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How to Lock In Today's Low Natural Gas Prices

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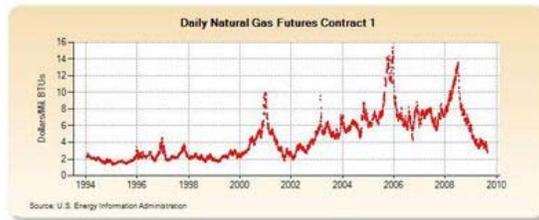
By Richard G. Lubinski

Wholesale natural gas prices are currently at 7-year lows. This fact presents you with an opportunity to lower your costs and increase operational predictability.

Two factors that have driven prices down are the development of new shale resources and declining industrial demand due to the recession. We now have a record surplus of gas in underground wells.

In some cases the price of natural gas is only 25 percent of the cost of oil on a price per MMBTU (million BTU) basis. This is important for the East Coast and New England, where oil is still used to heat buildings. In some regions natural gas is cheaper than coal on a price per MMBTU basis. As a result, electricity producers have an economical and environmentally friendly alternative to coal.

Because natural gas is trading at historic lows (see graph), now is the time to lock in current prices with a fixed-price contract and protect yourself from higher prices when the economy rebounds.



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Some companies are locking in their natural gas prices for 2, 3, or even 5 years to take advantage of low prices and to predict their future operating costs. The latter benefit may help your firm when operating costs affect the cost of goods sold, and thus the price of your company's goods and services. There is also a long-term opportunity to save money by switching from oil and electricity to natural gas for heating and water heating.

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Create Your Action Plan

Unless you have an energy consultant or an experienced facility manager, you may need to review how natural gas commodity offers are done. The key is understanding the method used so that you can compare natural gas commodity quotes on an apples-to-apples basis. Some suppliers quote only with their standard terms and conditions, regardless of your instructions and the formal terms and conditions of your RFP.

Some commercial building owners buy natural gas bundled by the local distribution company (LDC). This is the local regulated natural gas utility that owns the meters, pipelines, etc. In regulated markets, the natural gas commodity is only available from the LDC and your price per MCF (thousand cubic feet) varies depending on the LDC's cost and the time of the year. The LDC's price can change monthly or quarterly if it receives the public service commission's approval. Third-party energy commodity providers add sales tax on top of the natural gas commodity cost.

In a deregulated market, you can buy gas from the LDC via the traditional arrangement, in which case the energy commodity may be called the standard service offer (SSO). If you are permitted to shop for the natural gas commodity from a third party, then this price may be listed as your "price to compare." Unfortunately, if you purchase gas from a third party, some utilities charge more for delivery. Another factor is sales tax, which is typically included in the LDC price of the natural gas commodity. However, this cost may be hidden on your bill as the state's "general use tax."

How and when you use gas affects the supplier's cost. Residential accounts are unattractive because consumption is based only on the heating load. Manufacturers and restaurants have a more attractive load profile because they use natural gas year-round, and therefore they get better price quotes. Prices are higher in the winter due to supply/demand market forces and constraints on interstate pipelines and local LDC pipelines.

Make Sure You Have Apples to Apples

Natural gas commodity prices from different suppliers are not always comparable, and you need to adjust accordingly.

First, check if the delivery fees are the same for LDC gas and third-party gas. Next, check the three or four pages of terms and conditions attached to the price offer. A key element is the condition of the deal and the price. The price quote could be for "full requirements," which means you have the same price regardless of your natural gas consumption each month (volumes).

Alternatively, the price quote may be based on your exact consumption (volume history) during the prior 12 months. In this case, any increase or decrease in volume subjects you to a price adjustment every month for the difference between actual volume and contracted volume. A third contract alternative permits a percentage increase or decrease (i.e. a swing factor) before you are subject to price adjustments each month.

Some LDCs and natural gas marketers base your price on volume in CCF (hundreds of cubic feet) or MCF (10 times the CCF). Others will base your price on the volume adjusted for heat content (BTUs) measured in therms or decatherms (Dth, or 10 times the therm). A CCF is roughly equivalent (within 2 percent) to a therm, and an MCF is roughly equivalent to a Dth.

Your natural gas quote can be based on the NYMEX month-end closing price for natural gas plus transportation, balancing fees, risk, and overhead/profit. Alternatively, your natural gas price could be a fixed price for a period of time, like the next 12 months (called a 12-month strip). Your quote can be to the city gate delivery point (the most common type of quote) or to the starting point of the LDC pipeline. In most cases, this latter price seems lower because it does not include the LDC local natural gas commodity delivery charges as well as the LDC normal customer charge and the local distribution delivery fees.

An alternative type of quote is for the natural gas commodity delivered to the burner tip. This slightly higher price includes the LLC natural gas commodity delivery fee. It does not include the LDC traditional distribution delivery fees and customer charge.

Natural gas prices are quoted in the morning and generally are only valid until 1 p.m. or 2 p.m. that afternoon. If you go beyond the expiration deadline on the offer, it can be quoted again the following day.

The Bottom Line

Given the low prices of natural gas, you should consider "going long." Evaluate the lifetime cost of ownership of your HVAC systems as well as the relative cost per BTU of natural gas vs. oil vs. electricity. If you blend the energy cost with the energy efficiency of your equipment, then you will have a balance between supply-side and demand-side management. HVAC and lighting should be considered long-term investments whose energy efficiency will help your building for many years after a simple payback period.



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Richard G. Lubinski is president of Think Energy Management LLC, an energy consulting firm. He is president of the Northern Ohio Chapter of the Association of Energy Engineers and holds national professional certifications including Certified Energy Manager, Certified Energy Auditor, Certified Demand Side Management Professional, Certified Sustainable Development Professional, Certified Energy Management Systems Contractor, Certified Business Energy Professional and Certified U.S. Green Lights Survey Ally. He was named Energy Engineer of the Year 2009 (AEE Region III).

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