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October 26, 2000

California Energy Commission
Energy Facilities Siting and Environmental Protection
1516 Ninth Street, MS-15
Sacramento, CA 95814

Re: Docket #98-AFC-3 (Metcalf Energy Center)

Dear Sir or Madam:

This is a response for expert testimony requested by Californians for Renewable Energy, Inc. (CARE) on the reliability of California's natural gas supply for power generation.

According to a study we conducted earlier this year and posted on our Web site (see www.geoinvestor.com/archives/archives.htm), the price of natural gas has risen -- and can be expected to remain high for the foreseeable -- as a result of a variety of factors. Mostly notably, fuel switching by electric utilities in response to increased petroleum prices boosted demand for natural gas at time when supplies were low. Years of under-investment in the gas industry meant a slowdown in new exploration and production and left the U.S. woefully unprepared for the recent surge in natural-gas demand.

Given that it will take consider time for new domestic gas supplies to come on line and that oil prices are likely to remain relatively high, the pressure on natural-gas prices is unlikely to abate any time soon.

Our June 19 study, titled "Electricity Bills to Rise, Owing to Natural-Gas Woes" (a copy of which is attached), stated in pertinent part:

> Many electricity customers in the United States can expect higher utility bills for the rest of this year and probably longer, courtesy of federal policymaking errors. The immediate problem concerns the cost and availability of natural gas used to generate electricity. Natural gas prices have soared in recent months, and this in turn is driving up electricity prices. . . . Chances are the situation will get worse before it gets better. Natural gas in storage is considerably below its 1999 level, down almost 22% in May from a year earlier, and additions to stored gas show no signs of making up the difference any time soon. . . .
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> [T]he decline in petroleum revenues prompted a host of oil-exporting countries, led by Mexico, to reduce production by 7%, beginning in March 1998. As the flow of petroleum slowed, crude-oil prices began to rebound, nearing and sometimes exceeding $30 a barrel. Natural gas prices in the U.S. also began to rise, in part because fuel switching by large electric-

power generators makes oil and gas fungible. After hitting a recent low of $1.70 per million Btus in March 1999, natural-gas prices at the wellhead rose to $2.03 by December 1999 and $2.30 by February 2000, according to U.S. Department of Energy (DOE) data. The department's latest estimates, published this month, see wellhead prices averaging $2.92 in the second quarter of this year, $2.81 in third quarter and $3.09 in the fourth quarter. For this year as a whole, DOE expects an average wellhead gas price of $3.10, easing only slightly next year to $3.06 per million Btus. These prices, respectively, represent increases of 59% and 57% from 1998's average of $1.95. . . .

The softness in natural gas prices in 1998 through early 1999 seriously dampened new natural-gas exploration and development in the U.S., and the slowdown has now come home to roost. Total proved reserves of dry natural gas fell by 2% in 1998 from a year earlier, bringing to an end a four-year uptrend. Reserve additions in 1998 replaced only 83% of that year's dry natural-gas production. Worse, discoveries of new gas fields in 1998 decreased by 60% from a year earlier in terms of the total volume of gas found; extensions of old fields fell by 23%, and new reservoir discoveries in old fields were off 9%. All told, the amount of new gas discovered in 1998 was equal to just 61% of that year's natural-gas production. . . .

[T]he pace and scale of the renewed capital inflows into energy, as well as the rate of exploration activity itself, are insufficient to generate an overnight change in the rather pessimistic near- to mid-term outlook for U.S. natural-gas output.

Since the publication of our study in June, nothing has fundamentally changed in the U.S. energy sector to alter our assessment of the outlook for natural-gas prices and supplies. High-priced natural gas will continue to weigh heavily on electric utilities that burn natural gas and/or oil to generate power.

By way of background, I have written extensively on energy issues since 1976, when I began covering the North Sea oil and gas industry as a London correspondent for Dow Jones Newswires. I later spent a decade writing energy editorials for *The Wall Street Journal,* where I was a member of the Editorial Board. I founded GeoInvestor.com last year as a site for global investors.

Sincerely,

William P. Kucewicz

William P. Kucewicz
Editor & Publisher