

# KEYSPAN

## ENERGY UPDATE

*In our continuing efforts to communicate with the financial community, KeySpan prepared this fact sheet to update you on critical natural gas price and gas supply issues. The first section addresses the current gas price and gas supply environment. The second section reviews the relationship between natural gas and the heating fuel market. In particular, we address recent Oil Heat Institute comments made in the media.*

### **FOCUS ON NATURAL GAS**

Demand for natural gas in the Northeast exceeds that of any region in the United States. It is the fuel of choice in expanding markets for electric generation, air conditioning, and vehicle fuel application. We all know that the price of natural gas has risen steadily since early last year and has recently hit record highs. That's because supplies are tight and demand is high. This has caused heating bills across the country to rise. KeySpan Energy Delivery customers can expect to pay an average of 35 percent or more this year than they did last year, assuming comparable weather patterns.

At the center of this flurry, is KeySpan's Energy Trading Services, a group that manages the purchasing and trading of natural gas, electric, fuel oil and environmental credits. One of their big challenges this year has been to purchase enough natural gas supply at the best possible prices, and at the right mix, to meet the increasing demand in the Northeast.

#### **Media reports have natural gas costs rising 50 percent. Why is KeySpan telling customers 35 percent or more?**

The price of the gas commodity fluctuates based on a number of factors. KeySpan has managed to keep costs down through effective purchasing and storage strategies implemented by our Energy Trading Services organization. In the very volatile natural gas market we are experiencing this year, we have had to revise our initial estimates of a 15 percent annualized increase to an estimated increase of 35 percent or more. But according to our forecasts, KeySpan's NY and LI customers will not see the higher increase that are affecting gas customers in other parts of the country.

In our New England companies, the increase in an average residential heating bill is expected to be between 30-50 percent over last year.

#### **How do we protect customers from the fluctuations in the price of natural gas?**

KeySpan does its best to anticipate changes in natural gas costs and to structure our rates accordingly. Extreme weather conditions or volatility in the commodity price of natural gas can create unexpected shifts in the costs customers pay. Our purchasing practices and our use of storage, as well as our customer level payment plan options, help insulate customers from the rapid ups and downs in the price of natural gas.

#### **Do consumers pay too much attention to the daily spot prices of natural gas?**

Daily spot prices are not indicative of average natural gas costs to consumers. That's because only a portion of all gas supplies (especially during seasonal peaks) is bought in the daily market. KeySpan has multiple agreements with producers, the prices of which are tied to various indices.

#### **What is KeySpan's current natural gas supply situation?**

Right now, our storage caverns are 89 percent full. With that amount in storage, we're right on target to handle even a severe Northeast winter.

**Where is KeySpan's natural gas stored?**

Most of KeySpan's natural gas is stored in underground caverns in West Virginia and Pennsylvania, but we have large reserves in the South that are used as a back up.

**What is KeySpan's natural gas supply mix for the heating season?**

Currently, 51 percent comes from domestic Gulf Coast sources, 30 percent is from underground storage, 16 percent is from Canada, and 3 percent is from Liquefied Natural Gas plants. The lower priced natural gas we have in storage and obtain from Canada helps reduce the price impact to our firm customers.

**How did KeySpan prepare for the price spike?**

Our first priority is to always make sure there is enough supply to meet our customers' demand. At the same time, we try to optimize the price we paid for gas. During the summer, we purchased enough natural gas to fill our storage areas. Though the price of gas was rising then, it is well below the current price. Buying this amount of supply at the lower price helps lessen the impact that heating customers will feel. We also alerted our customers to the increases and asked them to consider conservation options, signing up for our level payment plan, and/or getting bids from marketers for gas supply.

**What role does the weather play in obtaining natural gas supply?**

If it's colder than normal in the Northeast, it increases demand and affects supply because more gas is used. This will exert some pressure on our storage facilities and other supply sources. Another concern is the weather in our gas production areas, especially Texas and Louisiana. Those states are typically warm, and very cold weather can influence equipment operation and delivery. While local cold fronts can influence demand, some cold fronts can cover the country more broadly and would have a greater impact.

**How does the price of oil affect the price of natural gas?**

Certain oil markets compete with natural gas; some do not. The crude oil market, for instance, does not compete with the natural gas markets. However, both #6 oil, used primarily by large industrial customers, and #2 home heating oil compete directly with natural gas. Any rise in heating oil prices will likely spread to natural gas because some users of heating oil will switch to gas and drive up costs there as well. In a free market, price follows demand.

**What's the long-term supply situation?**

Because of the current high price of natural gas, industry estimates say there will be 15,000 natural gas wells completed in 2000 and 2001. This is the highest level since 1985. When these supplies hit the market, it should exert downward pressure on the price. In addition, the large natural gas supplies discovered off Nova Scotia bode well for KeySpan. KeySpan Energy Deliver New England is already getting gas from this area and we hope to secure additional supplies for New York soon. The Nova Scotia supply source also creates a new source of supply competition, which will help pricing. Total reserves of natural gas are more than adequate for the foreseeable future.

Certain statements contained herein are forward-looking statements, which reflect numerous assumptions and involve a number of risks and uncertainties. Actual results may differ materially from those discussed in such statements. Among the factors that could cause actual results to differ materially are: available sources and cost of fuel; State and Federal regulatory initiatives that increase competition, threaten cost and investment recovery, and impact rate structures; that ability of the Company to successfully reduce its cost structure; the ability of the Company to successfully integrate acquired operations; the degree to which the Company develops non-regulated business ventures; the effect of inflationary trends and increases in interest rates; and the ability of the Company and its significant vendors to modify their computer software, hardware and databases to accommodate the year 2000; and risks details from time to time in reports and other documents filed by the Company and its predecessors with the Securities and Exchange Commission.

# **KEYSPAN'S GAS RATES**

## **How Do They Really Affect Home Heating Oil Supplies?**

During last winter's oil shortages, questions arose about the impact of KeySpan's "interruptible" gas customers on New York City and Long Island fuel supplies. With the weather getting colder and oil inventories at even lower levels than last year, this issue is likely to remain in the news. So, here's a quick overview on KeySpan's natural gas rates and their role in the heating fuel market.

## **KEYSPAN'S NATURAL GAS RATES**

KeySpan's natural gas customers basically fall into three different rate classes – Firm, Temperature Control (TC) and Interruptible.

Firm rate customers are the largest group of KeySpan customers and include single-family residences, moderately sized multi-family dwellings, and small commercial facilities. Firm gas customers have dedicated natural gas heating systems, with no alternative fuel choice.

KeySpan's gas transmission and distribution system was built to be able to bring natural gas to these firm customers under even the harshest winter conditions. We calculate the amount of gas needed for these customers based on a "coldest day" design of zero degrees Fahrenheit. The New York State Public Service Commission allows KeySpan to recover the cost of building a system that meets these requirements in our rates.

Our need to use the full capacity of our system varies from day to day. Naturally, the demand for gas is lower in the summer and higher in the winter. Cold spells during the winter increase demand and, therefore, consumer costs. TC and Interruptible Rate customers allow us to maximize the use of our transmission and distribution system and storage capacity when it is not needed to service firm customers.

Temperature Control rate customers sign contracts with KeySpan that allow them to receive a lower gas rate in exchange for switching to oil when the temperature drops to a pre-determined level. There are two different "cutoff" points: 20 degrees or 15 degrees Fahrenheit. The rates provided to these customers are based on customer size. Larger accounts are cutoff at 20 degrees and there is a lot of manual labor involved in the switchover. There are approximately 68 of these accounts. All other TC accounts are cutoff at 15 degrees. The rate TC customers pay is lower than firm customers, but higher than the rate paid by Interruptible rate customers. There are 100 TC customers on Long Island and 3,420 in New York City.

Interruptible rate customers are large-volume users who sign contracts with KeySpan that allow them to switch back and forth between natural gas and oil year-round, based on the price of fuel at that time. In return, KeySpan may "interrupt" service to these customers on the coldest days of the year, in order to ensure ample gas supply to our firm customers. This arrangement provides low fuel costs to the customers who use the most energy and allows KeySpan to maximize the use of its system year-round. There are 700 Interruptible customers on Long Island and seven in New York City.

## **Are Interruptible rates new?**

Interruptible rates have been in effect for decades, are negotiated well in advance, and are no secret to the oil industry. In fact, the oil industry can benefit from the Interruptible rate because when oil prices are lower than gas, these large volume customers switch over to oil. Historically, the oil industry has planned its inventories to take advantage of the opportunity presented by both TC and Interruptible gas customers.

## **Do TC and Interruptible customers affect homeowners when they switch to oil?**

The impact, if any, is minimal because these large customers use mostly #6 fuel oil, not #2 home heating oil. During last winter's cold snap, TC and Interruptible customers used only 1.6 percent of the #2 fuel oil inventory in the Northeastern United States. Homeowners cannot use #6 fuel oil in their heating systems, so its use has no impact on residential customers.

## **So, what was the oil industry's issue?**

There were two issues raised last January. The first was a claim that KeySpan "opposed the amendment of the public service law that would require interruptible gas users to keep on hand a 10-day supply of heating fuel." These charges are untrue.

In New York City and Long Island, KeySpan requires that TC customers have a 10-day supply. We also require our Interruptible customers to maintain sufficient fuel supply in the event an interruption occurs. The proposed law that the oil industry referred to required companies to maintain their supply on-site, which raised significant environmental issues around large-scale oil storage facilities. While we strongly encourage our Interruptible customers to maintain a 10-day supply, we will permit a smaller on-site supply if it is coupled with a definitive contract from an oil dealer to fully meet supply needs.

The second issue was the implication that KeySpan was buying up the supply of #2 heating oil to burn in electric generating units during the coldest days last winter. This issue arose again last week when the Oil Heat Institute (OHI) asked the New York State Attorney general to investigate KeySpan for "manipulating" the heating fuel market.

KeySpan Generation operates five major electric plants on Long Island and one in New York City. All of these are fueled by natural gas or by gas and #6 fuel oil, and thus had no impact on January's #2 fuel oil shortages. KeySpan also has 42 "peak shaving" units in 13 locations on Long Island which are only used during periods of high electric demand. Thirty of the 42 units can only use kerosene or #2 fuel oil; the remaining 12 units can use natural gas as well as #2 oil. So, only 12 of the units could have switched from gas to oil and effect the #2 oil market. Overall, the use of #2 fuel oil in these electric generating facilities accounted for only 2.5 percent of January's peak demand.

## **So, what's the real issue?**

The real issue comes down to basic economics. Last year, with oil prices high, oil distributors maintained lower than normal inventories. When the weather turned very cold in January, they did not have sufficient supplies to service all of their customers. This year, the inventories are even lower than last year and with predictions for a colder winter, the fuel supply situation is even more critical. So, the OHI is again trying to shift the blame for high prices and tight supplies to KeySpan. Their actions are also an outgrowth of their rising concern over their loss of market share. Over the last year, approximately 25,000 New York and Long Island customers have converted to natural gas. Our successful marketing programs have affected their bottom-line. It is unfortunate that they feel the need to respond with these false allegations.

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