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Studies: Long-term gas contracts needed to lock in benefits of gas-fired generation

By Bryan Schutt

Long-term natural gas contracts have been underestimated and underutilized by the power generation sector and utility commissions across the country, according to upcoming natural gas industry studies.

A new report from the American Clean Skies Foundation argues that natural gas acquisition strategies should be augmented by long-term contracts as a means to reduce risks and costs, while increasing resource diversity and security. Further, regulators should embrace a "nondiscriminatory playing field" for review and approval of such contracts to allow gas-fired power generation to be judged on equal grounds as coal and renewables, both of which make use of long-term supply agreements.

"The economic benefits of locking in record-low prices for natural gas may total tens of billions of dollars," according to the report, which is expected to be released on June 25. "These potential savings are akin to the very large benefits that homeowners and businesses can realize by refinancing mortgages and long-term debt at today's historically low interest rates."

The report, "Power Switch: A No Regrets Guide to Expanding Natural Gas-Fired Electricity Generation," sets out to help the electricity sector and consumers take advantage of decade-low natural gas prices, which ultimately helps natural gas producers. The American Cleans Skies Foundation, or ACSF, promotes energy independence and a low-carbon energy sector through expanded use of natural gas, renewables and efficiency.

ACSF notes that long-term contracts themselves will need some tweaking. Proper long-term purchase agreements would spread the risk of price changes between supply and demand outlets, the report said. "These new agreements would be designed to provide mutually beneficial incentives for gas suppliers and power generators," according to the report. "For example, suppliers and generators could agree to a fixed price for a portion of the fuel, with the balance priced at the market rate."

Five specific stakeholders were singled out by the report as needing to work together: fuel suppliers, utilities and merchant generators, regulators and state governments, consumer advocate groups, and natural gas pipelines.

"Unless key changes to commercial and regulatory frameworks are established at the state level, longer-term, large scale fuel shifts by existing power plants and commitments to new gas-fired capacity are at risk," the report said. "Today's state utility regulations and other factors push most gas generators to rely almost exclusively on spot market gas purchases. We believe that ratepayers are unlikely to be well served by this situation in the long run and that regulators should therefore give close scrutiny to any new short-term gas supply arrangements."

The ACSF report is complemented by an upcoming report from the National Regulatory Research Institute that was commissioned by America's Natural Gas Alliance. NRRI surveyed state utility commissions and the report describes their positions, policy practices and utilization of long-term gas contracting and hedging.

"For the most part, states really haven't addressed this issue. … I would say it's sort of an oversight" author and NRRI principal Ken Costello said. "We could be in an environment that is conducive to them and they could be a good deal for customers."

Costello said the report found that only three states have made significant headway on using long-term contracts: Oklahoma, Colorado and Oregon. In those states, Costello said there's a lot of evidence that the contracts could offer significant savings in the long run, if natural gas follows the price projections of the U.S. Energy Information Administration and others. The natural gas industry needs to do a better job promoting those savings, according to Costello.

"It's sort of the chicken and egg problem. The gas utilities don't want to go ahead unless they get some sort of signal from commissions, and commissions need to be more educated on them," Costello said. "Their mind-set is, 'prices are so low not, why go long term and pay something more.'"

Costello said stakeholders need to convince commissioners to think about issues further out on the horizon, although their tenure may be short. Both Costello and the ACSF report also said long-term contracts need to be structured in a fashion that minimizes the perception of an unfavorable risk/reward balance.

"One possible reason for why gas and electric utilities rely little on long-term gas contracts is that they see little economic gains relative to the risks," according to the NRRI draft report. "As reflected in the survey responses, utilities generally receive no profits from long-term contracts but risk cost disallowances from an after-the fact review. Hindsight review is more likely when the market price of natural gas falls below the contract price and the long-term contract contains rigid terms and conditions. One implication is that state commission would be more accepting of long-term contracts when they contain flexible terms and conditions, including renegotiation rights for the utility."

Costello said both studies show the need for stakeholders to come forward and press the issue. If they can show economic benefits, and commissions take time to listen, all parties could better take advantage of the shale gas revolution.

"[Suppliers and fuel users] should take the initiative and show there could be large potential benefits to customers. And the commissions should have an open mind," Costello said. "Even though the spot is lower than what these contracts would be for the next few years, in the long run they could be lower and save customers a lot of money."