



Business Owners **ALERT**

By Alan Lamme

No matter what business you're in, electricity probably makes up a sizable portion of your business expenses these days. It's a constant cost of business that will never go away. But with power prices sitting at their lowest levels since electricity deregulation began in Texas nearly a decade ago, business owners need to be aware that the cost of electricity will more than likely rise in coming months and years. In fact, with the power market at near bottom, there may never be a better time to lock into a fixed electricity rate.

Understanding the basics of how electricity is priced is quite simple, as power prices are essentially tied to the cost of natural gas. This is because in Texas, about 70 percent of the capacity to generate power comes from natural-gas-fired

POWER RATES at 10-Year Lows Won't Last Much Longer

power generation. In a nutshell, wherever the price of natural gas goes, electricity rates will follow.

Currently, the U.S. natural-gas market is sitting near the bottom of a 10-year price chart, oscillating between \$2.50 and \$3.00 per million British thermal units (MMBtu). Despite the fact that natural-gas and electricity prices are at near-record lows, natural-gas prices could be going up (as soon as 2013 and beyond), which is likely to lift commercial and residential electricity rates noticeably.

Natural-gas prices are at ten-year

lows primarily due to a combination of factors: the tepid 2011–12 U.S. winter (logged into the record books as one of the warmest winters seen in the U.S. in decades) and several years of non-stop drilling in prolific natural-gas shale production areas created a massive glut of the home-heating and industrial fuel. While some additional near-term downside could still be ahead for natural-gas futures prices this fall—around late August through late September—the longer-term horizon suggests that natural gas could make one of the

most surprising bounce-backs seen in many years.

From a technical standpoint, natural-gas prices have been in a descending trend over the past four years, beginning in fall 2008 and continuing all the way through today. In fact, since the highs in July 2008, when prices hit nearly \$15/MMBtu, natural-gas prices have dropped roughly 70 percent—making natural gas one of the worst-performing commodities of the last few years.

The ultra-low price of natural gas, recently trading in the \$2.50 to \$3/MMBtu range, has pressured natural-gas producers to put the brakes on production, new drilling initiatives, and well completions.

In fact, that slowdown in the drilling process is already underway, evidenced by months of steadily falling natural-gas rig counts, as reported by the weekly Baker Hughes rigs report.



Over the last several months, one of the largest natural-gas producers in the world, Chesapeake Energy, announced a 50 percent production shutdown. Producers such as Conoco, Occidental, Talisman, and others are following suit.

As natural-gas prices have drifted lower, more and more natural-gas producers are bringing natgas production and drilling initiatives to a near screeching halt. Over the last several months, one of the largest natural-gas producers in the world, Chesapeake Energy, announced a 50 percent production shutdown. Producers such as Conoco, Occidental, Talisman, and others are following suit. It's become obvious that, the production of natural gas in some of the most prolific gas production areas all across the U.S. is now falling into decline.

Meanwhile, on the demand side of the equation, all sorts of new natural-gas demand is undoubtedly on its way into the U.S. market. This demand creates a situation in which the proverbial stars are aligned: a notable reduction in supply will be met with a notable increase in demand in the months and years ahead. This is a recipe for a very bullish outcome in natural-gas prices—and for electricity rates as well.

From the demand perspective, because of the current low price of natural gas, utilities across the U.S. are initiating an enormous coal-to-natural-gas switch. Furthermore, the Energy Information Administration (EIA) estimates that, with the new intrastate

clean-air rules being mandated by the Obama administration, utilities will be retiring and decommissioning a vast number of old, "dirty," coal-fired power-generation plants across the U.S. over the next couple of years—a trend that is already beginning to take shape in 2012. A majority of these utilities are opting to build new natural-gas-fired power-generation plants. The federally mandated clean-air rules, coupled with historically low interest rates, are supporting utilities' rapid move to build these new gas-fired power plants immediately, rather than waiting.

Countless other natural-gas end-user and consuming initiatives are also happening in the U.S. For example, public transportation, as well as the industrial/commercial complex, is entering aggressively into the natural-gas market. Everything from fleets of natural-gas-fueled buses to masses of new 18-wheeler freight trucks are already a reality in many states throughout the U.S.—but many, many more of these vehicles are coming.

Case in point: earlier this year, Houston, Texas hosted the first-ever "natural-gas vehicle infrastructure" conference. The conference was focused on creating a nationwide network of natural-gas fueling stations. Once the network is built, companies like Ford, Toyota, and General Motors

will build more vehicles that run on natural gas. Clearly, natural gas is quickly becoming an alternative to gasoline as a transportation fuel.

In addition, liquid natural gas (LNG) import facilities built in the U.S. in the last five to 10 years are now converting to export facilities to take advantage of natural-gas prices running as high as \$17/MMBtu outside the U.S.

As well, natural gas has typically been a good barometer of the health of the overall U.S. economy because the fuel is so heavily enmeshed in the production of hundreds—if not thousands—of products, including chemicals, fertilizer, steel and aluminum, plastics, carpet, textiles, food, and so on. As such, a return to a healthier economic environment in the U.S. is likely to notably increase the industrial-demand/consumption side of the natural-gas market.

Lastly, as we all know, Mother Nature can certainly throw curve balls when it comes to demand for the home-heating and industrial fuel in the winter, summer, and hurricane seasons. All it will take is a series of unusually cold winters or exceedingly hot summers, or another active hurricane in the Gulf of Mexico, to throw the supply/demand balance out of equilibrium, which could be another feather in the cap of natural-gas market bulls.

When it comes to electricity prices for commercial businesses in the Houston area, business owners and managers need to understand that power rates fluctuate daily with the underlying natural-gas market. Currently, however, fixed rates for one to three years are ranging from 5 cents per kilowatt hour to just over 6 cents per kilowatt hour, not including the utility's transmission and distribution charges. The utility's fees do not change from electricity provider to electricity provider, so the most important component in comparing rates is the straight electricity rate.

Working with an energy consultant and analyst can offer some real advantages for businesses, including knowledge of the best time to “trigger” a rate based

on market conditions. Consultants can also explain the advantages and disadvantages of certain provider contracts.

Any way you look at it, now is the time to lock into longer-term electricity rates if you're a business owner or manager. **N**

Alan Lammey has 15 years of experience as an analyst and journalist on the topics of crude oil, natural gas, power markets futures, basis and options markets. For seven years, Alan has also hosted a radio program, Energy Week, on Houston's NewsTalk 1070 AM. Alan can be reached via his website, www.TexasEnergyAnalyst.com, or at alammey@TexasEnergyAnalyst.com.