

Utility vs. Marketer

Understanding today's natural gas marketplace | *Blake Baxter*

In an environment of tight or decreasing budgets, schools have been searching all facets of their budgets for any area where they can find savings. For years, one area that has attracted attention has been the utility bill. Many schools have upgraded their physical plants to garner greater efficiencies and lower their energy bills. Another area of interest for school officials has been to try to save money on their natural gas purchases.

Unfortunately, most districts have little understanding of the natural

gas supply chain; how to calculate basic gas industry metrics; or how to negotiate a fair natural gas purchase contract. In numerous cases, school districts have left the protection of the local gas utility and paid more for their natural gas from marketers than they would have paid if they stayed with the local gas utility.

In this two-part series, we will look at these issues and attempt to provide a best practices approach to contracting and evaluating the savings that can be achieved with a metrics-driven gas purchase program.

The Wisconsin Regulated Marketplace

If you do business in Wisconsin, you can either buy natural gas from local distribution companies (*i.e.*, WE Energy, WPS, Xcel, Alliant or MG&E) or you can buy it from a marketer.

If you buy your gas from a local distribution company, then you are buying a regulated gas supply. That is not necessarily a bad thing as the local distribution companies are required to provide all the gas you need and they do so at one price.



However, to meet the first objective, the Public Service Commission requires the local distribution companies to own an excess of pipeline capacity and natural gas to meet any conceivable peak day requirement. Moreover, to meet the second requirement of providing natural gas at one price, the local distribution companies must buy natural gas in accordance with guidance from industry regulators. This almost guarantees that the local distribution companies will never have the low price in the marketplace.

However, when you purchase natural gas from the local distribution companies, because it is regulated, you know exactly what you are going to pay at the start of each month. Most of the pricing components are known well before the start of the month as they are established through a rate case process controlled by the Public Service Commission. For example, Wisconsin Public Service (WPS) is currently approved to charge the

following rates for any sales service customer that consumes between 20,000 Therms and 200,000 Therms of gas per year:

LOCAL DISTRIBUTION CHARGE	
Daily Fixed Charge	\$4.9315/Day
Volumetric	\$0.0624/Therm
Gas Supply Charge	\$0.0149/Therm
Gas Base Rate	\$0.5786/Therm

Once approved, rates will remain in place until the Public Service Commission approves new rates for the local distribution companies.

However, since no one can actually know the future price that gas will be set at, the local distribution companies gas price is adjusted monthly through a process known as the purchased gas adjustment. Prior to the start of each month, each local distribution company is required to provide the Public Service Commission with updates on the cost of gas and pipeline services that the local distribution companies actually incurred.

Based on those actual charges, the local distribution companies then publish a purchased gas adjustment value, which modifies the base rate and results in the price that will be charged for gas in the following month. Again, we will use WPS as the example by using their December 2015 rates:

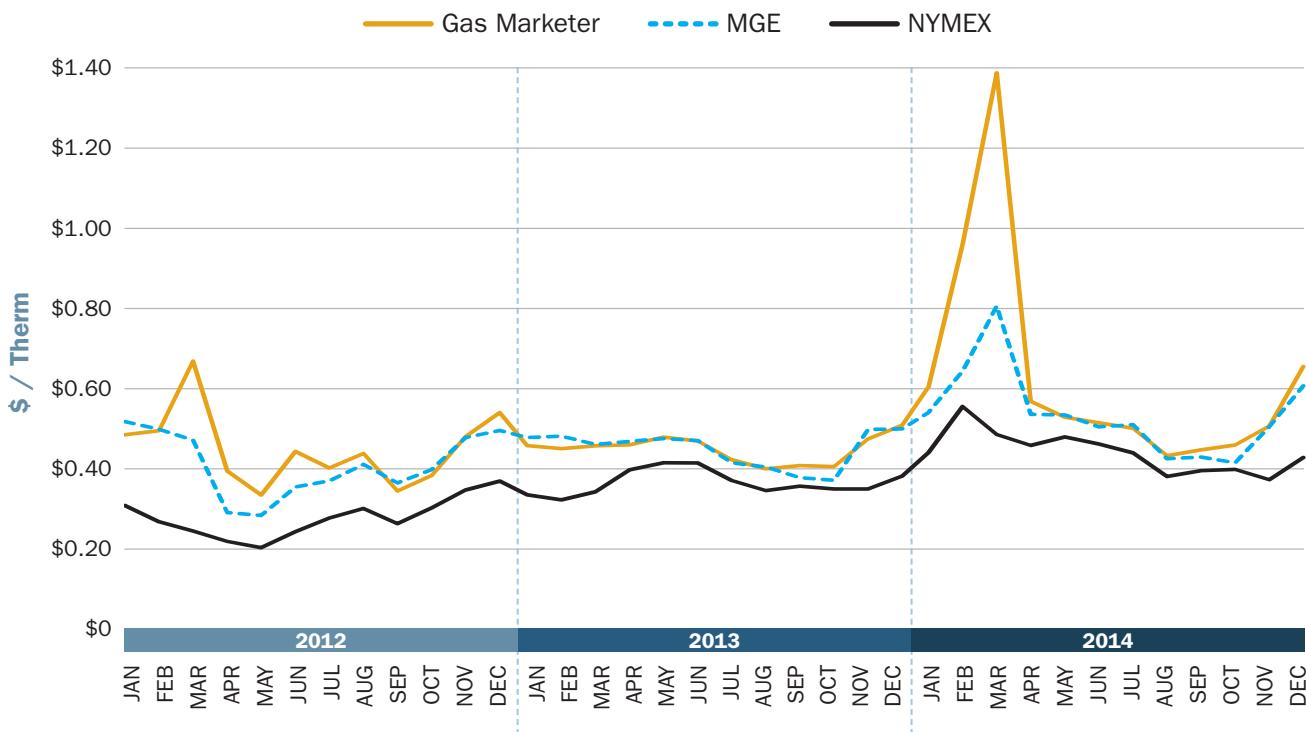
Gas Base Rate	\$0.5786/Therm
Gas Supply Charge	-\$0.2005/Therm
Monthly Gas Rate	\$0.3781/Therm

Since all of these rates are published prior to the start of the month, it is possible to estimate your gas expense for the month:

Daily Fixed Charge	31 days	\$ 152.88
Volumetric	20K Therms	\$1,248.00
Gas Supply Charge	20K Therms	\$ 298.00
Gas Base Rate	20K Therms	\$7,562.00
Total Charges		\$9,260.88

Thus, in the regulated Wisconsin gas market, you have the protection of the Public Service Commission and a certain level of transparency

GAS COST HISTORY FOR COMPANY B



WITHOUT A BASIC UNDERSTANDING of [natural gas] options it is entirely possible to end up with something that is completely unpalatable.

on what you are charged and why. However, you are not likely to get the best gas price nor can you lock in your future price of gas. If prices surge, as they did during the year of the Polar Vortex, then you will be going along for the ride with your local distribution company.

Natural Gas Markets

As mentioned earlier, gas consumers in Wisconsin have the option to purchase their natural gas from marketers instead of the local distribution companies. This means that gas consumers can access a proverbial Chinese menu of gas purchase and delivery options, including both physical and financial terms. However, without a basic understanding of these menu options, it is entirely possible to end up with something that is completely unpalatable. We will start to unravel this topic by looking at the natural gas supply chain.

Natural gas is not unlike most

products that we purchase day in and day out. First you have a product, whether it is a book, a pencil or a dekatherm of natural gas. That product has to be shipped from where it is produced to a location near you. In the case of a book or a pencil, they may be delivered by ship, rail or truck. In the case of natural gas, it is always shipped through the large interstate gas pipelines.

For most of eastern Wisconsin, gas is transported by ANR Pipeline Company and for much of western Wisconsin, gas is transported by Northern Natural Gas Company. Finally, the product is moved from a local delivery location to your facility by your local distribution company.

As with most commercial products, there are numerous sources for determining the price of natural gas. First and foremost, natural gas is traded as a fungible product on the New York Mercantile Exchange or

NYMEX. The NYMEX is sometimes referred to as the futures market as it trades financial contracts for delivery of specific products at specific periods in the future.

In the case of the NYMEX gas contract, the purchaser is buying the right to take delivery of 10,000 dekatherms of natural gas delivered at the Henry Hub in Louisiana at some time in the future such as January of next year. The prompt contract, the one trading for next month's delivery, is extremely liquid with trading volumes that are generally second only to crude oil. As a result, the price of the NYMEX gas contract is reported by numerous sources on the web and in the press.

It is important to remember that the NYMEX contract does not include the cost of shipping the natural gas to any specific location. Thus, anyone purchasing gas must also determine the cost of shipping the gas to their specific region. Fortunately, natural gas trades in numerous locations around the country and the prices paid at these locations are published daily by a variety of industry trade papers. These prices, known in the industry as basis, should be available from any reputable gas marketer or consultant.

Finally, the third leg of the natural gas supply chain is the local delivery function which is performed by the local distribution company. As we noted above, the rates for this service are determined by the Public Service Commission and made publicly available through the local distribution company or Public Service Commission.

Thus, all three legs of the gas supply chain have prices that are transparent and available with a minimum of work.



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Determining Your Gas Metrics

We now have the necessary inputs for measuring the performance of your natural gas purchasing activity. But keep in mind that there are two fundamental and sometimes contradictory strategies that are pursued by most gas purchasers.

The first strategy is called “Beat the Utility.” In this strategy, the sole purpose of purchasing from a marketer is to achieve a better price than what you would have gotten from the local distribution company. The metrics for this are very straightforward as you simply take the rates published by the local distribution company and compare them to what you are paying the marketer. If you are paying more to the marketer, then you have a problem.

The second gas purchasing strategy is called “Beat the Budget.” In this strategy, the gas price is less of a concern than trying to achieving

budget certainty. This one can be harder to evaluate, but you have a number of tools. First and foremost, did you achieve your goal of beating the budget? It is surprising how many purchasers opt for the “Beat the Budget” strategy, but never check the results.

On the other hand, even if you did beat the budget, what price did you pay for that success? Was the budget skewed from the start by the price impacts of the Polar Vortex? The only way to answer these questions is to look at other metrics.

As we discussed above, the obvious choice is to look at what you would have paid the local distribution company. Did you pay more than you would have paid the utility? The second measure would be to look at how the budget price would have compared to the market price in the “Beat the Utility” strategy. Given the gas price movements of the last several years, it is possible that your budget

price may have ended up costing you significantly against the actual market. If that is the case, then you might want to revisit the strategy and the underlying guidelines for its implementation.

Gas Marketers

While local distribution companies are regulated by the Public Service Commission, marketers are not subject to regulation. Marketers are typically subject to the consumer protection laws of the state they reference in their contracts such as New York, Texas or Delaware. This means that there is generally a much lower standard of consumer protection in a marketer contract than you have with the utility.

In the next article, we will take a closer look at marketer contracts and ways to improve your odds of saving money on your gas purchases. ■

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