

# KING OF LNG





# SEMPRA AGGRESSIVELY PURSUES OPPORTUNITIES

BY AL SENIA

More than four years ago, top executives with California energy giant Sempra identified a major opportunity developing in the natural gas market. Their prediction of an impending natural gas shortage drew criticism from numerous quarters, but they pushed forward with an ambitious and somewhat risky multi-billion-dollar investment in liquefied natural gas development.

Now, with the first of Sempra's LNG receiving terminals scheduled to start operating early next year on Mexico's west coast about 50 miles south of San Diego, the \$15 billion company is at the forefront of the domestic LNG industry. It is also cementing a diversification strategy that positions it far beyond its core utility businesses, Southern California Gas Co. and San Diego Gas & Electric Co.

In fact, it is Sempra's commitment to diversification — and its desire to leverage its various business components — that help explain its multi-billion-dollar gamble on LNG development. The LNG operation is just one segment of Sempra Global, the nonutility family of businesses that operate in a competitive marketplace and that includes power generation, pipeline and storage, and an energy trading company. They comprised more than 40 percent of Sempra's total revenue last year.

"What LNG is for Sempra is a catalyst for growth in our associated businesses," explained Darcel Hulse, president of Sempra LNG. "As we move forward in our LNG business, that provides an opportunity for a better understanding of the market for our trading group to participate on a global scale, as well as our pipeline and storage group."

Fundamentally, Hulse and other Sempra executives see a growing need for natural gas worldwide and adequate supplies in many parts of the world that have small local markets and the desire to export their supplies. "On an energy-equivalent basis, proven gas reserves now exceed proven oil reserves," said Hulse. "So there is more energy locked in gas than there is in oil. As we analyze that going forward, it means gas is going to take a more predominant role in our energy mix."

To meet that need, Sempra has invested an estimated \$2.2 billion in developing three LNG receiving terminals in Baja, Mexico, in Port Arthur, Texas and near Lake Charles, La.

The \$800 million Baja facility is the most interesting because it will be the first of its kind on the Pacific Coast.

◀ A construction worker at Sempra Energy's new Energia Costa Azul facility in Baja Mexico

AP PHOTO/SANDY HUFFAKER



SEMPRA HAS  
BEEN AT THE  
FOREFRONT OF  
BRINGING LNG TO  
THE UNITED STATES

▲ Sempra Energy's new Energia Costa Azul, South of Rosarito, in Baja Mexico.

A similar LNG facility off the coast of Long Beach, Calif., backed by Mitsubishi-ConocoPhillips, was all but killed in January because of safety and environmental concerns. The Baja plant, named Costa Azul, is the first Sempra LNG plant scheduled to come online. It is expected to process 1 billion cubic feet (Bcf) per day of natural gas when it begins commercial operation early next year. Officials hope to eventually increase daily production to 2.5 Bcf. Sempra plans to sell about one-half of initial production in the western United States and the other half in Baja, Mexico. "It's moving along very well and construction is coming along," Hulse said.

The second Sempra plant, Cameron LNG near Lake Charles, La., will process 1.5 Bcf per day of natural gas when it begins operation in late 2008. The third plant, Port Arthur LNG, is under development along the Port Arthur Ship Canal on the Gulf Coast. It is expected to deliver between 1.5 Bcf and 3.0 Bcf per day of natural gas in 2010.

#### LEADING THE PACK

LNG industry pundits believe Costa Azul puts Sempra a big step ahead of competitors because it will provide a needed West Coast outlet for natural gas producers and marketers. "It's a huge development in terms of the global LNG business because it opens up the West Coast market," noted Damian Gaul, an economist with the Energy Information Administration who in January co-authored a report about the global LNG market. "Sempra has been at the forefront of bringing LNG to the United States. That is a big deal because they will be able to bring in new supplies of natural gas."

According to the Federal Energy Regulatory Commission, which has regulatory authority over LNG plant development, there are 40 LNG terminals currently being discussed with six currently operating off the East Coast, the Gulf Coast and Puerto Rico. Analysts predict only about 12 of the 40 plants will ultimately be built, thanks to



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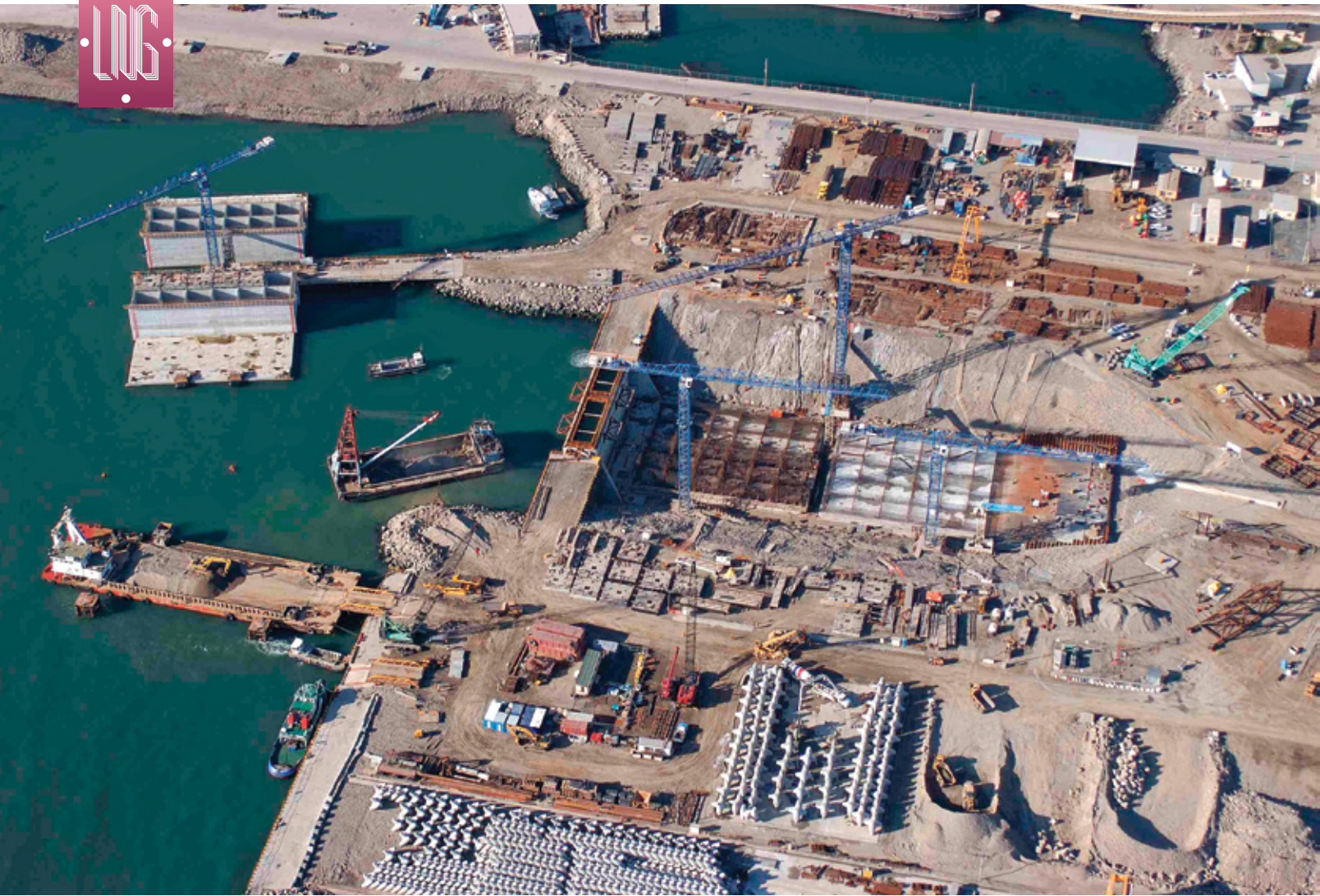
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▲ Another view of Sempra Energy's new Energia Costa Azul

the complex political, environmental and regulatory hurdles that LNG plants must overcome before being built.

New LNG plants clearly are needed if the technology is to gain traction because the volume of LNG imports decreased during the past two years. In his EIA report, Gaul noted that LNG “still accounts for less than 3 percent of total U.S. natural gas supplies, but the global market is growing, and EIA foresees another wave of U.S. LNG growth over the next two years.”

As global LNG supplies grow, EIA predicts domestic LNG imports will increase 34.5 percent this year and 38.5 percent next year. Sempra’s plan may position it well to compete in this growing market. “They are taking a risk, but it will be rewarded,” said Gaul. “There’s no lack of proposals to build these facilities, but oftentimes, the proposals are not very well formulated” and they quickly die. He noted that for its part, Sempra “has already gone through a lot of different hurdles to get to where it is now. It’s ahead on the

West Coast of North America, and the market is going to open up a lot.”

#### OIL PARALLEL

Sempra’s Hulse sees a parallel between development of the global LNG industry and the oil industry. “As LNG grows around the world, we’ll start seeing LNG trading a lot more like a commodity, much like there is in oil,” he said. “LNG will be a prominent commodity like oil. It’s going to require a lot more infrastructure globally.”

The oil industry “provides a good history for us to look at,” Hulse added. “It will move like that.” Hulse conceded that LNG is still much less developed as an industry than the oil business, and it is “very difficult to put all the pieces together, simply because of the liquefaction process. On the oil side, “what we do upstream with LNG, we do downstream with oil.” An oil refinery translates crude

oil into products that are traded globally. He believes the natural gas liquefaction technology central to LNG “allows you to move it around the planet like oil.”

How long will that take? “It’s hard to predict,” Hulse said. “If you look at the history of oil, oil traded locally and then it traded regionally and then it traded globally. LNG has done the same thing... There’s a period of transition from a bilateral market to a global-commodity market. It will move like oil. How long it will take I can’t predict. All I can tell is that there is a trend moving in that direction.”

Gaul agreed there are some similarities in LNG and oil in that a global market is developing for both commodities and both are being transported to different, far-flung geographies. “It is reasonable because of the companies involved and the countries,” said Gaul, noting that LNG imports to the United States come from countries such as Egypt, Nigeria and Libya. Two-thirds of U.S. imports last year, however, came from Trinidad and Tobago. “You find natural gas where you find oil. Spot trade in LNG is starting to develop. But a spot market that comes close to imitating the oil market is still many years away. And the transportation cost for natural gas is a lot more than for oil. So there is not going to be much liquidity in the marketplace.”

Another detriment for LNG is that unlike oil, it costs a lot more capital to build a liquefaction processing facility — and the environmental and political obstacles are often immense. Even so, Hulse’s proposition isn’t so far-fetched, especially if natural gas emerges as the fuel of choice for developed countries.

For Sempra’s part, such forward thinking plays right into the company’s strategy of staying ahead of the curve. “We come at it from a market focus,” said Hulse. “We’re an infrastructure builder of LNG pipelines and generation. Plus tied into all of that, we have the ability of a trading company.

“The important thing is to see market trends and movements before they become very clearly evident to the rest of the market,” added Hulse. “We started early, we got ahead of the cost curve, so we now can offer good services and strategic locations. We will always try to stay ahead. That’s why this market-based approach is important. We spend a lot of time trying to study market trends. We’ve had to take contrarian views in pursuing this. If you can spot the trends in advance and position yourself, you’ll benefit.” ☞



▲ Darcel Hulse, president of Sempra LNG.



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