

EIA Study on Effect of Increased LNG Exports: Regulatory Uncertainties and Higher Gas Prices?

By John Burnes, Michael McBride, and Janna Chesno

On Thursday, January 19, 2012, the U.S. Energy Information Administration (EIA), the statistical and analytical agency within the Department of Energy (DOE), released a study which concluded that, under all of the cases and scenarios considered, increased LNG exports of domestically-produced natural gas will lead to higher domestic natural gas prices, increased domestic gas production, reduced domestic natural gas consumption, and increased natural gas imports from Canada by pipeline. Among other things, the study also determined that higher natural gas prices will lead electric generators to burn more coal and less natural gas, which when combined with the impact of adding liquefaction equipment, results in an increase in CO₂ emissions. The EIA report can be accessed [here](#).

The study was requested by DOE to evaluate the “cumulative impacts” that the growing number of applications to export natural gas might have on the domestic supply and demand for natural gas. DOE has also commissioned another “cumulative impacts” study by a private company which is expected to be completed in the first quarter of 2012. These studies will be used by DOE to determine whether to grant applications to export LNG and whether previously-authorized exports remain in the public interest.

BACKGROUND

When DOE considers a request to export LNG, it must determine whether the proposed export is consistent with the public interest, which requires an evaluation of a number of factors, most importantly, whether there will be enough natural gas available at reasonable prices to meet current and future domestic needs over the term of the proposed export if it is granted. On May 20, 2011, the DOE, Office of Fossil Energy, authorized Sabine Pass Liquefaction, LLC (Sabine Pass) to export LNG from the Sabine Pass LNG terminal to non-free trade agreement countries, representing the first time DOE has authorized a long-term, large-volume export of domestically-produced LNG from the lower-48 states to non-free trade agreement countries. In the Sabine Pass order, DOE attached a condition that will permit DOE to monitor domestic supply and price conditions and to take appropriate action concerning that authorization and other subsequent export authorizations if the “cumulative impacts” of the export authorizations subsequently lead to a reduction in the supply of natural gas needed to meet essential domestic needs. Following issuance of the Sabine Pass order, DOE commissioned two studies to evaluate the “cumulative impacts” of exportation of domestic natural gas.

In the Sabine Pass order, DOE did not specify what “appropriate actions” it was prepared to take if exports reduced the availability of domestic supplies or increased prices to unacceptable levels. DOE stated that it might



issue supplemental orders and was prepared to perform any and all acts under existing authority, including amending, suspending, and revoking existing export authorizations. Such actions could take place at any time during the term of an export authorization that typically lasts for 20 or 30 years. DOE has never issued an order revoking or retroactively modifying an LNG export authorization when there was no violation of the terms and conditions of the authorization, and DOE's claimed authority to do so has not been judicially affirmed.ⁱ

Nevertheless, DOE imposed the condition in the Sabine Pass export authorization, and stated that it would apply this same condition in the future to evaluate the "cumulative impacts" of subsequent LNG export requests together with the Sabine Pass export authorization. DOE has announced that it is holding all pending LNG export applications in abeyance until the two studies are completed and reviewed. Meanwhile, on January 4, 2012, Congressman Edward Markey, Ranking Member of the House Committee on Natural Resources, wrote a letter to Secretary of Energy Chu asking detailed questions about the consequences of exporting LNG, requesting more information on DOE's authority to monitor the impact of LNG exports, and asking DOE to describe what specific actions DOE was prepared to take to protect U.S. gas consumers, including under what circumstances DOE would deny new LNG export applications or withdraw approvals of previously granted export authorizations. Although DOE has yet to respond to this request, Secretary of Energy Chu briefly discussed DOE's authority in response to press inquiries following a speech made recently in Cleveland. As reported by the *Plain Dealer*, he said "[o]ne has to proceed with care on this. We have given a permit to one plant." When asked whether DOE would revoke an authorization once granted, he responded "The best way to do this is you don't want to be granting six or ten permits and then say 'Oops.' You don't permit a whole rash of them and find out what a terrible mistake you made." The *Plain Dealer* article can be accessed [here](#).

IMPLICATIONS

The EIA study is one of two studies that DOE will use to evaluate applications to export LNG. DOE has not yet explained how it will use those studies, what specific actions it will take, or what circumstances will trigger its authority to limit the amount of natural gas that can be exported from the U.S. As explained by DOE, however, this authority would include not only taking action with respect to proposed export applications, but could also enable DOE to amend, suspend, or even revoke existing export authorizations. There are seven applications currently pending before DOE to export the equivalent of roughly 18 percent of the natural gas now consumed in the U.S. Multiple applications are also pending at the Federal Energy Regulatory Commission (FERC) to authorize the construction and operation of liquefaction facilities at LNG terminals needed to export domestic LNG. More export and construction requests are anticipated. DOE's monitoring condition creates a great deal of uncertainty over the ability to rely on an export authorization over its entire term, and could restrict or increase the cost of financing capital-intensive energy infrastructure such as LNG export projects. Clarification of the scope of DOE's authority is needed because contracts are now being negotiated and signed with potential LNG export customers and financing arrangements are also being discussed and finalized for proposed LNG export projects. In addition, related infrastructure projects, such as the construction or modification of pipelines to deliver domestic supplies to LNG export terminals are also under consideration.



Some clarity may be provided by DOE in response to Congressman Markey's questions concerning DOE's regulatory authority and intentions. The second "cumulative impacts" study, which should be completed in the first quarter, may also provide additional information on DOE's grounds for taking action in the future. Following review of the completed studies, DOE will act on the pending LNG export applications, and may provide needed definition to its retroactive authority announced in the Sabine Pass condition. Congressional action, including possible hearings on the domestic impact of increased LNG exports and DOE's authority, is also likely in 2012.

Parties seeking to obtain or provide financing of LNG export projects, as well as upstream natural gas pipelines that could deliver gas to the proposed LNG export terminals, will want to thoroughly understand the potential risks and consequences of DOE's claimed authority to amend, suspend, or revoke existing export authorizations. Interested parties should also recognize that there are opportunities to protect their interests by participating in the regulatory process before both DOE and FERC for the approval of LNG export projects. There may also be opportunities to participate in the likely Congressional debate concerning the impacts of increased LNG exports.

FOR ADDITIONAL INFORMATION

Van Ness Feldman maintains one of the most active and prominent LNG practices in the U.S. Our practice includes the review and negotiation of LNG sale, purchase, and tolling agreements, and due diligence reviews of proposed projects and contracts for financing LNG facilities. Our team has first-hand experience in obtaining LNG-related permits from DOE and the needed authorizations to construct and operate LNG terminals and related pipeline facilities from FERC. Further, Van Ness Feldman professionals have worked on every piece of federal energy legislation over the last two decades. In addition to our representation of existing U.S. pipelines and LNG terminal owners, our team includes members who litigated the Trunkline LNG Project before FERC and DOE where the issue of DOE's revocation authority arose for the first time, and members with first-hand experience in developing the statutory language of Energy Policy Act of 2005, which facilitated the development of LNG import terminals in the U.S. For more information, please contact [John Burnes](#), [Janna Chesno](#), [Lisa Epifani](#), [Michael McBride](#), or any member of our [LNG practice](#) at 202.298.1800.

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ⁱ The issue was litigated, however, in a series of orders involving an LNG import project in the 1980's. DOE determined that it had such revocation authority, but chose not to exercise it in the context of the case. FERC assumed without deciding that it had the authority, but also determined not to exercise it based on the facts of the case. On review, the U.S. Court of Appeals for the D.C.



Circuit did not reach the issue for procedural reasons, but noted, almost with relief, that it did not have to address the “nettlesome issue whether [DOE] does indeed have authority to revoke a section 3 authorization, pursuant to which approximately \$ 1 billion was invested in U.S. facilities alone, in the absence of a violation of the terms and conditions of the authorization.” *Ass’n of Businesses Advocating Tariff Equity v. Hanzlik*, 779 F.2d. 697, 702 n.7 (D.C. Cir. 1985).