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Congress of the United States

House of Representatives

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October 11, 2001

MEMORANDUM FOR MEMBERS OF THE GOVERNMENT REFORM SUBCOMMITTEE ON ENERGY POLICY, NATURAL RESOURCES AND REGULATORY AFFAIRS

FROM: Doug Ose Doug Ose

SUBJECT: Briefing Memorandum for October 16, 2001 Hearing, "Natural Gas Capacity and Infrastructure Constraints"

On Tuesday, October 16, 2001, at 12:00 p.m., in Room 2154 Rayburn House Office Building, the Government Reform Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs will hold a hearing on natural gas. The hearing is entitled, "Natural Gas Capacity and Infrastructure Constraints."

The Federal Energy Regulatory Commission (FERC) re-regulated the interstate natural gas industry through Orders No. 636 and 637 in 1992 and 2000, respectively. Order No. 636 introduced competition into the interstate natural gas industry; subsequently, customers benefited from lower natural gas prices. Order No. 637 lifted price caps in the secondary natural gas market with FERC's recognizing that market power could be exercised in two ways: through withholding capacity to raise prices or through price discrimination" (Order No. 637, p. 83). In recognizing that an entity could exercise market power, FERC noted the importance of monitoring market behavior in Order No. 637.

Despite the last nine years of relatively low natural gas prices, June 2000 to May 2001 experienced very high natural gas prices throughout the country, particularly in Southern California.

Several factors most likely added to the high natural gas prices from June 2000 to May 2001. During that period, California and the West experienced a hot, dry year coupled with a booming economy and a great need for energy. Because the last few years were exceptionally dry, the West had less hydropower than expected. States surrounding California had less excess electricity to sell to California. California found that it required more natural gas to meet its own electricity needs, and drew on older natural gas-fired plants and less efficient peaking facilities.

By August 2000, natural gas prices were almost double at the California border as what they had been in April 2000. Then, on August 19, 2000, El Paso Natural Gas had a fatal explosion that reduced the amount of natural gas on its South Mainline, which feeds Southern California, by 1,100 million cubic feet per day (MMcf/d) for a week ("Prices Fall; El Paso South Mainline Out Indefinitely," Natural Gas Intelligence, August 24, 2000). Approximately 500 to 700 MMcf/d of capacity delivered to Southern California were recovered and maintained throughout the winter. To reduce the spot market price, natural gas suppliers drew on storage in August 2000 to stabilize natural gas prices. They were, therefore, not injecting gas into storage at average rates in preparation for the winter heating season. As a result, natural gas suppliers in Southern California entered into the winter with low natural gas reserves and less interstate capacity delivered.

In November 2000, a cold snap occurred both on the East and West Coasts; natural gas prices increased around the country during the cold snap, but dropped shortly thereafter. However, prices did not drop in Southern California. The market in the electricity and natural gas industries became intrinsically linked and, through most of November 2000 to May 2001, electricity and natural gas prices in California were significantly higher than throughout the rest of the United States. Producer prices of natural gas remained relatively stable during this time period. However, natural gas prices increased dramatically at the California border, especially in Southern California.

The interstate natural gas transportation capacity in California is now approximately 7,040 MMcf/d ("Natural Gas Infrastructure," CEC, September 2001, p. 44), with approximately 45 percent in Northern and 55 percent in Southern California. The intrastate take-away capacity is 3,045 MMcf/d in Northern and 3,180 MMcf/d in the Southern California for a total of 6,695 MMcf/d (ibid, p. 49). The Energy Institute of America, Southern California Gas and California Public Utilities Commission (CPUC) reported different capacity data for the interstate and intrastate capacity; however, all the data show less take-away capacity than incoming capacity. According to the California Energy Commission (CEC), the California intrastate capacity was designed for 15 percent excess of an average weather year. The disconnect in infrastructure between the interstate and intrastate capacity most likely added to the high market prices through scarcity rents and may have provided companies with the ability to exercise market power.

Since May 2001, several factors helped to reduce the high natural gas prices including: a downturn in the economy; more interstate natural gas participants providing more competition; FERC's June 19, 2001 market mitigation plan, which helped bring down electricity prices; FERC's investigation into affiliate abuse and market power; FERC's market monitoring efforts; and, some build-out of intrastate capacity, including Southern California Gas's expanding its system by 375 MMcf/d by the end of this year. While some regulatory and industry actions took place, and prices have stabilized, now is the time to take action to improve the infrastructure, capacity, and policies to help create a healthy, competitive natural gas market

FERC has investigated for several months the allegations against El Paso Natural Gas and El Paso Merchant for possibly exercising market power and collusion. This week a FERC administrative law judge found that El Paso Natural Gas and its affiliate colluded but did not manipulate prices.

This hearing will investigate the barriers to expanding natural gas capacity and infrastructure in California. The aim is to also determine what policies prompted such a market situation in California, with the objective to avoid a similar calamity in other regions of the United States.

The invited witnesses for the October 16, 2001 hearing are: FERC Chairman Patrick Wood III; CPUC President Loretta Lynch (invited); CEC Commissioner Michal A. Moore; Lad Lorenz, Director, Capacity & Operational Planning, Southern California Gas Company; Paul Carpenter, The Brattle Group; Professor Joseph Kalt, Kennedy School of Government; Paul Amirault, Wild Goose Storage, Inc.; and Interstate Natural Gas Association of America (invited).