



AGA
LEADER
DOWNES
DEFINES
BIG
ISSUES

Soaring natural gas heating bills this winter is driving home the need for a multifaceted energy strategy for tens of millions of consumers, according to the outgoing chairman of the American Gas Association. Utility executives accept the view that America's energy base needs to be diversified, with a hefty reliance on renewable power.

"This is a major shift that we are making from a policy perspective in this country," said Laurence M. Downes, AGA chairman in 2005 and chairman and CEO of New Jersey Resources and its principal subsidiary, New Jersey Natural Gas. "We want less reliance on fossil fuels. We are focused on environmental issues—and all of this is totally appropriate."

At a time when energy and its cost has become a top concern to citizens, small business and corporate America, EnergyBiz interviewed Downes to discuss the future of the natural gas industry. Among the highlights of the conversation:

◆ Congress must deliver on its promise to provide billions of dollars a year of increased heating assistance to low-income Americans. ◆ Natural gas remains the fuel of choice as our economy transitions to greater reliance on renewable, nonpolluting energy. ◆ Natural gas companies are poised to invest \$100 billion—and pipelines will spend \$50 billion—upgrading our natural gas infrastructure.

By
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Downes' comments, edited for length and style, follow.



...the problem is not going to go away.

News Flash >>

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GAS AND OIL

Gas consumption will climb 50 percent faster than oil use in the next 25 years, predicts the International Energy Agency. Natural gas is on track to become the second most important energy source, passing coal by 2020. Oil, however, will remain king.

The predictions were reported in the *Wall Street Journal*, which also said the oil companies are aware of this important shift.

Jeroen van der Veer, Royal Dutch Shell chief executive, is quoted in the newspaper as saying, "One day, the question will be whether we should be (called) an oil-and-gas company or a gas-and-oil company."

Russia has the world's largest gas reserves.

energybiz: What will be the political ramifications as consumers get record-high natural gas bills to heat their homes this winter?

DOWNES: Well, it's not going to be good. There will be a greater focus on the need for a multifaceted strategy to deal with this issue of growing demand while supply is constrained. There will be a greater focus on natural gas utilities having the opportunity to use all the tools available to them to hedge their portfolios and reduce volatility. Hopefully, we will see an increase in the dollars made available for those who need help paying their heating bills.

energybiz: Can you explain natural gas prices?

DOWNES: This has been a situation that has been building over the past several years, even before the impact of the hurricanes last summer. We saw prices that were moving up from \$6.50 per 1,000 cubic feet of gas in May to around \$9 in August because of the hot weather we had during the summer, which resulted in a 25 percent increase in the amount of gas used for electric generation. And then along came the hurricanes which drove us up to as high as \$15.

energybiz: And the future?

DOWNES: Even when the infrastructure that was affected by the hurricanes is brought back online, the problem is not going to go away. There is still going to be that fundamental imbalance between demand and supply, which will continue to lead to prices that are higher than what they need to be. When you look at the relationship between demand and supply, you don't see an ability to increase supply in response to changes in demand. That is what has led to a lot of the volatility we have seen in prices.

 **Manufacturers In Turmoil**

THE RISE OF NATURAL GAS prices this winter is cutting into the manufacturing muscle of this country, according to the National Association of Manufacturers.

Almost half of those surveyed by the association said that rising gas costs will force them to lay off employees or freeze or cut wages. More than one-fifth will consider reducing health care or

energybiz: How high will natural gas customers' home heating bills climb this winter?

DOWNES: According to the U.S. Energy Information Administration, a range of about 20 percent up to more than 70 percent is expected, with an average climb of about 48 percent. That will be regionalized, depending on the level of hedging activities that companies did to lock in prices before the run up we saw this summer.

energybiz: Everybody knows that the consumer will bear the pain of this—but what about AGA members, the gas utilities? Are they at risk of having customers switch to other fuels?

DOWNES: That actually depends on the area you are in. But in general, it's fair to say when you have a rising or high-price environment, that's not good for the industry.

energybiz: What action is the industry proposing? Natural gas drilling is at a record-high level, but it's just keeping supply stable. Is the answer increasing liquefied natural gas (LNG) imports?

DOWNES: There is no single answer, and that is a point that sometimes gets lost. The reserve base in the United States is ample. We're seeing levels of wells being drilled at very high levels, yet the reserve additions are not at corresponding levels. We are drilling in mature areas, and we are deciding not to exploit the areas where there could be potentially more prolific reserves. We have to address that issue.

energybiz: Do you recommend going into areas that some deem environmentally sensitive?

DOWNES: The issue has been postured as an "either or." It's either drilling or protect

benefit because of gas price increases.

About two-thirds of respondents said natural gas is their primary energy source. Manufacturers use one-third of the natural gas used in the United States. Its price has doubled in the past year and is six-times higher than in the 1990s, the association said. The following are some comments from the association survey:

the environment. It's important to find the middle ground between both interests. LNG could play an increasing role. Conservation, efficiency and renewables could also play an increasing role. Diversifying our sources of fuel for electric generation beyond just natural gas will also be important. As our economy grows, energy use will continue to grow, and a plan must be established to meet these concerns. Absent that plan—which is what we're seeing right now—you're going to see the response in the form of higher prices.

energybiz: So, you are saying there is no plan on the federal government level?

DOWNES: No, that's not what I am saying. We are taking steps, but still more needs to be done. This is a major shift that we are making from an energy policy perspective in this country. We want less reliance on fossil fuels, and we are focused on environmental issues—and all of this is totally appropriate. Shifting to other sources of energy such as clean coal and renewables is going to take time. Natural gas should be viewed as a bridge in that transition.

energybiz: Let me ask you about the 2005 energy act that was many years in the making. Did the gas industry get what it needed?

DOWNES: We did get some things. We got some incentives for additional infrastructure investments. We also received an additional allocation for the federal Low Income Home Energy Assistance Program (LIHEAP); however, we need that money to be appropriated now. We did get some incentives to promote conservation and efficiency, but more needs to be done because the current fundamental situation in our industry is an imbalance between demand and supply.

energybiz: You mentioned that LIHEAP needs to be funded? What's the issue there?

DOWNES: The energy bill called for funding LIHEAP at a level in excess of \$5 billion a year, but that doesn't guarantee the money. It has to be officially appropriated by Congress. Some have concerns about increasing LIHEAP at a time when federal spending will have to increase because of the impact of the hurricanes. We need to increase LIHEAP funding above the currently authorized level of \$2 billion, which has not been changed for many years. We are in a much higher price environment, and many more people need help. We as an industry believe it's important to increase those dollars.

energybiz: Where do you see natural gas companies in ten years?

DOWNES: I see a greater diversification of the sources of supply of natural gas in ten years, and probably a much greater reliance on LNG.

energybiz: Is LNG currently about 3 percent of the market?

DOWNES: Yes. Historically, it has been valued as a peaking fuel.

energybiz: As you look around the world, how much LNG is out there and how large could that percentage grow in your view?

DOWNES: It could be anywhere from the mid-teens to more than 20 percent of total supply. The world has plenty of natural gas reserves which historically have not been economically feasible to develop. In a higher price environment, those reserves could be brought to market using the liquefaction process. The demand for global energy will continue to increase and you're going to see competition for more LNG. It's not all going to

AMERICAN GAS ASSOCIATION

- Represents 195 local utility companies
- Serving 56 million homes, businesses and industries
- Natural gas meets one-fourth of U.S. energy needs

NEW JERSEY RESOURCES

Operating Revenues the 12 months ended:

- September 30, 2005—\$3.1 billion
- September 30, 2004—\$2.5 billion

Net income 12 months ended:

- September 30, 2005—\$76.3 million
- September 30, 2004—\$71.2 million

NEW JERSEY NATURAL GAS SERVES

- 460,000 customers

It's the worst I've seen since we started this company 45 years ago. It's a seismic market disruption.

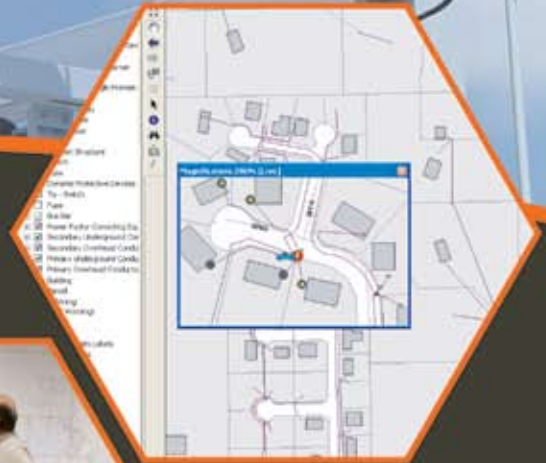
Virginia Ferrell
President, Capital Engineering and Manufacturing Co.
Chicago

We make automotive components. The cost of oil and natural gas has increased our price of materials by as much as 93.1 percent since March 1, 2004. We will have to resort to job cuts, wage freezes and benefit cuts to stay in business.

James Marshall
President, Sur-Flo Plastics & Engineering Inc.
Warren, Mich.

We are in a rural area and hate to lose our employees to stay in business. Something needs to be done now.

David Miller
President, Volunteer Adhesives Corp.
Lafayette, Tenn.



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go to the United States. We will be competing with China, India and the entire Asian region.

energybiz: Do you think distribution companies like yours will be playing a role as fuel cells take off and as natural gas becomes a fuel for transportation?

DOWNES: Fuel cells could represent a really important market diversification opportunity for distribution companies. There are a lot of exciting things going on with fuel cells in Japan right now. Those will be unfolding over the next several years.

energybiz: Putting generation closer to users helps avoid congestion on the electric transmission grid.

DOWNES: That is correct. It's also a more efficient use of the natural gas infrastructure.

energybiz: What level of capital spending does the industry face?

DOWNES: Energy companies in New England have expressed concern about the need for additional pipeline capacity in that part of the country. There is going to be substantial spending unfolding in the next decade. We're expecting distribution companies to spend \$100 billion on infrastructure, and an additional \$50 billion will be invested in pipelines.

energybiz: Are investor-owned natural gas distribution companies in a position to raise that sum?

DOWNES: The AGA membership includes more than 70 publicly traded companies. Overall, their credit profiles have improved over the past several years as companies have gone back to focusing on the basics, their

core business. The \$100 billion that we will have to raise may seem like a large number. But we have the capacity to do that.

energybiz: Mergers and consolidation are transforming the electric utility sector, with companies like Duke Energy and Cinergy, Entergy and Public Service Electric & Gas, coming together. Will the gas side also consolidate?

DOWNES: I won't speculate on that.

energybiz: But the argument that is raised by some on the electric side is you need larger, more efficient entities to raise the kind of capital that must be invested in coming years. Doesn't that hold true on the gas side too?

DOWNES: New Jersey Natural Gas has been spending \$60 million a year consistently, and we have never had a problem raising money. There is a tendency in our industry to generalize about certain topics. There have been some unfortunate examples of utilities with less-than-expected performance on some non-utility investments in recent years and that has obviously affected their ability to get to the capital markets. When you look at the companies with solid regulated activities, they have been able to raise the money that they need.

energybiz: Is that a polite way of saying natural gas companies have not made the bad bets that some electrics have?

DOWNES: I wouldn't say that. Again, you can't generalize these things because companies have different strategies. They have different growth opportunities within their core businesses. They have different views

of the world. Some natural gas utilities have had their own share of bad outcomes on the diversification side.

energybiz: If you were in a position to develop a national energy policy, what would it look like?

DOWNES: There would not be a single solution. The solution would be multifaceted. It is increasing production and doing that sensibly, in an environmentally responsible way. It is about diversifying our fuel sources. It is increasing infrastructure, building things like the Alaskan Natural Pipeline and LNG facilities. Energy efficiency, conservation and renewables are also things we should be focusing on because prices are high.

energybiz: How do investors view natural gas companies?

DOWNES: Wall Street is looking very carefully right now at how different companies are positioned to deal with a changing environment. On the gas distribution side, we still have an industry that has good, solid growth prospects with a fuel that is well positioned in the home heating market. It is an industry that has had a great track record as far as investment returns over the past several years. The financial community is doing its job probing all of these issues and how companies are dealing with them strategically.

energybiz: How are the stocks of gas utilities doing?

DOWNES: The industry is down since October, probably 8 or 9 percent. Given the constant negative messages that have been out there, we have held up pretty well. We're in a period right now where there are some

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Manufacturers In Turmoil

Our natural gas rates are up 66 percent. It's now our biggest cost. We're a brick manufacturer. We've tried to pass the cost on, but you can't do it when you're competing with lower-cost products from China. It's just killing us. We're talking about closing one of our two plants.

Terry Medovich
Controller, Refractory & Industrial Supply Group Inc.
Freeport, Pa.

Our paint line ovens and our galvanizing kettle will cost more than double to operate this winter than last. We're trying to compete with imports that don't have this pressure. This is a crisis for manufacturing.

Phil Raimondo
President, Behlen Mfg. Co.
Columbus, Neb.



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challenges. Our job to convince the financial community is that we are going to deal with them and our performance will remain strong.

...our industry has the leadership to get through it.

energybiz: Do state regulators understand the gas industry?

DOWNES: In general, yes, they do. Right now, a lot of learning is going on. Some states are ahead of the curve. Some are trying to learn from what has worked in other states to see if it's appropriate for them.

energybiz: How has New Jersey Resources performed?

DOWNES: Our company recently announced its 14th consecutive year of higher earnings. That's the longest streak among any electric and natural gas utility in the country.

energybiz: Are you optimistic about the future of natural gas utilities?

DOWNES: When you look back over the last 25 years, there has always been some major event that threatens the industry, such as pipeline deregulation, retail competition, Order 636 (the 1992 Federal Energy Regulatory Commission rule to spur more efficient use of interstate gas pipelines), the corporate scandals and now rising prices. We have been able to get through those and continue to prosper. It's a challenge out there now, but our industry has the leadership to get through it. That's what we get paid to do. ☒

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