Obama Administration Says No to Full Environmental Study of LNG Exports

By Peter Mantius, on April 22nd, 2013

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LNG tanker at sea (Photo courtesy of FERC)

The Obama Administration is blocking a comprehensive environmental study on the impact of exporting massive quantities of liquefied natural gas, or LNG, on the grounds that new gas drilling induced by the exports is not "reasonably foreseeable."

Meanwhile, the U.S. Department of Energy is resisting calls by Dow Chemical and other manufacturers for a more clearly defined and transparent DOE process for determining whether proposed LNG export projects serve the "public interest."

Both the DOE and the Federal Energy Regulatory Commission face mounting pressure to evaluate the economic and environmental consequences of licensing LNG export facilities. Since the agencies licensed an LNG export terminal in Sabine Pass, La., in 2011, 19 other applicants have lined up with licensing requests.

Sensitive to the potentially huge cumulative impact those projects could have on the U.S. economy, the two agencies suspended approvals pending a two-part economic study by the Energy Information Agency and a private contractor, NERA Economic Consulting.

Christopher Smith

Both analyses are now finished, and Christopher Smith, a deputy assistant secretary of DOE for oil and gas, testified March 19 that LNG export applications would be considered on a "case-by-case basis" in light of their economic conclusions, which have been sharply criticized.

Consideration of the toll LNG exports have on the environment is still up in the air. "I will be unable to comment today on … the appropriate scope of environmental review," Smith added.

Independent studies predict that unfettered LNG exports will drive up the domestic price of natural gas, spur a boom in fracking shale formations and cause a major transfer or wealth from consumers and energy-dependent industries to the natural gas industry and its investors.

While NERA, the DOE’s private contractor, has not disputed those points, its December 2012 report asserts that aggressive LNG exporting would be a net positive for the U.S. economy. “Moreover, for every one of the market scenarios examined, net economic benefits increased as the level of LNG exports increased,” NERA wrote in its policy-driving report.

Response to NERA’s conclusions have been broad and intense. Potential LNG exporters applaud it, but many of the 188,000 comments it triggered were negative.

For example, John Detwiler, an engineer from Pittsburgh, wrote that none of NERA’s scenarios “take a realistic view of the swings in gas supply, demand and pricing in the real world.” Detwiler also charged that NERA has a “consistent public record of advocacy against environmental protections and promoting denial of climate change” and that its lead author, W. David Montgomery, has publicly opposed carbon emission controls and DOE investments in green energy.

While NERA concluded that LNG exports would slightly boost gross domestic product, researchers from Purdue University found the exports would slightly depress GDP. But the two conclusions on GDP were not far apart and were not nearly as important, the Purdue team said, as the wealth-shifting and environmental effects of LNG exports.

“Using the natural gas in the U.S. is more advantageous than exports, both economically and environmentally,” the Purdue report concluded.

While the DOE has listed the environment as one factor it may consider when evaluating the "public interest" of a proposed LNG export project, FERC takes the lead in applying the National Environmental Policy Act (NEPA). In February, FERC granted Cheniere Energy authority to build the Creole Trail Pipeline to connect to its already-approved LNG export terminal in Sabine Pass, La.

The Sierra Club is suing to block the project, alleging that FERC's failure to require a comprehensive environmental impact statement, or EIS, violates the NEPA law. It argues that FERC's stance that LNG export-induced gas drilling is not "reasonably foreseeable" collapses in the face of detailed models prepared by the Energy Information Agency. The EIA predicts that an average of 63 percent of exported LNG will come from new gas drilling. Deloitte and other private analysts agree that LNG exports and new gas drilling go hand in hand.

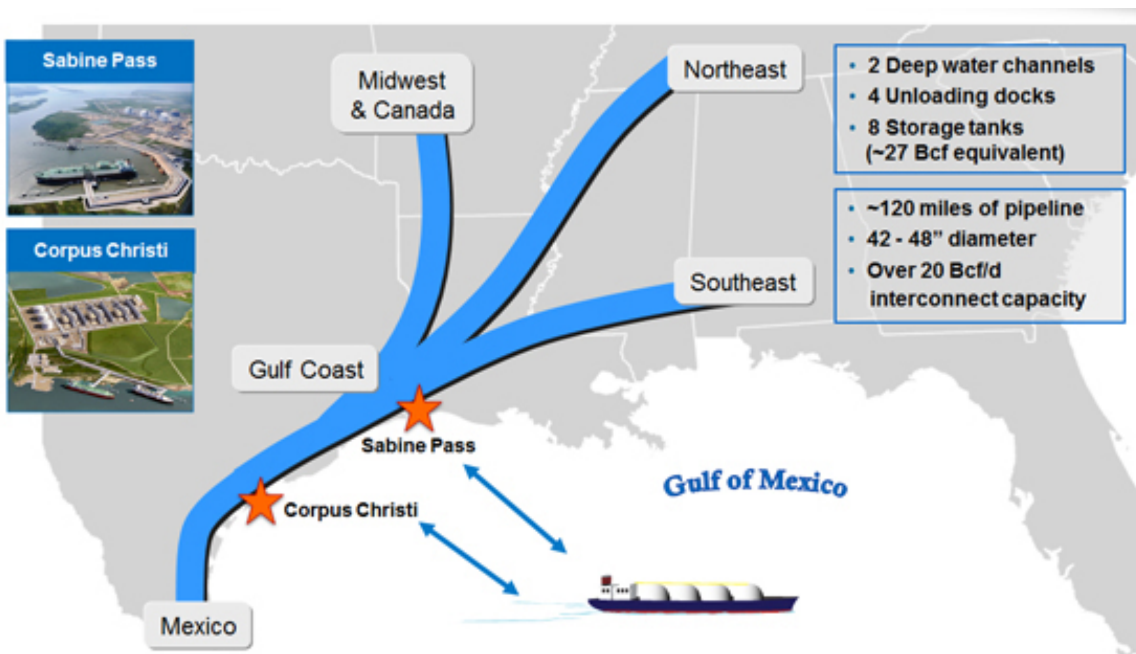
The NEPA law requires a formal EIS whenever there is a "substantial question" about a project's potential to harm the environment. Since export-induced gas drilling is a given and the preferred modern method of drilling — high-volume hydrofracking — has a controversial environmental record, the FERC staff had no authority to waive a formal EIS, the Sierra Club argument goes.

In fact, the environmental advocacy group claims an LNG-export induced fracking boom would be a calamity for the nation's water and air quality, and it would exacerbate climate change.

Cheniere responded to the Sierra Club legal challenge April 9, writing: FERC "has previously explained that 'projections of the locations and amount of future (gas drilling) production would be very speculative if attempted on the basis of' the Creole Trail Expansion Project. Sierra Club's mere disagreement with the commission does not entitle it to a stay."

Cheniere is in favored position. It is the only company recently licensed by FERC and the DOE to export LNG to countries that do not have a free trade agreement with the United States (aside from a small facility in Alaska that has been exporting to Japan for decades). Virtually all of the world's leading LNG importers are non-free trade agreement countries, including Japan, China, India and most of Europe. (Licenses to export to countries with a free trade agreement with the U.S. are routinely granted and are far less valuable.)

Cheniere, which plans to complete export terminal construction at its Sabine Pass facility by early 2017, recently signed a contract to deliver LNG to the United Kingdom.



Located on the Sabine River on the Texas-Louisiana border, the terminal is authorized to export 2.2 billion cubic feet of gas per day. The 19 pending non-FTA export applications seek a combined 26 bcfd, nearly half of the existing domestic gas supply.

The DOE has divided the applications into two groups, prioritizing according to when they were filed and how much success they've had lining up financing and customers. Of the nine projects with the best chance, one is in Maryland, two are in Oregon and six others are in Texas or Louisiana on the Gulf Coast.

The applicants expect FERC and DOE to apply the same licensing standards to them that they applied to Cheniere. "We're pretty confident that we deserve these permits," Thomas Farrell, chairman and CEO of Dominion Resources Inc., told Jim Cramer, host of CNBC's "Mad Money" April 2. Dominion has signed deals to export Marcellus and Utica shale gas to India and China from its planned Cove Point terminal in the Chesapeake Bay.

Although FERC dismisses the likelihood that an LNG exporter might stimulate new gas drilling, Dominion's license application touts the project's power to do precisely that. "The most basic benefit of the proposed LNG exports will be to encourage and support increased domestic production of natural gas," Dominion says in its FERC application.

U.S. Rep. Steny H. Hoyer

The Obama Administration can count on intense lobbying and political pressure to approve LNG export projects like Dominion's. In the case of the Cove Point project, U.S. Rep. Steny H. Hoyer, a Maryland Democrat and the House minority whip, has voiced support.

Meanwhile, Japan and other key U.S. trading partners are eager to tear down the regulatory barriers that prevent them from importing America's relatively cheap shale gas.

The market price for natural gas in the U.S. has been fluctuating around $3.50 per million cubic feet, compared to around $15 mcf in Japan. Even allowing for shipping and processing costs, that leaves room for wide profit margins.

Aside from the gas industry's profit motive, the other incentives to export LNG relate to its potential contribution to the U.S. balance of trade and to trade relations with allies. "It would be a major mistake not to do it in terms of U.S.-Japanese relations," Dennis Blair, Obama's national intelligence director from 2009 to 2010, told Platt's earlier this month. "History shows that every time you try to set government policy against market forces in the interest of near term popularity, you end up making your lift that much heavier in the long run."

But approving all pending LNG export applications could hurt U.S. consumers and manufacturers by causing domestic natural gas prices to spike.

Dennis Blair

Purdue researchers Wallace E. Tyner and Kemal Sarica calculated that LNG exports totaling 6 bcfd would push domestic wellhead gas prices up 16 percent above the no-export case by 2035. Exports of 18 bcfd would drive a 47 percent increase by that year.

Both the EIA and NERA, the DOE's economic consultant, predicted a similar effect but found smaller jumps in domestic prices. On the other hand, Charles River Associates found that unlimited LNG exports could triple domestic gas prices. That study was sponsored by Dow Chemical, a leader of America's Energy Advantage, a group of prominent manufacturers who rely on low-cost energy. Dow uses gas to run its plants, and gas is a raw material for many of its plastics and chemicals. As the shale gas drilling boom has lowered domestic prices, Dow has launched plans to spend $4 billion on new chemical plants along the Texas coast.

Andrew Liveris

Andrew Liveris, Dow's CEO, argues that high-margin, labor-intensive domestic manufacturing is a far better use for domestic gas than simply exporting it wholesale to foreign manufacturing rivals. "America's natural gas bounty is more than a simple commodity. It's a once-in-a-generation opportunity for America to export advanced products, not just BTUs," he said in testimony at a Senate committee hearing in February. Liveris said he doesn't categorically oppose LNG exports — only unchecked exports that threaten to knock the economy out of whack by devouring domestic supply. He acknowledges that banning LNG exports entirely could invite shortages too because gas drillers might have dangerously little incentive to drill.

Liveris has tried to prod the DOE to be more forthcoming on how it strikes the right balance when it rules on export applications. Last October, Sen. Ron Wyden, chairman of the Senate Energy and Natural Resources Committee, tried to pin down the DOE on that exact point. He wrote the agency asking for "an all-inclusive description of the factors" DOE considers in ruling on an LNG export application. Wyden has said the U.S. needs to seek a "sweet spot" in LNG exports, allowing enough to spur drilling and gas supply, but not enough to create export-driven supply shortages.

Oil and gas giants that have invested heavily in U.S. shale gas plays, including ExxonMobil and Royal Dutch Shell, tend to favor unlimited LNG exports. They say the gas drilling boom could die if exports aren't allowed to push up domestic prices.

Under the Natural Gas Act, the DOE is legally obligated to approve LNG exports deemed to be in the "public interest." The agency construes that law to mean that exports are presumed to be in the public interest unless opponents successfully argue that they're not. So the DOE relies on advocates and opponents of specific projects to set the terms of the "public interest" debate.

Those "narrow and vague" criteria are dangerously inadequate, given the stakes, Liveris and the Sierra Club now argue. They and others are campaigning for the agency to launch a rule-making process that establishes what Liveris describes as "uniform and actionable criteria with measurable metrics" on whether a given LNG export application meets the "public interest" test.

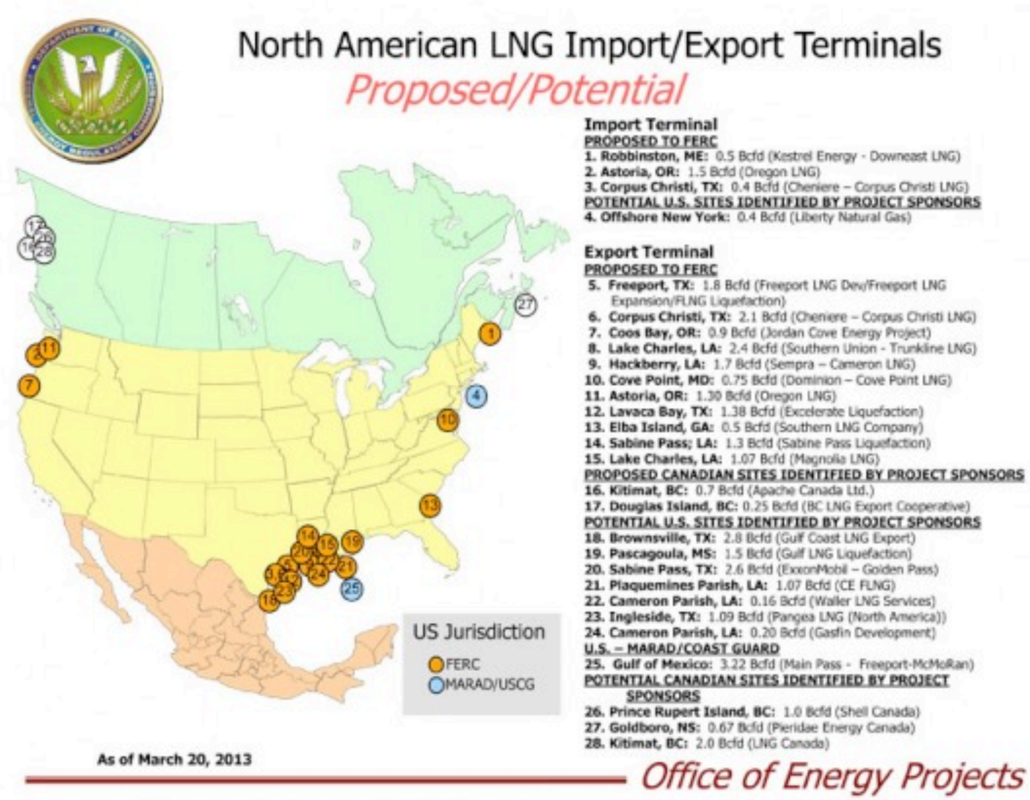
But comments by the DOE's Smith in March don't suggest that any such initiative is in the works. He said the agency is reviewing the NERA report and the comments it stimulated, and it "will address those comments when it issues decisions on the applications."

Meanwhile, another factor could emerge as a wild card that completely alters the LNG exports debate.

Leaders of Trans-Pacific Partnership Member States

A proposed new free trade agreement, the Trans-Pacific Partnership, could strip federal regulators of their obligation to conduct a “public interest” test on LNG exports to future TPP partners, including Japan.

That’s because a 1992 amendment to the Natural Gas Act created a giant loophole in the “public interest” test. It requires that any LNG exports or imports with a free trade partner be approved automatically on the grounds that they are presumed to be in the public interest. The rule was passed to address an urgent U.S. need two decades ago: gas imports from Canada. But the amendment’s final language was expanded at the last minute and without debate to include gas exports as well.



Negotiations for the new Pacific trade deal are mostly secret. But several fundamental provisions that are known are deeply troubling to Ilana Solomon, a trade representative at the Sierra Club. The TPP would apply to LNG trading, and the pact’s membership would be open to additional countries after its initial ratification. “Anyone can jump on, so it’s a potentially ever-expanding web that gets automatic licensing (for LNG trade with the U.S),” Solomon said. “It will become illegal to deny a licensing.”

Ilana Solomon

The principle beneficiary of the loophole would be Japan, which relies more heavily than ever on natural gas after shutting down its nuclear power industry in the wake of the Fukushima nuclear meltdown in 2011. Japan, which operates more LNG import terminals than any other country in world, said in March that it wants to join the TPP. Because Japan currently pays three or four times the U.S. market price for its natural gas, investors see a huge opportunity to arbitrage the gigantic price gap between the two countries. That arbitrage potential is one reason investors — banking on a relaxed approach to LNG trade licensing — are committing billions of dollars to build new LNG export terminals in the U.S.

Solomon said President Obama has set October as his target for completion of TPP negotiations. She said the next set of negotiations is scheduled for Peru in May. Further talks may be held in Canada in July and Indonesia in October, she said. At that point, the president might well seek “fast-track” treatment in Congress for the trade deal that administration negotiators have fashioned, Solomon added. If the president is successful, Congress would get an up-or-down vote on the TPP, but no opportunity to fine-tune it.

Still, the rush by investors to fund LNG export projects could slow down at any time for multiple reasons:

Many experts note alarmingly high well-depletion rates for fracked shale formations, a potentially ominous sign for those counting on nearly unlimited and cheap supplies of domestic gas.

Foreign demand for cheaper U.S. gas may not last indefinitely.

Environmental restrictions on fracking or even taxation of exports are possible.

Blair, Obama's former national intelligence director, has argued for such a tax to fund proper regulation of gas drilling, though he concedes it will be a tough sell to industry and Congress.

Ernest Moniz

Ernest Moniz, the MIT nuclear physics professor Obama has nominated to head the DOE, has promised to weigh carefully all LNG export applications. Moniz views natural gas as a bridge fuel "over the next couple of decades" to cleaner sources of energy, and he has acknowledged the need to stringently regulate gas drilling.

A 2011 MIT study on natural gas that Moniz co-authored hinted that the existing patchwork of state regulation for fracking shale formations has fallen short and that industry best-practices need to be applied across all shale plays.

But the report stopped short of advocating federal regulation of gas drilling — an untouchable third rail issue for many in the energy industry.

Peter Mantius

Peter Mantius is a reporter in New York. He covered business, law and politics at *The Atlanta Constitution* from 1983-2000. He has also served as the editor of business weeklies in Hartford, CT, and Long Island. He is the author of *Shell Game* (St. Martin's Press 1995), a nonfiction book on Saddam Hussein's secret use of a bank office in Atlanta to finance billions of dollars in arms purchases from Western countries before the 1991 Persian Gulf War.