

INSIGHTS

DOE Approves LNG Export Authorization for Freeport LNG " A Win for LNG Exports?

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The Department of Energy recently authorized Freeport LNG Expansion, L.P. ("FLEX") to export LNG to non-Free Trade Agreement countries. Importantly, this is the first order on LNG exports issued by the DOE since it collected comments on its two-part LNG Export Study and likely represents the analysis DOE will use in reviewing the queue of pending LNG export applications. FLEX proposes to export 1.4 Bcf/day from the Freeport LNG terminal, which is situated on the Gulf Coast in Texas. After filing its export application, FLEX secured long-term contracts with three entities for 88 percent of the requested export capacity; most of the gas for export would be sourced from Texas, and in particular, the Eagle Ford Shale. By way of background, as the domestic natural gas markets shifted to favoring LNG exports in recent years, numerous applications were filed with the DOE for authorization to export LNG. In response to this onslaught, DOE commissioned a two-part study, consisting of (1) an Energy Information Administration study on the effects on increased natural gas exports on domestic energy markets; and (2) a NERA Economic Consulting study on the macroeconomic impacts of LNG exports (together, the "LNG Export Study"). The NERA study has recently been the subject of substantial debate as DOE noted that it received over 188,000 comments and 2,700 reply comments, though DOE admits the majority of such comments were nearly identical form letters. Substantive and unique comments numbered nearly 800, with 11 different economic studies prepared by commenters. In general, the FLEX order is a positive development for LNG exporters for two main reasons: (1) DOE found the LNG Export Study to be sufficiently reliable and supportive of LNG exports; and (2) DOE strongly suggested that it would let market forces govern LNG exports (while being closely monitored by DOE). The FLEX order tracks with and builds upon DOE's last order granting authorization for LNG exports to non-FTA countries, *Sabine Pass*, issued nearly two years ago. In approving the application as "not inconsistent with the public interest," DOE considered the same public interest factors relied upon in its earlier *Sabine Pass* order, namely, the economic impacts, international impacts, and security of natural gas supply. DOE continued to consider the factors identified in its now-expired 1984 policy guidelines, including whether the arrangement is consistent with DOE's policy of promoting market competition. While at first glance the FLEX order appears to represent a big win for the LNG export industry, there are several conclusions worth attention. Arguably, the order is a broad endorsement of free-market principles as DOE determined the competitive market to be the proper mechanism for allocating a scarce resource like natural gas. However, although DOE

did not state it would impose limits or caps on LNG exports, DOE did indicate that it will take a "measured approach" in reviewing other pending LNG export applications. "Specifically, DOE/FE will assess the cumulative impacts of each succeeding request for export authorization on the public interest with due regard to the effect on domestic natural gas supply and demand fundamentals." This approach suggests lower-queued applications may face a higher hurdle due to the cumulative impacts of the preceding applications and possibly suggests that DOE has a "cap" in mind. Third, DOE confirmed that the Federal Energy Regulatory Commission will conduct the environmental review, subject to independent review by DOE. Fourth, DOE found that the net economic benefits to the U.S. from LNG exports outweigh potential harms. Fifth, DOE continued to caution LNG export applicants that it will monitor the market and the impact of LNG exports and "may issue, make, amend, and rescind such orders . . . as it may find necessary" Such statements continue to inject some uncertainty into the contracting process. Finally, DOE suggested that local and regional benefits in terms of employment and income may be important in deciding whether to grant specific applications. Moreover, with respect to FLEX project, DOE noted that no one challenged the data provided by applicant in this regard. A significant issue raised by commenters on the LNG Export Study was to what extent LNG exports would raise natural gas prices, how natural gas production would react to increased demand, and whether the net economic benefits accruing from LNG exports would outweigh negative impacts for higher domestic natural gas prices. As discussed in the FLEX order, DOE is clearly concerned about these issues, but it found arguments persuasive that the U.S. had a substantial oversupply of natural gas that would mitigate the preceding concerns. DOE cautioned that it would closely monitor the domestic natural gas markets and reiterated its authority to revise or rescind LNG export authorizations should the public interest require it. DOE did not indicate what market conditions would trigger such action, but changes in the domestic natural gas oversupply condition could be pivotal in subsequent approvals of LNG export applications or in rescinding/amending already issued export authorizations. DOE imposed numerous conditions on the export authorization, including a requirement that FLEX must file publicly with DOE (a) all executed long-term contracts associated with the long-term export of LNG; and (b) all executed long-term contracts associated with the long-term supply of natural gas to the terminal. DOE noted that commercially sensitive provisions may be redacted. DOE also reduced the duration of FLEX's requested 25-year export authorization and approved only a 20-year authorization. Overall, our sense is that the FLEX order is a step in the right direction for the LNG exports industry and is a sign that, after a two-year study period, DOE once again will begin its process of issuing non-FTA export authorizations. As previously rumored, we expect that those projects that are further along in the development process (*e.g.*, those that have completed FERC's pre-filing process and have commercial arrangements in place for a sizable portion of the terminal capacity) will receive priority processing regardless of the project's place in DOE's queue. As a result, less developed projects will face greater uncertainty, especially if DOE has a "cap" in mind. Further, project sponsors should continue to include provisions in their contracts that address the possibility that DOE would modify or revoke a non-FTA authorization in the event of changes to the current domestic natural gas oversupply condition.