Summary of Statement by Skip Horvath,
President and CEO, Natural Gas Supply Association

Before the House Subcommittee on Energy and Air Quality
"Winter Outlook 2005-2006"

November 2, 2005

- The impact of the hurricanes was devastating in terms of natural gas production in the Gulf of Mexico. These shut-ins are exacerbating the tight natural gas supply and demand balance in the United States.
- We share legitimate concerns about regional natural gas constraints that could impact customers, particularly during peak days this heating season.
- NGSA's 5th annual Winter Outlook projects upward pressure on wholesale natural gas prices as a result of relatively flat production, hurricane-related production losses, and an increase, relative to last winter, in seasonal heating demand in the residential and commercial sectors.
- Urgent efforts by producers and the industry are focused on ensuring adequacy and reliability this winter.
- Storage inventories continue to be above the five-year average, already hitting more than 3.1 trillion cubic feet (Tcf).
- Coupled with the 60 billion cubic feet per day (Bcf/d) in projected domestic and imported production, storage inventory levels should be more than adequate to serve U.S. firm-service demand requirements under at least normal weather conditions this winter.
- While producers and the industry as a whole continue to work around the clock to ease potential constraints, customers can also play a critical role this winter; end-use conservation will be a big help this heating season in offsetting the price impact of production losses.
- We hope that this hurricane season serves as a national wake-up call with regard to natural gas and overall energy policy; promoting the use of clean-burning natural gas should be coupled with access to new supplies to help fuel growing demand.
- It is in our national interest to continue to expand supply resources, both to help stimulate economic expansion and to reduce air pollution, creating a more secure energy future for America.
- Without additional and diversified sources of supply, the market will continue to be at risk for disruptions like Katrina and Rita, and the higher costs that inevitably result.

Statement of

Skip Horvath, President and CEO
Natural Gas Supply Association (NGSA)

On behalf of
NGSA

Before the
House Subcommittee on Energy and Air Quality

"Winter Outlook 2005-2006"

November 2, 2005
Washington, D.C.

Mr. Chairman and members of the subcommittee, my name is Skip Horvath and I am the president and CEO of the Natural Gas Supply Association (NGSA). Today, I am testifying on behalf of the major natural gas producers and marketers comprising our association. Thank you for the opportunity to participate in this timely forum.

The impact of the hurricanes was devastating in terms of natural gas production in the Gulf of Mexico. These shut-ins have exacerbated the tight natural gas supply and demand balance in the United States during the last several years. Today, I would like to share with you NGSA's winter season outlook and hurricane recovery updates, as well as provide some facts regarding market conditions.

First of all, we share legitimate concerns about regional natural gas constraints and costs that could impact customers, particularly during peak days, this heating season. These constraints could be most evident in those regions that rely heavily on supplies from the Gulf of Mexico.

To put the importance of the Gulf of Mexico into perspective, at pre-hurricane levels, the offshore region's production of 10 billion cubic feet per day (Bcf/d)

represents approximately 13 percent of average daily winter consumption[1]. As of Monday, approximately 5.4 Bcf/d was shut-in in the offshore region. This represents approximately 7 percent of average daily winter consumption.

While sensitive to potential regional constraints, I want to clarify that I am here today to address market fundamentals from a broad, national perspective. In our fifth annual Winter Outlook, released September 28, we outlined the key supply and demand factors we expect to affect natural gas prices this heating season.

We anticipate upward pressure on wholesale natural gas prices as a result of public projections of relatively flat production, hurricane-related production losses, and an increase, relative to last winter, in seasonal heating demand in the residential and commercial sectors. Another factor in our assessment is that it cost more to put gas into storage this summer, and we anticipate those higher costs will be noticeable in customers' home heating bills in the coming months.

Today, we have further post-hurricane updates to some of the numbers in our Winter Outlook, as well as additional data that supports our assessment and demonstrates that the market is responding appropriately to temporary Gulf of Mexico production delays.

[1] Approximately 75 Bcf/d (Source: Energy Information Administration)

We have had a couple of macroeconomic changes since we last presented our Outlook. For example, GDP growth has been lowered for the winter, from 3.4 percent to about 3.3 percent, and manufacturing is down, from 2.9 percent to 2.7 percent, which indicates some demand coming off.

Weather is always the most critical factor in determining demand during the winter heating season; it is also the most difficult to predict. Using government weather data, we are predicting warmer than normal temperatures across much of the Western States, with near-normal temperatures in the East and East Central States. Based on this forecasting provided by the National Oceanic and Atmospheric Administration (NOAA), the winter is expected—in aggregate—to be slightly warmer than normal, but colder than last winter.

Given that weather scenario, and the decline in the GDP and manufacturing index, our revised estimate for U.S. natural gas demand this winter is now 72.7 Bcf/d, down 0.7 percent since Hurricane Rita.

On the supply side, prior to the hurricanes, the nation's 6,000 natural gas producers were on a pace this year to expand domestic production. Now, factoring in the effects of the hurricanes, despite increases in capital spending and rig counts, production is projected to be relatively flat this winter, due in large part to the decline rate in traditional basins. According to the consulting

firm Energy and Environmental Analysis (EEA), post-hurricane data show that annual well completions, for example, are projected to increase to 26,100 from 23,400, and the rig count is forecast to increase this winter to 1,189, from 1,025 last heating season, indicative of an accelerating response to ongoing tight-market conditions.

Although we anticipate relatively flat production overall, there are additional amounts that may not make it to market early in the winter, due to the continuing recovery of processing plants from hurricane damage. Downstream issues continue to have a dampening effect on some supply – although we are still trying to assess the extent of that effect.

Any decline in traditional supplies, however, is being offset somewhat by an increase in unconventional production, as well as pipeline and LNG imports. Since our Winter Outlook—and in response to market conditions since the hurricanes—projected net pipeline imports have increased to 8.9 Bcf/d.[2] Imports as a whole will continue to play a critical role this winter to help compensate for some hurricane-related production losses, and to add further certainty to the marketplace. In fact, according to EEA, LNG imports are now expected to increase 28 percent from last winter. For this winter, however, our LNG and

[2] Canadian 10.0 Bcf/d; offset by 1.1 Bcf/d export to Mexico (Source: Energy and Environmental Analysis)

Canadian import capability will be limited by existing infrastructure, as well as competing worldwide demand for LNG.

Since our preliminary assessment of the effects of Hurricanes Katrina and Rita on natural gas supply, new data from EEA suggests that the total hurricane disruption will average about 2.5 Bcf/d during the official heating season, November 1 through March 31. In total, reflecting the shut-in supply in the Gulf of Mexico, domestic, Canadian and liquefied natural gas (LNG) supplies are expected to amount to about 60 Bcf/d.

Storage is the last piece of the supply puzzle needed to balance supply and demand. We are now at the end of the traditional injection season, and inventories are above the five-year average at more than 3.1 trillion cubic feet (Tcf). With one more reporting week to go, we are confident that storage will be healthy this winter, potentially even reaching the 3.2 trillion cubic feet (Tcf) mark. A storage inventory level at 3.1 Tcf translates to almost 21 Bcf per day on average. Coupled with the 60 Bcf per day domestic and imported production, it should be more than adequate to serve the U.S. firm-service demand requirements under at least normal winter weather conditions.

There are four scenarios that could impact the supply demand balance that I've presented for you today: 1) slower than anticipated rate of supply/infrastructure

recovery from the hurricanes, 2) colder than normal weather conditions, 3) natural gas quality restrictions and 4) lower-than-projected levels of LNG or Canadian imports. Weather is probably the most critical factor this winter or any winter. Severe weather conditions can alter the supply-demand balance significantly and, as is the case anytime there is a heavy regional dependency on a single supply source, there is the risk of localized constraints.

Let me emphasize: under most weather scenarios (including those more conservative than the weather predicted by NOAA), supply and demand will balance, meaning there is no natural gas supply shortage. There are, however, access and infrastructure constraints. The industry's challenge this winter will be getting available supply to where it is needed, and we've been working hard to not only restore damaged facilities, but to reroute supply to bring it to market and address these regional issues.

While producers and the industry as a whole continue to work around the clock to ease potential constraints, customers can also play a critical role this winter. As we highlighted in our Outlook, end-use conservation will be a big help this heating season in offsetting the price impact of production losses. For example, recent statistics from the Department of Energy reportedly show that precautionary conservation to reduce demand by only 5 percent would amount to a savings of 3.5 Bcf/d—which alone would more than compensate for the

projected Gulf of Mexico shut-ins. Conservation can be as simple as customers installing programmable thermostats, or turning their thermostats down by only two degrees from their usual setting. These measures will be the most effective, efficient and money-saving precautions customers can take to alleviate heating season impacts.

Altogether, urgent efforts by producers and the industry are focused on ensuring adequacy and reliability this winter. Although heating costs are still projected to increase—significantly in some regions—this data supports our view that ample storage, coupled with import and production responses, will likely mean sufficient overall supply for this winter. Ongoing conservation precautions also can help ease localized constraints, and all will help to protect the nation's firm-service customers this winter.

Importantly, under normal weather conditions, even with the affects of the hurricanes on the supply coming from the Gulf of Mexico, our market balances itself with the help of Canadian and LNG imports, and production from other regions in the U.S., such as the Mid-Continent. Allowing the market to work to move supply to address localized imbalances, and to facilitate needed infrastructure repairs, is the most important step government can take in the short-term. Additional government actions to expand future supply, as outlined by others in our industry, could also have a calming effect on the futures market.

Going forward, it is our sincere hope that this hurricane season serves as a national wake-up call with regard to natural gas and overall energy policy. Promoting the use of clean-burning natural gas should be coupled with access to new supplies to help fuel growing demand. The impact of the hurricanes on the market has underscored the importance of increasing supplies and resource diversity.

The Energy Policy Act of 2005 is a good first step, but more needs to be done. It is in our national interest to continue to expand supply resources, as outlined by other industry participants on this panel, both to help stimulate economic expansion and to reduce air pollution, creating a more secure energy future for America. Without additional and diversified sources of supply, the market will continue to be at risk for disruptions like Katrina and Rita, and the higher costs that inevitably result.

Thank you, Mr. Chairman, for this opportunity to outline our assessment of the challenges we face this critical heating season.