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Highlights

Highlights of GAO-06-420T, a testimony before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, United States Senate

February 13, 2006

NATURAL GAS

Factors Affecting Prices and Potential Impacts on Consumers

Why GAO Did This Study

In early December 2005, wholesale natural gas prices topped $15 per million BTUs, more than double the prices seen last summer and seven times the prices common during the 1990s. For the 2005-2006 heating season, the U.S. Energy Information Administration predicts that residences heating with gas will pay 35 percent more, on average, than they paid last winter.

This testimony addresses the following: (1) the factors causing natural gas price increases, (2) how consumers are affected by these higher prices, and (3) the roles federal government agencies play in ensuring that natural gas prices are determined in a competitive and informed marketplace.

This testimony is based on GAO's 2002 published work in this area, updated through interviews, examination of data, and review of relevant publications. GAO's new work was conducted from December 2005 through February 2006 in accordance with generally accepted government auditing standards.

www.gao.gov/cgi-bin/getrpt?GAO-06-420T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Jim Wells at (202) 512-3841 or wellsj@gao.gov.

What GAO Found

Since 1999, wholesale prices for natural gas have trended upward because of expanding demand and supply that has not kept pace. The domestic natural gas industry has been producing at near capacity, and the nation's ability to increase imports has been limited. Tight supplies have also made the market susceptible to extreme price spikes when either demand or supply change unexpectedly. Prices spiked in August 2005 when hurricanes hit the Gulf Coast, disrupting a substantial portion of supply and again later when demand was pushed higher because of, among other reasons, colder-than-expected temperatures in early December. Although prices have dropped, they remain higher than last year. Other factors—such as market manipulation—may also have affected wholesale prices. We are currently examining futures trading in natural gas markets for signs of manipulation and expect to report on our results later this year.

While most consumers' gas bills are rising, the degree of the increase depends, in part, on how much of their supply is purchased from wholesale spot markets. Consumers who directly, or indirectly, buy their natural gas mainly from spot markets will see prices that reflect both recent price spikes and the longer-term trend toward higher prices. Our work shows that some of the largest natural gas utilities in a few states expect to buy at least 70 percent of their gas at spot market prices this winter. These companies generally pass these prices on to their customers. On the other hand, consumers and suppliers that have reduced exposure to spot market prices because some of their gas has been purchased through a process called hedging may be insulated from price spikes and may postpone their exposure to even gradual price hikes. In this regard, utilities in more than half the states have hedged at least 50 percent of their supply for this winter by entering into long-term fixed-price contracts and other techniques. This will help stabilize prices for their customers. Nonetheless, high gas prices will hit some consumers hard, including lower-income households and companies that depend heavily upon natural gas, such as fertilizer manufacturers.

The Federal Energy Regulatory Commission (FERC) and the Commodities Futures Trading Commission (CFTC) play key roles in ensuring that natural gas prices are determined in a competitive and informed marketplace. Both agencies monitor natural gas markets and investigate instances of possible market manipulation. Since 2002, FERC has settled a number of investigations involving natural gas market manipulation; for example, one company agreed to pay a settlement of $1.6 billion after FERC found it had exercised market power over natural gas prices in California during the 2001-2002 heating season. From 2002 through May 2005, CFTC investigated over 40 energy companies and individuals, filed over 20 actions, and collected over $300 million in penalties, most of which were natural gas related.