CENTER FOR ENERGY STUDIES

NEWSLETTER

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RESIDENTIAL AND COMMERCIAL NATURAL GAS PRICES IN LOUISIANA: SOME QUESTIONS ABOUT REGULATORY EFFECTIVENESS - by Wumi Iledare

The price Louisiana's industrial and electric utility customers pay for natural gas is well below the national average and lower than most of the other major natural gas producing states. However, the price that Louisiana's residential and commercial customers pay for natural gas was above the national average (five percent higher for residential customers and nine percent higher for commercial customers) in 1990 and above prices in other producing and/or neighboring states (see Table 1). As we tried to make sense of this anomaly, using data newly available from DOE, we found some explanations but also patterns that cause us to question the effectiveness of natural gas regulation in Louisiana. The results of our analysis are summarized in a study which the Center will publish in June.

The most striking characteristic of residential and commercial natural gas prices in Louisiana is the extreme variation from one distribution system to another--frequently over 200 percent--even for systems of similar size, location and regulatory regime. Residential prices ranged from a low of $2.12/mcf to $9.96/mcf in 1990. Even among the five largest firms that dominate the market (supplying 78% of Louisiana's residential customers), the range was wide--$5.01 by Gulf States Utilities was the low and $7.04/mcf by TransLouisiana Gas was the high. We looked at the following for explanations for this wide variation.

Price, Size and Regulation: Grouping distributors by price, size and the relevant regulatory authority, we noticed that three of the four largest Louisiana Public Service Commission (LPSC)-regulated companies--the exception being Gulf States Utilities--charged well above average prices. Residential and commercial customers of these companies paid $23.8 million more than they would have, had they paid the state average price (with the state average calculated without the three companies in question) and $19.1 million more than if they had paid the national average price. But, somewhat paradoxically, the smaller LPSC-regulated companies had well below average prices.

For distributors operated or regulated by local governments, the relationship was reversed. The four largest non-LPSC-regulated distributors--NOPSI and the three largest municipals--charged well below average prices. (Their customers paid $11.6 million less than if they had paid the state average price). However, the numerous, smaller, municipal distributors had well above average prices.

Price, Acquisition Cost of Gas and Margins: All four of the largest LPSC-regulated companies paid a higher-than-average price for gas, with the average of the four as a group being almost 20 percent above the state mean. However, margins for the group were 22 percent below the state average. Acquisition cost for the larger non-LPSC-regulated distributors averaged about 12 percent below the state average with margins about 28 percent lower.

The Spread Between Residential and Commercial Prices: Commercial prices were closer to residential prices (therefore higher) in systems which had higher residential prices and, conversely, the spread between commercial prices and residential prices was larger (therefore lower) in those systems which tended to have lower residential prices.

Responsiveness to Changes in Acquisition Costs: A substantial drop in the average acquisition cost of gas between the two years for which we have data (1990 and 1991) allowed us to explore the responsiveness of the distributors (and their respective regulatory authorities) to changes in costs. We found that those systems with higher prices reduced prices by less as the cost of gas fell, or not at all, while systems with lower prices reduced prices by more.

Conclusions: The principal implication of our analysis is that the pattern of natural gas prices in Louisiana does not fit very well with the pattern one would expect to find if regulation was based on the realities of the natural gas market place. A more sophisticated statistical analysis detailed in the full report showed the association between the costs of distribution and prices paid by their customers was much weaker than one would expect under effective, cost-based regulation. At a less aggregated level of analysis, the above-average gas acquisition costs of the largest four, LPSC-regulated firms that dominate the Louisiana residential and commercial market raises obvious questions about the advisability of treating the acquisition cost of gas as a simple "pass-through" cost. Acquisition cost accounts for approximately half of total costs; thus, if treated as a pass through, a significant portion of potential savings to the consumer is excluded from regulatory oversight.

A second set of questions is raised by the poor price performance of many of the large number of relatively small, non-LPSC-regulated municipals. Within this group, prices are highly variable. But despite their highly variable nature, both prices and margins are, on average, higher in this group than in any other. An informal phone survey of some of these small distributors with very high margins provided only a limited response but some said they used gas system "profits" to pay for other governmental services. Such practices raise policy questions of openness and equity in local government as well as questions about efficiency and effectiveness of the regulation of natural gas pricing.

Table 1 currently not available.

IMPACT OF BTU TAX ON LOUISIANA - The Center recently completed an analysis of the impact of the Administration's proposed BTU tax on Louisiana at the request of, and with support from, the Affordable Energy Alliance. Potential effects on E&P, refining, chemicals and state and local governments were emphasized. We found Louisiana would pay the highest rate of taxation in the nation in relation to the State's economic output and that exemptions to the tax would distort the market for Louisiana natural gas. Copies of the report are available by request. A summary will be published in the next issue of the Newsletter.

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