

Decision 08-10-025 October 16, 2008

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Determine
Issues Relating to the California Utilities'
Procurement of Natural Gas Supplies from
Liquefied Natural Gas Sources.

Rulemaking 07-11-001
(Filed November 1, 2007)

**DECISION DETERMINING PROCEDURES FOR
PROCURING LIQUEFIED NATURAL GAS SUPPLY****1. Summary**

The California Public Utilities Commission (Commission) opened this rulemaking to consider issues relating to whether and how the largest California utilities should enter into procurement contracts for natural gas from liquefied natural gas (LNG) suppliers on the West Coast, in order to help ensure that there will be adequate supplies of natural gas at reasonable prices to meet California's long-term needs. The order instituting rulemaking set forth two specific areas of inquiry. First, we sought comment on how ratepayers can best benefit from long-term LNG supply contracts. Specifically, we inquired whether the utilities can negotiate long-term LNG supply contracts to guarantee reliable gas supplies at a reasonable cost, and whether ratepayers benefit more by allowing the utilities to continue to purchase natural gas without regard to whether the supply is domestic or LNG. Second, we sought comment on what procedures the utilities should use to solicit LNG supply offers and what procedures the Commission should use to pre-approve LNG supply contracts.

With respect to the first question, the comments generally recommend against adopting particular reliability and/or cost guarantee requirements for long-term LNG supply contracts, suggesting that the reasonableness of any contract should be evaluated on the basis of the contract as a whole. The comments further suggest that ratepayers may benefit from LNG without the need for the utilities to serve as anchor tenants and, in any event, will benefit most by allowing LNG supply to compete head-to-head with domestic supply.

With respect to the second question, although the comments present a range of opinion on how the utilities should solicit LNG supply and how and whether the Commission should pre-approve it, there is general consensus that LNG supply should compete head-to-head with domestic natural gas. We agree. We, therefore, decline to develop special guidelines or procedures for the utilities' solicitation and procurement of LNG supply at this time, or for the approval of cost recovery related to LNG supply. LNG supply procurement and cost recovery should continue to be subject to the procedures that apply to the procurement and cost recovery for natural gas supply generally.

2. Background

The Commission and the California Energy Commission's (CEC) Energy Action Plan I (EAP I), adopted in 2003, stated our goal to "[e]nsure adequate, reliable, and reasonably priced electrical power and natural gas supplies, including prudent reserves, are achieved and provided through policies, strategies, and actions that are cost-effective and environmentally sound for California's consumers and taxpayers." (EAP I at p. 2.) The Commission's and CEC's Energy Action Plan II (EAP II), issued in October 2005, found that "California must also promote infrastructure enhancements, such as pipeline and

storage capacity, and diversify supply sources to include liquefied natural gas (LNG).” (EAP II at pp. 12-13.)

The Commission opened Rulemaking (R.) 04-01-025 to adopt policies in furtherance of this goal. In so doing, we noted that forecasts indicated decreasing production and declining proven reserves in most of the producing basins in the United States, along with decreasing deliverability from Canada. Responding to the need for additional natural gas infrastructure, Decision (D.) 04-09-022, issued in Phase I of that rulemaking, adopted procedures for the utilities to seek pre-approval of contracts for interstate pipeline capacity, and ordered the California natural gas utilities to provide non-discriminatory open access to all new supplies of natural gas, including LNG.

The Commission opened the current rulemaking in order to address supply procurement issues related to LNG. In so doing, we noted our heightened concerns about the adequacy of future natural gas supplies based upon the Energy Information Administration’s (EIA) “Annual Energy Outlook 2007” issued in February 2007 and the CEC’s “North American Natural Gas Review” presented at the California Natural Gas Stakeholders Working Group Meeting at the CEC on September 6, 2007. Both of these reports forecast an increase in North American natural gas demand, decreasing North American production available to the United States, and our increasing need to rely on LNG to help meet our demand. With these concerns in mind, we undertook to address the process for pre-approving the natural gas utilities’ procurement contracts with LNG suppliers in order to help ensure that there will be adequate supplies of natural gas at reasonable prices to meet California’s long-term needs.

We received opening comments on January 24, 2008, from the following parties:

- San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) (collectively, the Sempra utilities), whose affiliated company, Sempra LNG, is developing the Energia Costa Azul LNG receiving terminal in Baja California and whose other affiliates operate the pipelines that would market natural gas from that terminal.
- Pacific Gas and Electric Company (PG&E), whose affiliate has an equity agreement in a proposed interstate pipeline which would transport LNG-supplied natural gas from a proposed LNG import terminal in Coos Bay, Oregon, to Northern California.
- Southern California Edison Company (Edison).
- Clearwater Port LLC (Clearwater Port), which plans to construct and operate the Clearwater Port project, an offshore LNG receiving terminal with an average natural gas production capacity of 1.2 billion cubic feet/day,¹ for delivery into the SoCalGas pipeline system.
- Woodside Natural Gas, Inc. (Woodside), which plans to construct and operate the OceanWay Secure Energy project, an offshore underwater buoy receiving station, for delivery of up to 800 million cubic feet/day (MMcf/d) of re-gasified LNG into the SoCalGas pipeline system.
- Coral Energy Resources, L.P. (Coral), a seller of natural gas to wholesale and retail customers throughout North America; Coral purchases gas supplies in all of the producing basins that currently serve California and plans to market re-gasified LNG from the Energia Costa Azul LNG receiving terminal that is being developed by Sempra Energy LNG.

¹ Source:

http://www.energy.ca.gov/lng/documents/3_WEST_COAST_LNG_PROJECTS_PROPOSALS.PDF, updated March 2008.

- The Indicated Producers, an ad hoc coalition that includes BP Energy Company, BP America Inc., ConocoPhillip Company, Chevron U.S.A. Inc., and Occidental of Elk Hills, Inc.
- Gas Transmission Northwest Corporation (GTN), a wholly-owned, indirect subsidiary of TransCanada Pipelines Limited.
- El Paso Corporation (El Paso), the owner and operator of natural gas transmission pipelines; El Paso is also involved in several LNG projects, including an LNG terminal and pipeline in Sonora, Mexico, that is proposed to interconnect with the El Paso system at the Arizona border and could deliver to California and other markets.
- Community Environmental Council (CE Council), a non-profit environmental organization that promotes renewable energy and energy efficiency.
- Ratepayers for Affordable Clean Energy (RACE), a corporation organized for the purpose of advocacy and education regarding energy-related matters.
- South Coast Air Quality Management District (SCAQMD), the public agency responsible for comprehensive air pollution regulation and planning in Southern California.
- The Greenlining Institute (Greenlining), representing the interests of low-income communities, minorities, and residential ratepayers.
- The Utility Reform Network (TURN), a non-profit consumer advocacy organization representing the interest of residential and small commercial customers.
- The Commission's Division of Ratepayer Advocates (DRA).

We received reply comments on March 20, 2008, from the Sempra Utilities, PG&E, Edison, Clearwater Port, Woodside, Coral, the Indicated Producers, the CE Council, RACE, TURN, and also from the following parties:

- Sempra LNG, an affiliate of the Sempra utilities who, as identified above, is developing the Energia Costa Azul LNG receiving terminal in Baja California.
- Sound Energy Solutions (SES), who proposed building an LNG import terminal in the Port of Long Beach, with an average natural gas send-out capacity of 800 MMcf/d, which will connect with SoCalGas's pipeline system.

3. Benefits of Long-Term LNG Supply Contracts

The Commission has previously determined that LNG will promote a diverse supply portfolio and price benefits to the California market.

(D.04-09-022, affirmed in D.05-10-045.) However, according to the EIA, "the U.S. LNG market is expected to be tight until 2012, because of supply constraints at a number of liquefaction facilities, delays in the completion of new liquefaction projects, and rapid growth in global LNG demand." (AEO2007, p. 6.) We consider how ratepayers can best benefit from long-term LNG supply contracts. Specifically, we inquired whether the utilities can negotiate long-term LNG supply contracts to guarantee reliable gas supplies at a reasonable cost, and whether ratepayers benefit more by allowing the utilities to continue to purchase natural gas without regard to whether the supply is domestic or LNG.

The comments range from expressing cautious interest in exploring the possibility of long-term LNG supply contracts, to recommending against long-term supply contracts for any gas supply:

- The Sempra utilities believe that LNG imports have the potential to provide substantial benefits, "[b]ut we do not yet know whether long-term procurement contracts with LNG suppliers are the best approach, or even a viable one."
- PG&E believes that there are benefits to attracting LNG supplies in general to California, but does not prejudge the

contractual arrangements that would create the most value for its customers.

- Edison believes that utilities should be allowed to enter into long-term procurement contracts for natural gas (regardless of supply source), but should not require them to do so.
- Clearwater Port suggests that long-term contracts in general will increase investment in natural gas infrastructure, but recommends that each long-term LNG contract be evaluated on its own merits and on a level playing field with other natural gas supplies.
- Woodside shares the position that the Commission should allow, but not require, utilities to enter into long-term LNG procurement projects, and posits that LNG supply projects can and should be economically viable without long-term utility commitments.
- Coral believes that California has sufficient overall natural gas infrastructure and supply diversity to meet demand, promote gas-on-gas competition and provide supply reliability, and suggests that further economic benefit can best be achieved by incorporating price risk management into the utilities' procurement incentive mechanisms, without regard to supply source.
- The Indicated Producers maintains that LNG supplies should compete on an equal basis with other natural gas supplies.
- GTN likewise maintains that LNG supplies should compete on an equal basis with other natural gas supplies, and questions the need for long-term supplies from any source.
- El Paso, along with CE Council and RACE, cautions against long-term LNG procurement contracts at this time, given the current and expected near-term market conditions.
- TURN and DRA maintain that long-term LNG contracts do not make sense under current market conditions and question the need for any long-term supply at this time.

- CE Council and RACE suggest that there is no established need for LNG supplies in order to meet demand.²

Against this backdrop, we address our particular areas of inquiry below.

3.1. Reliability and Cost Guarantees: Other Benefits

We sought comment on whether the utilities can negotiate long-term LNG supply contracts to guarantee reliable gas supplies at a reasonable cost. There is general consensus that the Commission should not attempt to identify or require particular reliability or price guarantees. The degree of liability that the supplier assumes for *force majeure* events, the definition of what constitutes a *force majeure* event, whether the supplier must identify and dedicate the supply source, whether the supplier has the right to divert identified supplies, the definition of the price index, the length of the contract term – all these terms, and others, will impact the contract price. As we recognized in our order instituting this rulemaking, current LNG prices substantially exceed those of domestic natural gas; to the extent that terms and conditions increase the reliability of the supply and place more risk on the supplier, this premium is likely to increase. The comments generally suggest that, rather than identifying and requiring particular reliability or cost guarantee terms, the Commission should consider the reasonableness of LNG supply contracts based on the contracts taken as a whole. Given this record, we therefore set aside the question of whether it is possible for long-term LNG supply contracts to provide reliable supply at a competitive price.

² We decline to revisit the issue of need for LNG supplies, which CE Council and RACE raise here. The Commission has previously determined that there is a need for LNG in D.04-09-022, as affirmed in D.05-10-045 denying RACE's application for rehearing.

We nevertheless consider whether, all else being equal, utility contracts for long-term LNG supply might provide additional ratepayer benefits, for example, whether they will increase the likelihood or timeliness of developing the West Coast LNG market. We cannot, on this record, conclude that to be the case.

PG&E cites to its consultant Wood McKenzie's report which speculates long-term commitments by utilities and other companies representing wholesale natural gas loads are necessary in order for companies to undertake LNG infrastructure projects on the West Coast. However, we observe that there are a number of LNG projects currently being proposed on the West Coast, including those of parties to this rulemaking, as well as Sempra LNG's Costa Azul facility that has already been built, without a major California utility customer. As Edison points out, to the extent that new construction of LNG projects has been delayed, that has been due to regulatory and permitting obstacles, not to the absence of long-term contracts with California utilities. In addition, as Woodside points out, LNG projects may serve peak or seasonal demand, or serve customers other than the California utilities such as marketers and end-use customers. Given these facts, we are satisfied that California utilities need not take on the role of anchor tenants through long-term supply contracts in order to ensure the development of the West Coast LNG market.

Wood McKenzie speculates that potential offers of long-term LNG contracts by California utilities will increase the chances of attracting LNG suppliers to the West Coast gas market sooner and in greater volume than might otherwise occur, but offers no analysis supporting the premise that potential offers must be for long-term contracts, or with California utilities as opposed to wholesale marketers in order to have an enhanced effect. We expect, as TURN suggests, that LNG suppliers will be attracted to the West Coast market when the

West Coast market offers attractive prices relative to other international markets, regardless of the length of the contract and regardless of whether the party to the contract is a California utility.

3.2. Scope of Supply Solicitations

We sought comment on whether the utilities' purchase of LNG supplies should be treated the same as their purchase of any other natural gas supplies, and whether utility solicitations for LNG supplies should be open to all sources of gas. Most parties who commented on these issues agree that LNG supplies to the California market should be competitive with other supplies regardless of supply source. Notably, supporters of this viewpoint include LNG project developers and marketers such as Clearwater Port, Woodside, Coral, SES and Sempra LNG. We agree.

Most of these parties likewise recommend that the utilities conduct all-source requests for proposals for offers (RFPs) for gas supply. The notable exceptions are the Sempra utilities and Sempra LNG who recommend, instead, that the utilities conduct LNG-only RFPs.³

As discussed below, under our current gas policy and procedures, the utilities have the discretion to explore supply options by any means they choose, with cost recovery subject to the gas utilities' procurement incentive mechanisms (or, in the case of the electric utilities, Energy Resource Recovery Account (ERRA) review). We do not review the gas utilities' processes and procedures for soliciting gas supply; we only review the resulting costs under the

³ PG&E states that it does not have a strong view as to whether bilateral negotiations or an RFP is the better procedure, but recommends that, in the event of an RFP, it should be for "new" gas only.

procurement incentive mechanisms for purposes of cost recovery. Having found no basis to conclude that the California utilities' entry into long-term LNG supply contracts will provide ratepayer benefits, we decline to instruct the utilities on how to solicit LNG supply or gas supply in general.

The Sempra utilities recommend conducting LNG-only RFPs so that the utilities may serve as anchor tenants to allow economic incremental LNG supplies to materialize. They maintain that the Sempra utilities' RFPs, at least, should not solicit other natural gas supplies because they already have access to enough domestic supplies to meet their core customers' needs for the foreseeable future. We do not comprehend this rationale. As we concluded above, the California utilities need not serve as anchor tenants in order to spur the development of the West Coast LNG market.

Sempra LNG recommends conducting LNG-only RFPs on the basis that LNG supply arrangements require a long lead-time for the development of infrastructure in the supply delivery chain, in contrast to domestic supply arrangements. Sempra LNG points out that LNG supply arrangements typically require time for the supplier to complete production, transmission and liquefaction facilities, make shipping arrangements, and develop receipt, storage and re-gasification facilities well in advance of the commencement of deliveries. Sempra LNG's observations raise the issue of whether and how to incorporate longer-term planning into the California gas utilities' portfolios. This issue is beyond the scope of this proceeding, which is focused on LNG supply only.

4. Procedures for Soliciting LNG Supply Contracts

We sought comment on what procedures the utilities should use to solicit LNG supply offers. The parties' comments are summarized as follows:

- The Sempra utilities recommend that the California utilities conduct RFPs beginning as soon as 2008, for total LNG supply for up to 25% of their forecasted core and utility electric generation (UEG) demand; the utilities propose to consult with Energy Division, DRA and TURN in the design of the RFP and the identification of preferred terms (e.g., firmness, relevant indices, gas quality, in-service date).
- PG&E believes that immediate active engagement with the major LNG players is necessary so that potential opportunities are not foreclosed, and proposes that utilities collaborate with Commission staff and stakeholder groups to identify contract terms that are most desirable to their customers and commercially feasible.
- For its part, Edison does not believe that it requires long-term gas contracts given its current estimates of its long-term gas needs.
- Clearwater Port urges the Commission to establish long term procurement policies now, given the long lead time for all long-term natural gas projects (production, LNG, pipeline or storage) and so that new supplies will be available when LNG and domestic prices converge.
- Woodside urges the Commission to establish long term contracting guidelines so that the utilities can have the opportunity to enter into long term contracts if and when they determine that they are in the best interests of their ratepayers.
- Coral emphasizes that, as a first order of business, the Commission needs to develop a procurement policy and procurement incentive structures that encourage a portfolio approach that encourages low prices, price stability and risk management. Coral maintains that California utilities need to incorporate price risk management into their gas supply portfolios through staggered terms, fixed prices, hedged and index-priced supplies.

- DRA maintains that, given current economic and market conditions, it is not worth undertaking the considerable effort necessary to develop procedures for soliciting LNG supplies.
- TURN recommends all-source solicitations only after the Commission examines the issue of long-term gas supply procurement in the context of its core supply procurement policies and incentives mechanisms.

As these comments highlight, under the status quo, we do not review the gas utilities' processes and procedures for soliciting gas supply or the reasonableness of their resulting arrangements. Rather, the gas utilities' recovery of costs of gas supply is subject to their procurement incentive mechanisms, which peg rewards and penalties to spot market prices. The gas utilities have the discretion to explore and enter into any supply options by whatever means they choose, with cost recovery subject to their procurement incentive mechanisms (or, in the case of the electric utilities, ERRA review). Having concluded, as discussed above, that LNG supply should compete head-to-head with other supply regardless of source, we find no basis to establish guidelines or procedures for cost recovery related to LNG supply contracts outside of the procurement incentive mechanisms.

Coral and TURN note that, by pegging rewards and penalties to spot market index prices, the procurement incentive mechanisms effectively discourage the gas utilities from entering into long-term fixed-price gas supply contracts. Coral and TURN recommend that we consider whether and how to incorporate price risk management in the utilities' gas supply portfolios through staggered terms, fixed prices, hedged and index-priced supplies, and that we do so in our now-open rulemaking to address the gas utilities' incentive

mechanisms.⁴ This issue applies to all gas supply without regard to source. It is beyond the scope of this proceeding, whose focus is LNG supply only.

With respect to the Sempra utilities' specific proposal to develop and conduct an RFP by 2008 to solicit LNG supply to meet up to 25% of their core and utility electric generation natural gas demand, we reiterate that, while we invite them and the other California utilities to explore their various LNG supply options, we are not prepared on this record to condone any particular contract terms or supply portfolio composition. The utilities have the discretion, under current policy and procedures, to pursue their various natural gas supply options as they deem appropriate, with cost recovery subject to their procurement incentive mechanisms (or, in the case of the electric utilities, ERRRA review). We have no basis on this record to dedicate a portion of the utilities' natural gas demand to LNG supply or exempt it from the cost recovery procedures that apply to their procurement of gas supply generally.

5. Pre-Approval of LNG Supply Contracts

We sought comment on what procedures should be used to pre-approve LNG supply contracts. We identified, as one option, the procedure that we adopted for interstate pipeline contracts whereby utilities present proposed contracts within pre-approved capacity amounts and term ranges to Energy Division for informal review and approval. For proposed contracts that fall outside of the pre-approved ranges, the utilities are to confidentially consult with DRA, TURN and Energy Division about their plans and efforts in advance of

⁴ The Commission issued an Order Instituting Rulemaking to Address the Gas Utilities' Incentive Mechanisms and the Treatment of Hedging under those Incentive Mechanisms (R.08-06-025) on June 26, 2008.

entering into a contract; if those parties do not reach agreement, the utility may seek pre-approval by advice letter. (See D.04-09-022.) Another option is to require utilities to file advice letters for pre-approval of all LNG supply contracts. There is no dispute or proposal to deviate from the requirement, under D.06-12-029, that the utilities obtain pre-approval for any affiliate transaction for the procurement of LNG supply, pursuant to D.06-12-029.

The range of comments on the pre-approval procedures for LNG supply contracts generally reflects the parties' respective views on the appropriate procedure for their solicitation:

- The Sempra utilities propose to consult with Energy Division, DRA and TURN in the design and issuance of the RFP and in the awarding of any LNG supply contracts, and to submit the contracts for pre-approval by advice letter filing.
- PG&E similarly proposes to confidentially discuss any proposed LNG contract with Energy Division, DRA and TURN prior to its execution, and recommends pre-approval by advice letter for simple contracts, e.g., price tied to a regional price index, and by application for more complex or very long-term contracts.
- Edison supports applying the interstate pipeline contract pre-approval procedures to LNG supply contracts, but suggests that subjecting contracts of five years or longer to the application process may be too unwieldy for LNG supply contracts.
- Clearwater Port supports applying the interstate pipeline pre-approval procedures to LNG supply contracts, but suggests that an application, rather than advice letter, be required (1) where a contract involves an affiliate, and (2) where the contract deviates from the Commission's gas supply procurement policies (once established).

- Coral opposes a pre-approval process as it presupposes that the costs of any long-term supply contract will be accounted for outside of the utilities' procurement incentive mechanisms. Coral submits that the Commission should modify the incentive mechanisms to include the costs of all long-term and short term contracts within it. Coral recommends pre-approval only in the case of affiliate contracts.
- The Indicated Producers and GTN question the appropriateness of applying the interstate pipeline contract pre-approval procedures to LNG supply contracts.
- TURN proposes that the issue of possible pre-approval of supply contracts be addressed in the upcoming rulemaking addressing procurement incentive mechanisms. In the meantime, utilities should submit formal applications for pre-approval of any LNG supply contract.
- DRA supports allowing the utilities to file advice letters for pre-approval of LNG supply contracts with the provision, as adopted in D.04-09-022, that DRA reserves the right to have the requesting utility file a formal application in lieu of advice letter. DRA shares the Indicated Producers' and GTN's view that the expedited pre-approval process for interstate pipeline capacity contracts is inappropriate for LNG supply contracts.

Having concluded that LNG should compete head-to-head with other sources of natural gas, and without prejudice to the utilities' ability to apply for pre-approval of particular LNG supply contracts in the future, we find no basis to establish a special procedure for the approval of LNG supply contracts or associated cost-recovery outside of the procurement incentive mechanisms. This does not excuse LNG supply contracts from D.06-12-029, which requires pre-approval for any affiliate transaction for utility resource procurement.

However, such review and pre-approval is for the limited purpose of ensuring that the transaction complies with the Affiliate Rules.

The utilities have the discretion to seek pre-approval of LNG supply contracts by application, just as they may do for any other relief. We expect such application to show good cause why we should approve the contract and associated cost recovery outside of the procurement incentive mechanism.

We do not authorize the utilities to seek pre-approval of LNG supply contracts by advice letter. The considerations that led us to authorize advice letters for the approval of long-term interstate capacity contracts do not apply here. In particular, D.04-09-022 authorized advice letters for pre-approval of capacity contracts under circumstances of an imminent opportunity to terminate or negotiate reduced amounts of capacity in certain expiring existing capacity contracts, and limited the advice letter process to proposed contracts that were within an established capacity range based on core capacity holding requirements. We do not face an imminent fleeting opportunity for the California utilities to enter into LNG supply contracts, and we do not have a basis to require the California utilities to procure a particular volume range of, or particular terms for, LNG supply. In addition, as the comments highlight, pre-approval of particular gas supply contracts outside of the procurement incentive mechanism implicates a number of significant issues regarding the procurement incentive mechanism. The advice letter process is not adequate to address these issues.

6. Environmental Issues

Several comments raise environmental issues regarding LNG supply contracts. Woodside suggests that the comparison of LNG and domestic natural gas supply options should take account of socio-environmental (and political)

issues such as greenhouse gas, air quality, water quality, environmental justice and regulatory jurisdiction. In a similar vein, CE Council recommends that the Commission establish a “sliding scale adder” to reflect the greenhouse gas (GHG) emissions associated with all power and natural gas contracts. SCAQMD recommends that we require contracts between LNG suppliers and the utilities to include monitoring and testing provisions to ensure that LNG will meet the 1385 Wobbe standard mandated in D.06-09-039, and indemnification provisions so that the costs of noncompliance with regulatory emission requirements resulting from the use of LNG will fall on suppliers. SCAQMD also urges the Commission to conduct a California Environmental Quality Act (CEQA) analysis of the use of LNG, which it maintains is legally required.

These issues are beyond the scope of the proceeding. The focus of this proceeding is the ability of long-term LNG supply contracts to guarantee reliable gas supply at a reasonable cost, and the process under which the utilities should procure and seek cost recovery for such supply. This proceeding does not undertake to establish contracting requirements related to environmental issues either with respect to LNG supply in particular or, having determined that LNG supply should be treated the same as domestic gas supply for procurement purposes, with respect to natural gas supply generally.

With regard to SCAQMD’s assertion that a CEQA analysis is legally required in this rulemaking, SCAQMD does not make any specific reference to the law and we do not find any law that leads us to agree with its conclusion. Generally, environmental review pursuant to CEQA is triggered when a public agency exercises its discretionary power to carry out or approve a project that may have a direct or a reasonably foreseeable indirect, physical impact on the environment. (Pub. Resources Code § 21065, CEQA Guidelines § 15002.) The

utilities' potential procurement of LNG supply is not a "project" under CEQA as it is not an activity directly undertaken by a public agency; it is not supported by financial assistance from a public agency; and it does not require a permit, license or certificate from a public agency. (Pub. Resource Code § 21065, CEQA Guidelines § 15378.) Our decision today does not commit us to any course of action, narrow the field of options and alternatives available, or dictate how any funds are to be spent. (*Kaufman & Broad-South Bay Inc. v. Morgan Hill Unified School District* (1992) 9 Cal.App. 4th 464, 476.) For all these reasons, we conclude that an environment analysis under CEQA is not required in this proceeding.

7. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on October 6, 2008, by the Sempra utilities, PG&E, Woodside, El Paso, CE Council, and RACE, and reply comments were filed on October 14, 2008, by the Sempra utilities, PG&E, Woodside, Coral's successor Shell Energy North America, the Indicated Producers, RACE, TURN, DRA and Sempra LNG. We have considered the comments; to the extent that they identified factual, legal or technical error in the proposed decision, we have made appropriate changes and, to the extent that they merely reargue positions taken in the proceeding, we accord them no weight.

The Sempra utilities express concern that requiring LNG supply to compete "head-to-head" with domestic supply may effectively foreclose the Commission from considering the non-price benefits of potential long-term LNG supply contracts in the future. To the contrary, our discussion acknowledges that the value of any supply contract is based on the contract taken as a whole,

including supply reliability, price guarantees and other contractual terms. There is no need to qualify our determination that LNG supply should be competitive with domestic supply.

PG&E expresses concern that the proposed decision's findings that formal RFPs should be for all sources of supply unreasonably ties the utilities' hands and is contrary to our determination that, pursuant to our current gas policy and procedures, the utilities' solicitation and procurement of LNG supply shall be at their discretion, with cost recovery subject to the gas utilities' procurement incentive mechanisms. We modify the decision to delete language directing the utilities to conduct all-supply source solicitations in the event of the conduct of an RFP for gas supply, so as to eliminate any suggestion that the utilities' procurement of LNG supply is subject to different requirements than apply to their procurement of gas supply generally.

PG&E contends that there is no record basis for the proposed decision's conclusion that California utilities need not take on the role of anchor tenants through long-term supply contracts in order to ensure the development of the market. To the contrary, the proposed decision cites to the number of LNG projects being proposed on the West Coast without a major California utility customer and the ability for LNG projects to serve customers other than the California utilities.

In its reply comments, PG&E reiterates its interest in a collaborative process with the Commission and other stakeholders to address issues related to LNG supply procurement. For all the reasons discussed, we decline to establish a special process to assist the utilities in their assessment and procurement of LNG supply.

CE Council urges the Commission to reconsider its previous determination of need for LNG, made in D.04-09-022, as affirmed in D.05-10-045, on the basis that it is outdated. The proper vehicle for seeking change to an issued decision is a petition for modification. CE Council urges the Commission to re-open the comment period on the Scoping Memo in R.08-06-025 to allow parties to address issues raised in this decision or, in the alternative, to open a new phase in R.08-06-025 to consider LNG contracting issues; CE Council also urges the Commission to consider the environmental characteristics of LNG versus domestic natural gas in R.08-06-025. The determination of the scope of R.08-06-025 is beyond the scope of this proceeding. CE Council identifies certain errata, which we correct as appropriate.

RACE challenges the proposed decision for declining to revisit the Commission's previous determination of need for LNG, and for determining that environmental issues are beyond the scope of the proceeding. RACE's comments merely reargue the points raised in earlier filings and do not require any separate discussion.

8. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Hallie Yacknin is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The record does not support the adoption of standards or requirements regarding supply reliability and/or cost guarantees for LNG supply contracts.
2. We cannot find on this record that the gas utilities' entry into long-term LNG supply contracts will increase the likelihood or timeliness of developing the West Coast LNG market.

3. Allowing LNG and domestic supplies to compete head-to-head will best achieve the competitive benefits of bringing LNG supply to the West Coast.

4. Under current gas policy and procedures, the utilities' recovery of gas supply costs is governed by their procurement incentive mechanisms.

Conclusions of Law

1. LNG supply should compete head-to-head with other supply regardless of source.

2. The utilities' procurement and cost recovery related to LNG supply should continue to be governed by the procedures and incentive mechanisms that apply to natural gas procurement generally.

3. The utilities' potential procurement of LNG supply is not a "project" under CEQA.

4. Environmental review under CEQA is not required in this proceeding.

5. This proceeding should be closed.

O R D E R

IT IS ORDERED that Rulemaking 07-11-001 is closed.

This order is effective today.

Dated October 16, 2008, at San Francisco, California.

MICHAEL R. PEEVEY

President

DIAN M. GRUENEICH

JOHN A. BOHN

RACHELLE B. CHONG

TIMOTHY ALAN SIMON

Commissioners