



Date: December 12, 2006

To:  Gerald R. Miller, City Manager

From: Christopher J. Garner, Director of Long Beach Gas and Oil

For: Mayor and Members of the City Council

Subject: Update on the Liquefied Natural Gas Negotiations With Sound Energy Solutions



As directed by the City Council, Long Beach Gas and Oil has been in discussions for the past three and a half years with Sound Energy Solutions (SES) relative to specific aspects of the SES proposal to construct and operate a liquefied natural gas (LNG) terminal in the Port of Long Beach (see attachments).

Cognizant of the enormity of the SES proposal in terms of both project revenue stream and terminal siting issues, the City's expectation has always been that negotiations with SES would provide very significant, on-going financial value to both the City and the LBGO ratepayers (provided the decision was made to proceed forward with the proposed LNG terminal). SES has indicated that its latest offer is representative of the maximum total overall value that SES is willing to provide and has rejected the major points included in LBGO's subsequent counteroffer. Therefore, it is not realistic to expect that further discussions with SES would provide any substantial additional value to what has been offered to date by SES.

From a natural gas supply perspective, competing LNG projects that will provide similar gas supply benefits to Southern California, without the potential siting risks to Long Beach, are either in construction or are further along in the regulatory process than SES. Additionally, other gas supply opportunities that potentially provide greater financial savings have also surfaced since discussions with SES began over three years ago.

Based upon the information included in this memo and previous memos concerning this subject, the value offered by SES is not nearly sufficient to recommend to the City Council that negotiations continue forward.

NOTE: *LBGO's negotiations have not considered security or safety issues, but have dealt solely with the business aspect of the gas supply and pipeline components of the project. Issues related to the suitability of an LNG terminal within the City's boundaries will be addressed in the final Environmental Impact Report/Environmental Impact Study that will be released in December 2006. These issues are under review by federal and state agencies, as well as the City's Harbor, Fire, Police, and Planning and Building departments.*

LBGO NEGOTIATIONS

In May 2003, the Port of Long Beach Harbor Commissioners approved a Letter of Intent with SES for the proposed construction of an LNG receiving terminal located on 27 acres at Pier T in the Port of Long Beach. One of the primary components of the Letter of Intent was a provision that, concurrent with any final agreement with the Port, SES was expected to enter into an arrangement for the benefit of the citizens of Long Beach and LBGO.

During the past year, LBGO has had numerous negotiation sessions with SES in an attempt to obtain an offer which will adequately address gas commodity discounts for LBGO customers, pipeline revenues to the City, as well as project incentives for the City (attached are copies of recent correspondence with SES and memos to the City Council discussing the status of negotiations).

The original offer presented by SES in December of 2005 was valued at approximately \$25 million, net present value, over a term of 15 years. Through LBGO's negotiations, SES increased the offer to the City in April 2006 to equal approximately \$60 million, net present value, over the same term. Of this amount, \$4 million would be flow to the City's General Fund in 2007 or 2008, upon SES receiving final regulatory approvals to proceed with construction of the terminal. The balance of the offer would be received by the City and LBGO customers in a fairly consistent basis over a 25-year term beginning in 2011, after the terminal would be expected to become operational.

Despite LBGO's written correspondence expressing dissatisfaction with the value offered, this latest SES offer was verbally characterized by SES as an offer that the City should consider as representative of the total overall value that SES was willing to provide to the City and LBGO customers. However, the structure in which this value is provided is not necessarily final. Essentially, the structure of the SES offer can be separated into two categories: 1) those benefits received directly by LBGO customers through a long-term gas supply contract with SES, and 2) those benefits received by the City through revenues received from pipeline charges and through a one-time project payment.

SES OFFER - LBGO CUSTOMERS

- Gas supply sold by SES to LBGO is indexed to the Southern California Gas Company's (SoCalGas) monthly price of gas charged to its customers
- Gas price is discounted by 1.5 cents per therm and the discount is passed through to LBGO customers
- Discount equates to about 60 cents per average residential customer's monthly gas bill, with a total annual discount value to all LBGO customers of approximately \$1.5 million or less
- Monthly gas price has a "floating" ceiling based upon market prices for prior 12 months

While the \$1.5 million aggregate annual cost savings to LBGO customers may appear sizeable, the individual savings to residential customers would represent less than 1 percent of their total average monthly utility bill (including gas, water, sewer and refuse).

Long Beach residents will likely perceive this average monthly savings, 60 cents, as negligible. In addition, from LBGO's perspective, the 1.5 cent per therm discount is not considered an extraordinary offer; as such a discount could be greatly exceeded by other gas purchasing strategies.

SES OFFER - CITY

- Upon SES obtaining all necessary permits and approvals to construct the project, the City's General Fund would receive a one-time payment of \$4 million. Such permits and approvals, if granted, would not be expected until late 2007 or 2008.
- As currently proposed, SES would construct, own, and maintain the new interconnecting pipeline. SES has proposed paying the City a pipeline franchise fee of \$3 million annually for the full 25-year term.
- If the City agreed to accept a much shorter term (5 to 12 years) during which SES would pay the City pipeline franchise fees, the City could realize pipeline revenue of \$5 to \$10 million annually (\$3 million minimum guarantee). Thereafter, the City would receive no further pipeline revenues despite the continued profitable operation of the LNG terminal by SES.

In order for SES to successfully proceed with its desire to provide LNG to Southern California from an onshore terminal, it must first attain a suitable site on land for a terminal, as well as a gas pipeline to transport their product. As the only potential site that could possibly fulfill both of these requirements in a timely manner, the Port of Long Beach site is essential to SES. The project anticipates gross annual gas sales of \$2 billion annually, and would be able to provide approximately 20 percent of the gas supply for all of Southern California for a period of 40 to 50 years.

In consideration of the magnitude of this project and the expected revenue stream for SES for 40 to 50 years, it is unreasonable that SES is proposing a limited-term pipeline franchise fee to the City. If, as originally planned, the City were to retain ownership of the 2.4-mile interconnecting pipeline, the City would realize a substantial revenue stream for the life of the pipeline. SES' annual cost for this offer to the City represents only about two-tenths of one percent of SES' estimated \$2 billion gross annual gas sales.

Based upon the information in this memo and previous memos concerning this subject, the value offered by SES is not nearly sufficient to recommend to the City Council that negotiations continue forward.

GRM:CJG:is:mn
M-CC re SES Update 12-12-6.doc

Attachments

cc: Christine F. Shippey, Assistant City Manager
Robert E. Shannon, City Attorney
Richard D. Steinke, Executive Director, Harbor
Board of Harbor Commissioners

- James C. Hankla
- Mario Cordero
- John Hancock
- Doris Topsy-Elvord
- Mike Walter

LIST OF ATTACHMENTS

**Update On the Liquefied Natural Gas Negotiations With Sound Energy Solutions
December 12, 2006**

Attachment #	Document Description
1.	May 7, 2003 – Memo to Development Committee of Harbor Department requesting approval of Letter of Intent with Sound Energy Solutions (SES)
2.	May 13, 2003 – Letter to City Council requesting approval of Memorandum of Understanding between Long Beach Energy (now Long Beach Gas and Oil) and SES
3.	May 24, 2005 – Letter to City Council requesting authorization to terminate negotiations with SES; or continue the suspension of such negotiations; or to resume such negotiations
4.	December 16, 2005 – SES original proposal to LBGO
5.	February 28, 2006 – Memo to City Manager for Mayor and City Council giving a negotiation update, along with a January 13, 2006 memo from industry expert providing a review of SES proposal
6.	March 7, 2006 – Letter to SES requesting a substantial increase to the December 16, 2005 offer
7.	March 9, 2006 – Letter to Mayor and City Council from SES expressing its desire to continue discussions with LBGO
8.	March 13, 2006 – Memo to City Council from City Manager, though not optimistic, expressing his willingness to provide additional time to SES for negotiations
9.	March 15, 2006 – Discussion points handout provided to SES by LBGO to assist in moving negotiations forward
10.	May 16, 2006 – Offer spreadsheet provided to LBGO by SES
11.	May 26, 2006 – Memo to City Manager for Mayor and City Council providing status update on negotiations with SES
12.	June 6, 2006 – Letter from Port of Long Beach to SES indicating that the Harbor Commissioners took no action to extend the May 8, 2003 Letter of Intent with SES
13.	June 12, 2006 – Letter to SES from LBGO outlining specific areas of improvement needed in SES' offer(s) of May 16, 2006
