

US Shale Gas Exports – DOE's *Freeport* Decision

On May 17th, the US Department of Energy's Office of Fossil Energy ("DOE") granted the application of Freeport LNG Expansion, L.P. and FLNG Liquefaction, LLC (together, "FLEX") to export up to 1.4 Bcf/d of LNG to non-FTA countries.¹ This was the second DOE order to authorize non-FTA exports of LNG and the first to analyze the cumulative impacts of LNG exports under the regime established in 2011's *Sabine Pass* order.²

While DOE's approval of FLEX's application was not really a surprise, the *Freeport* order is significant because it considered – and ultimately dismissed – many of the procedural and substantive objections to LNG export applications more broadly, and thus signaled to other applicants that DOE is likely to approve further exports. On the other hand, *Freeport*, like *Sabine Pass*, contains a caveat that may make prospective developers (and their lenders) nervous: DOE asserted that it has the right to make supplemental orders changing the export authorization if necessary to protect the public interest. Thus, the political risk of permit revocation when the holder is faultless continues to hang over these very capital-intensive projects. With all the above in tow, we now expect DOE to issue additional non-FTA orders soon. The interesting, and as yet unanswerable, question is how many more applications will be approved before DOE's cumulative impact analysis "starts to bite".

Analysis

Freeport was "not a surprise" because everyone expected DOE to approve *some* exports beyond the 2.2 Bcf/d authorized in *Sabine Pass*. Having established that it would process applications case-by-case in the order received and would consider the cumulative impacts of each of the 20 pending non-FTA export applications under the applicable public interest standard³, it was almost a foregone conclusion that DOE would approve the next application in line (FLEX's).

That said, *Freeport* is important because it upheld the validity of the EIA and NERA studies (together, the "LNG Export Study") on the cumulative impacts of LNG exports which DOE commissioned following *Sabine Pass* to inform future public interest evaluations, and because it addressed the many challenges to the LNG Export Study submitted by opponents of LNG exports. Having thoroughly considered those issues in *Freeport*, we see no reason for DOE to reopen them in other applications, and this should expedite the approval process.

Specifically, DOE considered and rejected the following major arguments against FLEX's proposed LNG exports:

- that the quantities being exported would cause domestic prices to rise. FLEX submitted evidence that the price increases would be small in the immediate vicinity

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of the project and insignificant elsewhere (e.g., 1-4 cents per MMBtu in New York). DOE dismissed arguments and evidence to the contrary submitted by the American Public Gas Association ("APGA") and others;

- that the FLEX exports would impact the availability of domestic natural gas supplies. FLEX relied on the estimates by EIA and others that the US has 100 years' worth of available natural gas resources, much of it from shale deposits. DOE rebuffed arguments from APGA and others that supplies could be inadequate, citing the LNG Export Study;
- that the natural gas that FLEX intends to export is required to meet US domestic demand. FLEX submitted evidence that natural gas consumption in the US would rise only slightly and would be more than met by discovery of new reserves. DOE rejected arguments by APGA suggesting a probable increase in demand for natural gas in electric generating plants;
- that the LNG Export Study was defective in design, methodology, input data and/or assumptions;
- that natural gas used for LNG exports deprives the US manufacturing industry of that gas. Rather, DOE found that the market will respond to increased demand by producing additional supplies and the market will also allocate those supplies to their best use – including possible interruption of LNG exports if better prices can be obtained in the US domestic market;
- that the environmental impacts of the project and related expanded natural gas production (including fracking) caused by the proposed exports were not consistent with the public interest. DOE deferred consideration of the environmental issues until FERC has completed its NEPA review, but reserved the right to consider environmental issues that FERC does not. (In the past both FERC and DOE have refused to consider the impact of shale gas production as beyond the proper scope of the Section 3 NEPA analysis); and
- that DOE erred procedurally in its consideration of the FLEX application (and the other pending export applications). Many of these procedural arguments seem designed to provide a basis for judicial review of the final DOE order.⁴

DOE found that FLEX's proposed exports would have a number of benefits, including:

- that the FLEX project would provide benefits to the local, regional and national economy through new jobs and economic benefits of \$3.6 - \$5.2 billion per year. Parties arguing to the contrary attacked the LNG Export Study's conclusion that the project would create positive economic benefits, contending that the benefits of developing additional domestic industrial use were higher; and
- that the FLEX exports would benefit international trade, provide global environmental benefits and enhance US national security. DOE dismissed APGA argument's that the exports would endanger US national security by preventing the US from developing energy independence.

DOE also found that potential adverse impacts on Energy Intensive Trade Exposed ("EITE") industries, such as chemical and fertilizer companies, did not outweigh the need to look to exports' benefits to the US economy as a whole in determining the public interest.

Taken together, DOE's findings in *Freeport* amount to a vote of confidence for the findings of the LNG Export Study and for FLEX's arguments, and a rejection of the positions of opponents of exports, including industrial users. DOE found that the LNG Export Study, which FLEX's opponents had criticized sharply for its general support for exports, "provides substantial additional support for conditionally granting FLEX's Application in this proceeding" and "is fundamentally sound and supports the proposition that the proposed authorizations would not be inconsistent with the public interest."⁵ And DOE concluded that APGA had not shown "meaningful errors or omissions in the studies provided by FLEX" and did not "provide a basis for rejecting FLEX'S claims of numerous economic and non-economic benefits from a grant of the Application."

Substantive Requirements of the *Freeport* Order

DOE's specific authorization to FLEX (in the ordering paragraphs of *Freeport*) contains, in substance, essentially the same conditions as those imposed in *Sabine Pass*, including a 20-year term (rather than the requested 25-year term), the obligation to begin shipping LNG within seven years, limitations on changes of control in the applicant, registration of principals (if FLEX acts as an agent), various reporting and filing requirements (including the terms of "relevant long-term commercial agreements"), and conditionality on completion of the FERC process (including its environmental review).

As noted above, the DOE in *Freeport*, as in *Sabine Pass*, purported to reserve the right to revoke FLEX's authorization if needed "to protect the public interest in the event there is insufficient domestic natural gas for domestic use,"⁶ and it is reasonable to expect DOE to do the same in future orders. The specter of revocation may be something that developers can live with,

however. In recent testimony before the Senate Energy and Natural Resources Committee, Cheniere Energy, the developer of the Sabine Pass facility, accepted that this reservation of authority by DOE constitutes "political risk", but contended it is one that it (and its lenders) have accepted as manageable.⁷

What Does *Freeport* Mean for Additional Non-FTA Exports?

Freeport technically addresses only the FLEX application. And as noted above, the evidence in the *Freeport* matter is derived principally from two sources: the material submitted by FLEX (both as part of its application and in rebuttal to the arguments of others) and the LNG Export Study. Thus, care should be taken not to read too much into *Freeport*. It does not constitute wholesale approval of the other pending non-FTA export applications, and DOE has been careful to say just that.⁸ If the evidence in other applications is weaker than FLEX's, or if opponents of exports develop stronger arguments than those marshaled against FLEX, it is possible that the rebuttable presumption in favor of exports might not be met in other cases.

On the other hand, having worked through many of the issues in and attacks on the LNG Export Study, future approvals should be easier. The key will be how the "cumulative impact" analysis plays out as additional non-FTA volumes are authorized for export, case-by-case. DOE has left itself plenty of room in this regard by simultaneously restating its commitment to market forces set forth in the 1984 Policy Guidelines, while also reasserting its right to issue supplemental orders if exports are no longer in the public interest.⁹

Conclusion

We continue to believe the following:

- DOE is likely to approve a number of pending non-FTA export applications in quick succession, but will pause at some level of exports (potentially in the 8-10 Bcf/d range) to consider their cumulative impact. DOE will not leave the quantity of exports entirely to the market, although approved projects with confirmed long-term contracts and financing will have a clear advantage in actually getting built.
- Political momentum is clearly in favor of non-FTA exports, and new Energy Secretary Ernest Moniz can expect support from the White House in approving more exports.
- When timely, opponents of exports will challenge the DOE's analysis in *Freeport* (and probably subsequent non-FTA export decisions) by seeking rehearing and then judicial review in one of the US Courts of Appeals. Given the deference to which administrative agencies are entitled on review, we expect that, absent some future egregious error, the courts will ultimately uphold DOE's non-FTA export orders.

¹ *Freeport LNG Expansion, L.P. and FLNG Liquefaction, LLC*, DOE/FE Order No. 3282 (May 17, 2013); herein "*Freeport*" or "the *Freeport* order". FLEX has submitted two separate non-FTA LNG export applications, each for 1.4 Bcf/d. The *Freeport* order approved FLEX's first application, which was submitted in May 2011. The second application, which FLEX submitted in December 2011, is third on DOE's list of pending applications.

² The first non-FTA exports were authorized in *Sabine Pass Liquefaction*, DOE/FE Order No. 2961 (May 20, 2011), and *Sabine Pass Liquefaction*, DOE/FE Order No. 2961-A (August 7, 2011) (herein, "*Sabine Pass*" or "the *Sabine Pass* order").

³ DOE evaluates export applications pursuant to Section 3 of the Natural Gas Act, which requires approval of such applications unless the proposed exports "will not be consistent with the public interest." 15 U.S.C. § 717b(a). This provision creates a rebuttable presumption that a requested authorization is consistent with the public interest.

⁴ Because it is conditional, *Freeport* is not "final agency action" and parties to the proceeding cannot yet seek rehearing from DOE (as required before seeking judicial review) or challenge *Freeport* in the US Courts of Appeals. The APGA is in the best position to raise such challenges, but other parties granted intervenor status may be able to show sufficient harm to also challenge aspects of the decision.

⁵ *Freeport* at 110.

⁶ *Id.* at 112-113.

⁷ Statement by Pat Outtrin, Vice President of Government and Regulatory Affairs, Cheniere Energy, Inc., during forum on Domestic Supply and

Exports, Senate Committee on Energy and Natural Resources, May 21, 2013.

⁸ *Freeport* at 113.

⁹ *Id.*

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