



# Energy News

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## Natural Gas Prices—Understanding the Complete Picture

Do you ever wonder what goes into the price of natural gas you pay on your invoice? Delivering gas from a wellhead to your meter can be a complex process involving many industry players, which may make it difficult for consumers to fully understand the complete picture. But the process can be simplified – and once you understand it, you'll be able to watch the market and make informed decisions about your natural gas supply purchases.

Natural gas prices are comprised of three key components: commodity, basis and distribution/operational costs.

### Commodity Cost

First, natural gas must be extracted from the ground (onshore or offshore domestic production) or imported (usually in the form of liquefied natural gas or LNG). The cost to produce and remove water and impurities from this fossil fuel will ultimately become the main portion of the natural gas commodity cost. Natural gas is either produced or imported from many geographical locations. The commodity price may vary based on the technology used for extraction or distance and volume of shipping (in the case of LNG). The natural gas industry uses one location as the central pricing point for natural gas, called Henry Hub. Henry Hub is a physical location in Erath, La., where many gas pipelines interconnect and gas is readily available. To that end, your natural gas price is assumed to start with the price at Henry Hub, in addition to the costs associated with getting that gas to your meter. (Sideline fact: New York Mercantile Exchange “NYMEX” Natural Gas Futures prices also are benchmarked off Henry Hub).

### Basis

Like other commodities, the cost of natural gas depends on supply and demand, which will vary by location. A densely populated city in the northeast part of the country, where consumers often experience extremely cold weather, likely will have very strong natural gas demand. Conversely, a warmer rural area of Texas may have less consumption and be located near a natural gas production area with high supply and low demand. Each of these areas will price natural gas differently based on its supply and demand balance, and therefore represents a unique market. The price of natural gas at a market is called basis. Basis is simply a purchasing point and its dollar value reflects the price difference between Henry Hub and the market in which the gas is used. Basis can be either a positive or negative value – meaning that a given market price may trade higher or lower than the Henry Hub benchmark price.

As an example, assume the Henry Hub benchmark price is \$5/MMBtu (million cubic feet of gas) and the Chicago basis is trading at \$0.60/MMBtu. This would imply a market price to buy gas in the Chicago market area of \$5.60/MMBtu. Now assume Houston Ship Channel basis is trading at -\$0.10/MMBtu. This would imply a market price to buy gas in the Houston market area of \$4.90/MMBtu.

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## Distribution/Operational Costs

The final component of natural gas price is based on meter location and volume requirements. Natural gas marketing companies and utilities purchase gas from producers and other marketers – on a wholesale level - at various purchasing points within a market (recall basis) and transport gas through pipes to your meter. The physical pipelines or utility systems that link these purchasing points to customer meters are much like a toll road system. Pipeline companies and utilities build this infrastructure and then charge for its usage. The cost to move gas through a pipeline or utility system to your meter is called the distribution cost. In some cases, these distribution costs are embedded in the basis (or market price) quoted by a marketer. In other cases, distribution costs are shown as a separate line item on a customer invoice or charged directly to the customer.

Natural gas marketing companies and utilities have many customers inside a market area. They aggregate their customers' needs and then buy and sell gas every day to cover their total volume requirements. Each customer burns gas in a unique pattern, also known as a load profile. When a marketer or utility goes out to the market to buy gas for a particular day, the amount they will purchase will be the total of the customers' load profiles for that day. If more gas is burned than expected, the marketer or utility must act quickly to purchase gas to cover the deficiency. Similarly, if less gas is consumed, the marketer or utility must sell the excess gas back to the market. All of the costs associated with balancing this gas for a customer or group of customers make up the operational costs of the gas price. A chemical processing company that runs around the clock likely will burn gas at a steady rate, keeping their operational costs minimal and flat. However, a manufacturing company that shuts down and starts up production likely will have major swings in its gas use and will incur larger operational (balancing) costs. Similar to distribution costs, operational costs may or may not be itemized on your natural gas invoice – as rules and requirements vary among marketers and utilities.

## Your Total Gas Price

The equation below summarizes the three key components of your gas price:

<b>Commodity Cost</b>	The general cost for gas production, benchmarked daily at Henry Hub
<b>+ Basis</b>	The locational value difference between gas at a particular market compared with the value of gas at Henry Hub
<b>+ Distribution/Operational Costs</b>	If broken out from Basis, the cost associated with moving gas from a purchasing point within a market area, through a pipeline or utility system to your meter and the costs associated with providing you with your daily volume requirements (balancing)
<hr/>	
<b>= Total Gas Price</b>	

## Factors That Affect Your Natural Gas Price

Gas prices can be volatile, often making it difficult to stay within your natural gas budget. Below are some of the major factors that can impact the three components of gas prices, as well as a short discussion on how to mitigate the burdens of volatility:

Price Component	Impacting Factors
<b>Commodity Cost</b>	<ul style="list-style-type: none"> <li>Supply disruptions or outages caused by major events like hurricanes</li> <li>Geopolitical events</li> <li>Sudden growth or downturn in the economy</li> </ul>
<b>Basis</b>	<ul style="list-style-type: none"> <li>Regional supply constraints or excesses</li> <li>Extreme weather</li> </ul>
<b>Distribution/Operational Costs</b>	<ul style="list-style-type: none"> <li>Infrastructure supply/demand (the greater pipeline capacity available to transport gas, the less demand and thus less transportation charge)</li> <li>Major swings in gas usage will result in higher operational/balancing costs</li> </ul>

As you can see, there are many factors that can impact the price of gas from a wellhead to your meter. Developing a natural gas purchasing strategy has been proven to be one of the most successful means of preventing budget uncertainty. You can hedge against price spikes by using NYMEX Natural Gas Futures (locking in the commodity) and other products (basis locks or city gate locks).

CES prides itself in providing the tools and resources to assist customers in developing a customized gas purchasing strategy to meet a business' needs. Speak to your CES account executive today to learn more!

**Develop a Strategy with CES:** An effective natural gas purchasing strategy requires four key actions:

1. Determine your objective—do you want to beat last year's budget, do you want to reduce risk, etc.?
2. Define your strategy—this step requires developing a written energy risk management plan and requires a good understanding of the various price components.
3. Study the market—having the ability to track the factors that affect gas prices will give you a competitive edge over the market!
4. Implement your strategy—establish a budget and a time frame and conduct a post-mortem review to confirm your strategy is working for you!

**Your account executive can assist you to develop a customized strategy for your business.**

# Energy News

## Regional Reports

### Gulf Coast

#### Louisiana/Mississippi/Texas

##### **Don't Leave Money on the Table:**

**Reminder:** CenterPoint Energy gas utility lowered its threshold for competitive gas supply to 25 Dth/day in the Texas market. Any utility customer with meters using at least 25 Dth/day is encouraged to switch to a transportation rate to realize savings immediately. Contact a CES account executive today!

### Midwest

#### Iowa/Minnesota/South Dakota/Wisconsin

##### **Minnesota Power buys high-voltage line to bring wind power to state from North Dakota:**

DULUTH, Minn. - Minnesota Power has bought a high-voltage power line that it plans to use to deliver wind power. The Duluth-based utility, a division of Allete Inc., purchased the 250-kilovolt line from the Square Butte Electric Cooperative, of Grand Forks, N.D. It runs 465 miles from Center, North Dakota, to Hermantown, Minnesota.

Minnesota Power spokeswoman Amy Rutledge says the line now provides the Duluth area with electricity from coal. But she says that power will be replaced entirely by wind energy over the next several years. Rutledge says the \$70 million purchase will save Minnesota Power the cost of building a new line for the 75-megawatt wind farm it's planning near New Salem, N.D. The line will help the company meet a Minnesota state mandate that 25 percent of its power come from renewables by 2025.

*As reported by Associated Press on StarTribune.com*

##### **WISCONSIN UPDATE:**

##### **Governor Doyle urges cap-and-trade deal:**

Wisconsin Governor Jim Doyle said the U.S. should move forward with federal cap-and-trade legislation if international climate legislators are unable to reach an agreement. Doyle believes coal-dependent states such as Wisconsin would need a phase-in period to meet carbon emission limits such as those included in the bill passed by the House of Representatives in June. Doyle suggested a 15 year period in which states would cut emissions below required levels without penalty. Wisconsin is reported to have about 15 companies that emit 25,000 metric tons or more yearly of the greenhouse gases that are affected.

##### **WE Energies coal plant to open:**

The \$2.3 billion coal-burning power plant, located in Oak Creek, flipped the switch to begin the process of having the capability to power 1 million homes. Currently demand for power is down, but the plant will sell excess power into the MISO, the Midwest regional wholesale energy market. Almost one-third of the plants cost was related to environmental controls. The plant also burns coal at a higher temperature than older plants, so it emits less carbon per unit of energy. The start-up comes four and one-half years after construction began.

### Northeast

#### Pennsylvania

##### **Recent Tetco Pipeline Rate Changes:**

Effective December 1, 2009, Tetco changed their pipeline fees for gas transported from the South to the Northeast. Specifically, for gas transported from ELA to M3, the winter fuel rate (December - March) decreased to 7.29% and the summer fuel rate (April - November) decreased to 6.47%.

The commodity fee, however, increased to \$0.0935/MMBtu. Effective February 1, 2010, the commodity fee for gas transported from ELA to M3 will be \$0.0941.

### North Central

#### Illinois/Indiana

##### **Peoples Gas Wins Rate Hike:**

The Illinois Commerce Commission granted Peoples Gas a nearly \$70-million rate hike, which will cost its customers about \$48 more a year on their heating bills.

Crain's Magazine reports the amount was below the \$122 million Peoples asked for but slightly above the \$66 million recommended by an administrative judge for the commission.

In another win for Peoples, the commission agreed to permit the utility to automatically collect from customers the cost of replacing aging cast-iron gas pipes. That provision was bitterly opposed by AARP Illinois and consumer watchdog group Citizens Utility Board which vowed a court appeal if necessary.

It's unclear how much the pipe replacement cost could add to customer bills, although Peoples two years ago estimated it would be about 75 cents per month.

# Energy News

## Regional Offices

Reliable service. People you trust.

### Gulf Coast

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### North Central

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### Northeast

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