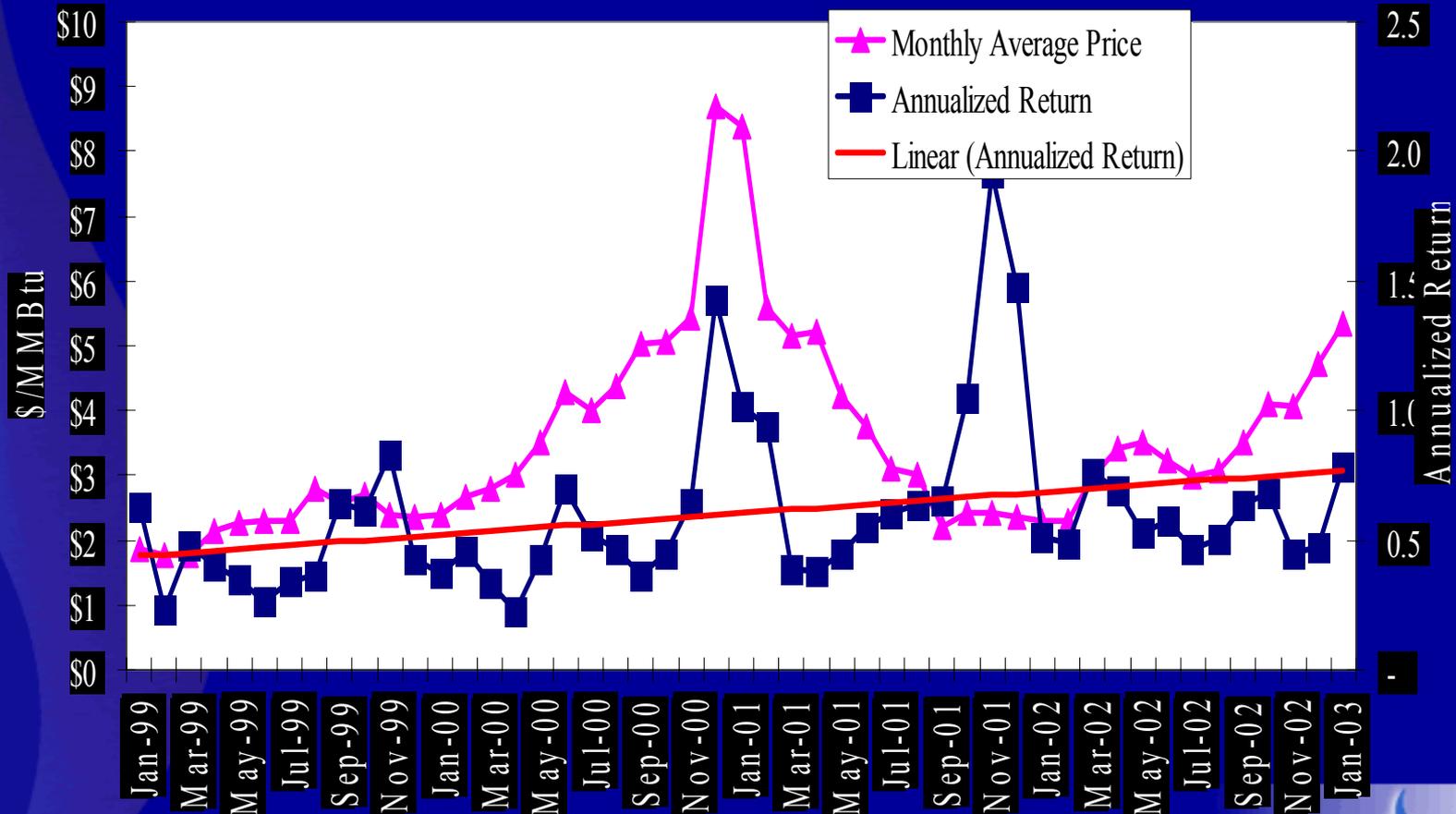
# American Gas Association

- AGA represents 191 local energy utility companies that deliver natural gas to 53 million homes, businesses and industries throughout the United States.
- AGA member companies account for 83 percent of all natural gas delivered by local natural gas distribution companies.
- AGA is an advocate for local natural gas utility companies and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international gas companies and industry associates.

# Topics to be Covered

- 1. Short Term Price Volatility and its impact on long term gas markets**
- 2. AGA's perspective on the role of storage**
- 3. Impact of high price volatility on LDCs**

# 1. Natural Gas Price Volatility has been Increasing



# 1. What does 70% Volatility Mean?

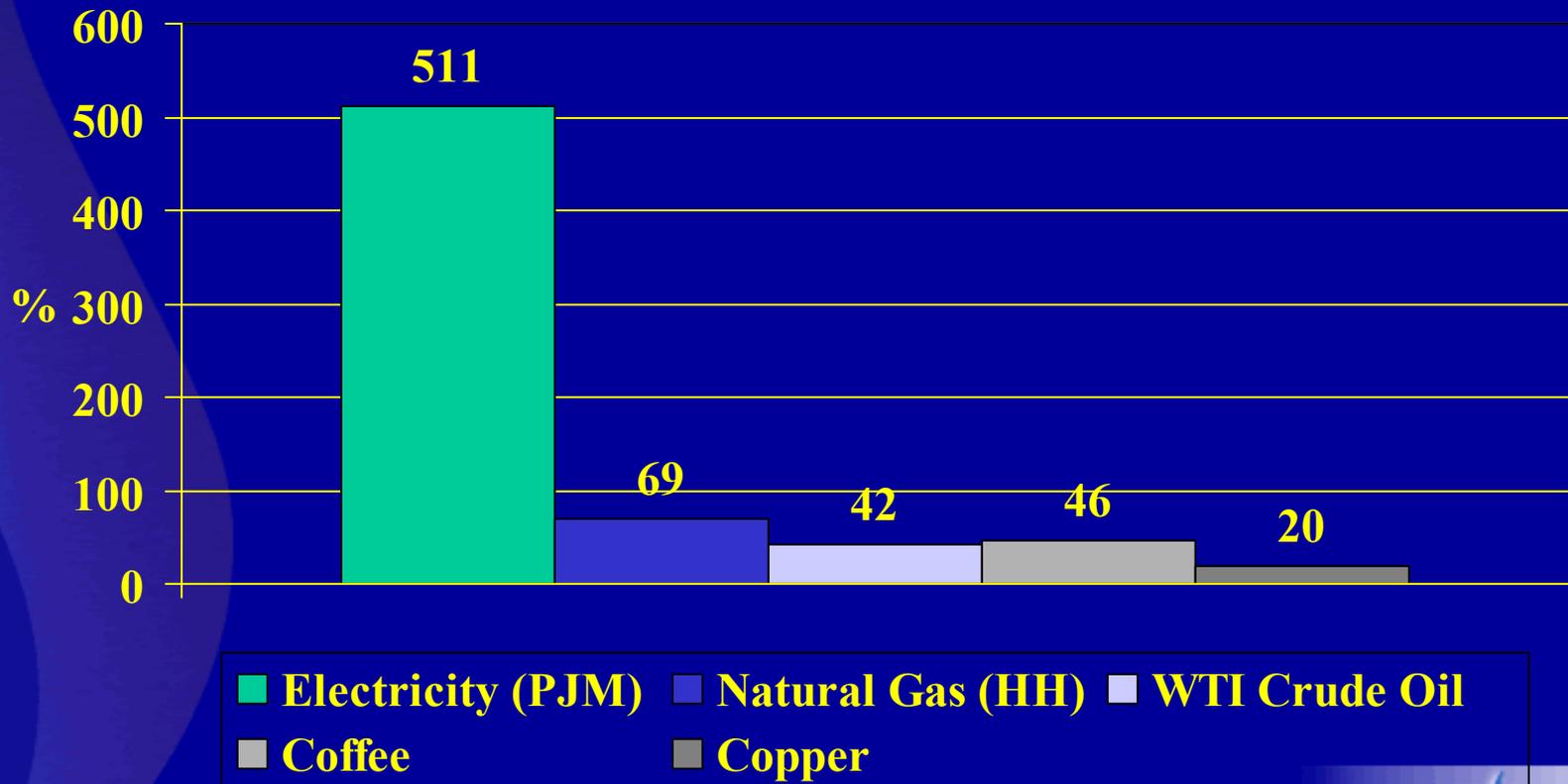
- **If prices are \$2.00 this month:**
  - *There is 70% probability that prices will be \$3.40 or \$0.60 the next month*
- **If prices are \$5.00 this month:**
  - *There is 70% probability that prices will be \$8.50 or \$1.50 the next month*
- **High Price+High Volatility=Big Impact**

# 1. Why are Natural Gas Prices so Volatile?

- a. Inelastic structure of demand**
- b. Inelastic structure of supply**
- c. Market imperfection/manipulation**
- d. Technical/speculative trading**

## 2. A Large Range of Price Volatilities for Different Commodities

1999-2002



Source: AGF Natural Gas Price Volatility Study

## **2. Factors that Explain the Range in Price Volatilities**

- 1. Storage is a key element in reducing volatility**
- 2. Commodities that are easily transported are less volatile**
- 3. Commodities with relatively constant supply and relatively variable demand are more volatile**

# 1. Implications

- **Short term price volatility is expected remain**
- **But tools exist to manage short term price volatility**
- **Continued high prices and high price volatility is expected to reduce the size of the natural gas market in the long run**
  - AEO 2004, NPC 2003
- **Strategies/policies that reduce volatility must...**
  - Increase the availability of “reserve supply” capacity or;
  - Increase the amount of dual fuel capacity

### 3. Impact of Price Volatility on LDCs

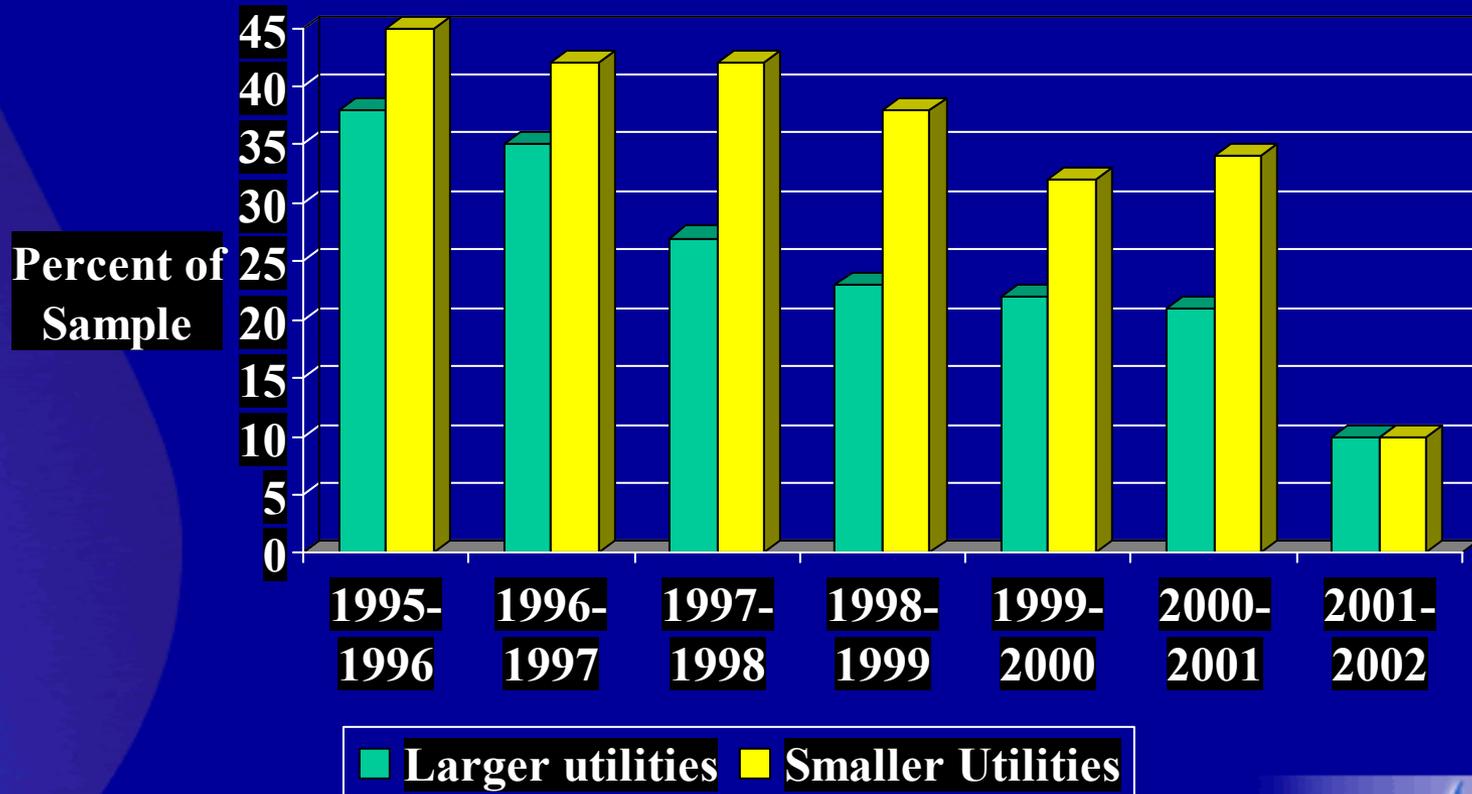
- **For LDCs financial performance can be adversely affected:**
  - Financial risk related to decreased and unpredictable throughput
  - Increase in uncollectible accounts
  - Increase in operating cost associated with shut-offs and reconnect activity
  - Regulatory risk of disallowance of costs

### 3. A Survey of PUCs: Importance of Pricing Goals for LDCs

	Slightly or not important	Somewhat important	Moderately important	Very Important	Extremely Important
Stable Prices	1	4	14	23	6
Lowest Reasonable Prices	0	1	12	18	16
Prices close to market	2	12	17	13	3

Source: GAO; Analysis of Changes in Natural Gas Prices, 2002

### 3. Percentage of Gas Utilities That Hedged None of Their Winter Gas Supply



Source: GAO; Analysis of Changes in Natural Gas Prices, 2002

### **3. AGA's Advocacy Messages to Manage and Reduce Price Volatility**

- In the short run, pre-authorization of hedging programs would promote their use and achieve a primary goal of its customers**
- In the long run, if the benefits of consuming natural gas is to be realized, the supply/access issue needs to be addressed**

**Thank You.**