

# LNG: FERC Asserts Control

CPUC questioned historic oversight authority.

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To guarantee the continued growth of liquefied natural gas (LNG) importation and use in the United States, the energy industry needs to pay close attention to govern the regulation, siting, and operation of LNG import terminals—issues traditionally overseen by the federal government. States may have a number of reasons for wanting to establish oversight authority over LNG import terminals, but these efforts, no matter how well intentioned, would have the impact of curtailing the development of LNG facilities at a time when the United States is in urgent need of new sources of natural gas.

The latest such effort was launched

by the California Public Utilities Commission (CPUC) in February and was rebuffed, quite forcefully, by the Federal Energy Regulatory Commission (FERC). This decision is good news for LNG terminal developers, state agencies, environmentalists, and, most importantly, consumers, because it clarifies and sets forth in decisive language the regulatory path that must be taken if a new terminal is to be built or an existing terminal expanded.

### FERC's Decision

On March 24, 2004, FERC issued a declaratory order determining that it has exclusive jurisdiction over the siting,

construction, and operation of onshore LNG import terminals. In so doing, FERC reaffirmed its 30-year precedent of reviewing and approving applications for construction and reactivation of LNG import terminals.

This decision came in response to a challenge by the CPUC, in which it had questioned FERC's authority in a February protest to an LNG project application filed by Sound Energy Solutions (SES), a Mitsubishi subsidiary. Surprisingly, the CPUC did not argue that the state commission has concurrent or overlapping jurisdiction, but rather that FERC has *no jurisdiction whatsoever* over LNG import terminals. This aggressive argument was based on four core components. First, since Section 3 of the Natural Gas Act (NGA) doesn't specifically mention "facilities" for the importation of natural gas or LNG, FERC has no jurisdiction over LNG facilities. Second, the Energy Policy Act of 1992 amended Section 3 of the NGA in such a way as to strip FERC of its authority »



Source: Panhandle Energy

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over LNG terminal facilities. Third, because the terminal facilities and sales of gas would be entirely within the state of California and would connect to an intrastate system—and therefore the transactions were intrastate, not interstate, in character—FERC had no authority to regulate intrastate commerce. Finally, the CPUC contended that, since it has delegated authority from the U.S. Department of Transportation (DOT) to do safety inspections of intrastate pipelines under the Natural Gas Pipeline Safety Act, it should make the siting and safety determinations on the SES project.

In a strong and decisive order, however, FERC rejected all of the CPUC's arguments. The commission acknowledged that the SES proposal would not involve interstate commerce, but since LNG import terminals are engaged in foreign commerce, they are subject to the exclusive jurisdiction of FERC under Section 3 of the NGA, regardless of whether the imported supplies are subsequently sold or transported in interstate or intrastate commerce.

FERC noted that more than 30 years ago the U.S. Court of Appeals for the D.C. Circuit in *Distrigas Corp. v. FPC* clarified Congress's intent and the exclusive federal role in regulating foreign commerce involving the import of natural gas and the facilities needed to support this commerce. The court held that Section 3 of the NGA provides FERC with "plenary and elastic" authority to regulate LNG import facilities. The Sound Energy Solutions

Declaratory Order was not a change in FERC policy, nor did it take any regulatory authority away from the states. It simply affirmed and clarified the existing jurisdiction of the commission.

The commission also pointed out that most of the CPUC's arguments already had been dealt with in 2001, when the commission rejected Dynegy LNG Production Terminal's request that FERC disclaim jurisdiction over LNG terminals on similar grounds.<sup>2</sup> Then, as now, the commission explained that the Energy Policy Act of 1992 was passed in order to facilitate the import and export of the commodity, and that the provisions of Section 3(a) of the NGA, which contain FERC's authority to regulate LNG import terminals, were not changed by the 1992 Act.

According to FERC, the jurisdictional character of the downstream facilities, i.e., whether the interconnecting pipelines are interstate or intrastate systems, is irrelevant to this analysis, as is the ultimate destination of the gas. The important fact is that Congress set aside LNG import terminals for exclusive federal regulation.

Finally, FERC acknowledged the CPUC's concern with safety and siting of the proposed LNG terminal but rejected the contention that the CPUC would be the appropriate agency to enforce the safety and siting rules. Noting the interagency agreement among DOT's Research and Special Programs Administration (RSPA), the Coast Guard, and the commission, FERC pointed out that it is the lead agency in

conducting National Environmental Policy Act (NEPA) review and is responsible for preparing the environmental analysis of new project proposals.

Among its other responsibilities, FERC reviews in detail the plant design and engineering, the operating procedures, and the various active and passive safety systems for proposed projects. The commission also requires systematic evaluation of the soils and seismic conditions of the site, as well as the potential environmental impact of any air, water, or noise emissions from the plant. Additionally, FERC applies the federal siting criteria for exclusion zones around the terminal site and reviews potential marine hazards of LNG vessel traffic in close cooperation with the Coast Guard and RSPA.

FERC also noted that this regulatory scheme serves an important public policy goal: the nation's need for a uniform national policy for LNG imports. Thus FERC recognized that the CPUC protest was a threat not only to the SES terminal, but to the development of all new LNG import terminals and the expansion of existing projects nationwide.

### Looking Ahead

The Sound Energy Solutions Declaratory Order is one of two FERC decisions that are vital for development of new and expanded LNG terminal capacity in the United States. In 2002, the commission issued a groundbreaking order in *Hackberry LNG*,<sup>3</sup> in which it decided to apply light-handed regulation to LNG import terminals by no longer requiring the open access rules and cost-of-service regulation that had previously applied. FERC took this step in recognition of the significant role LNG imports are predicted to play in response to the nation's growing natural gas supply needs, and the need for certainty that these capital-intensive undertakings require. »

Despite FERC's support, however, LNG developers still have their work cut out for them if the country is to get the seven to 10 new or expanded terminals needed to respond to the country's growing gas demand.<sup>4</sup> The CPUC protest is just one example of a widespread public skepticism aimed at LNG import projects.

LNG is not new to the United States. There are numerous LNG peak shaving facilities in operation throughout the country that liquefy, store, and deliver regasified LNG to domestic gas markets. Despite the fact that imported LNG has been widely used in Europe and Japan for decades, it has never been a significant part of the fuel mix in the United States. The United States currently has only four operating LNG terminals, plus one in Puerto Rico. Thus, it is not surprising there are concerns about what is essentially a new source of imported gas supplies.

### **Safety and Terrorism Concerns**

The situation also is affected by the significant amount of misinformation in circulation about LNG, particularly as to its safety and security. This complicates and lengthens the review process, and, in some cases, has caused project sponsors to cancel their plans altogether.

For these reasons, it is important for the public and state agencies to know that the FERC review process is rigorous and comprehensive, and each environmental impact statement issued by FERC will address these concerns in detail. Referring to its agreement with DOT and the Coast Guard, FERC attempted to reassure the state commission and the public in the Sound Energy Solutions declaratory order:

We believe the NEPA review, in conjunction with the actions of the other Federal agencies as

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outlined in the recent agreement, will preclude the authorization of all projects that present imprudent risks to health and safety or are inconsistent with the public interest.

Much more needs to be done, however. FERC considers the safety implications of LNG supplies and has recently commissioned a new security analysis—which should be available in late spring—that is intended to answer some of the safety and terrorism concerns. But the commission also must respond to the conflicting scientific views on the combustibility of LNG vapor clouds and the wildly disparate models being used to evaluate the safety risks of a marine spill. The scientific community must reach a common understanding of how to evaluate such concerns and the results of that evaluation must be publicly available. The only way to respond to public concerns about the safety and security of LNG is through the effective dissemination of the sound science that supports the fact that LNG is a safe and reliable energy source.

A realistic assessment of new LNG projects also should take into account the marked benefits of increased LNG imports, including diversity of supply sources, increased competition, and price relief for consumers. And the environmental benefits of LNG should not be forgotten. The SES project, for example, will also offer LNG in its liquid state, which means the product can be used immediately as a clean-burning vehicle fuel. California could see a pronounced environmental benefit from this if, for example, large diesel vehicles that operate in the Los Angeles basin converted to LNG, thus reducing both NO<sub>x</sub> and particulate emissions in the region.

The Sound Energy Solutions declaratory order clarified an important jurisdictional issue at a time when the United States is facing dwindling supplies of natural gas from traditional sources. While the order may ultimately be subject to judicial review, expeditious review and confirmation by the courts of the declaratory order may facilitate the development of new infrastructure and the expansion of existing LNG terminals. ■

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### **Endnotes**

1. 495 F.2d 1057, 1064 (D.C. Cir. 1974), cert. denied, 419 U.S. 834 (1974).
2. Dynegy LNG Production Terminal L.P., 97 FERC ¶61, 231 (2001).
3. Hackberry LNG Terminal, L.L.C., 101 FERC ¶61,294 (2002).
4. "Balancing Natural Gas Policy – Fueling the Demands of a Growing Economy," (Sept. 2003), available at [www.npc.org](http://www.npc.org), or by contacting NPC, 1625 K Street, Suite 600, Washington, D.C. 20006.