

# Client Alert

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## Update: US LNG Exports to Japan

### LNG Export Study

Most US free trade agreements (FTAs) provide for “national treatment” of liquified natural gas (LNG) exports, which means that exports from the US to FTA countries must be approved without delay by the US Department of Energy (DOE) under Section 3 of the US Natural Gas Act.<sup>1</sup> Japan and the US, however, have no FTA. The DOE is therefore required by the same US law to consider each application to export natural gas exports to non-FTA countries one by one, to ensure that LNG exports are consistent with the US public interest.<sup>2</sup>

To inform and assist in its public interest review of numerous pending applications for authorization to export LNG to non-FTA countries, DOE instructed a third party contractor to provide a report regarding the estimated economic impact of proposed LNG exports (the Export Study). The Export Study will be the second part of a two-part economic analysis.

DOE’s Energy Information Administration completed the first part of this economic analysis in January 2012, and issued a report that concluded increased LNG exports would result in a range of increases in prices for natural gas, coal and electricity in the US domestic markets.<sup>3</sup> DOE had initially indicated that the second report, the Export Study, would be released in March and then later revealed that report would be issued by the end of the summer. DOE recently announced a further delay in the Export Study, stating that the report would be completed by the end of 2012.<sup>4</sup> Accordingly, authorizations for LNG exports to non-FTA countries sought in a number of pending applications remain on hold, bar the authorization already granted for Cheniere Energy’s Sabine Pass project.

### Political Criticism of Delay in Processing Export Applications

There has been political criticism of the delay in the processing of pending applications for LNG exports to non-FTA countries. Some of the criticism has been bipartisan in nature, reflecting the views of members of Congress from both the Democratic and Republican Parties, though criticism from Democrats has been centered among representatives from states with strong and longstanding involvement in the production of natural gas and with considerable amounts of recoverable natural gas. For example, a bipartisan group of 44 members of the US House of Representatives (34 Republicans and 10 Democrats from Arkansas, Louisiana, Oklahoma and Texas) sent a letter to DOE Secretary Steven Chu in August urging expedited review of pending LNG export applications.<sup>5</sup> Further pressure was applied by a bipartisan group

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of 14 members from the Western US, including Colorado and Utah, by way of a letter dated 24 September. They stated that they: *"strongly urge him to avoid any delays in the approval process for pending projects and ask for renewed urgency in completing the macroeconomic study at [DOE]."*<sup>6</sup>

The Republican Party has harshly criticized the delay in the issuance of the Export Study and the associated delay in processing of pending applications for LNG exports to non-FTA countries.<sup>7</sup> Excerpts from the Research section of the Republican Party website include *"putting politics first, Obama has slow-walked permitting process for LNG plant construction...ignoring our vast resources Obama prefers to import energy...with this second delay, the energy department will go back on its pledge to release LNG Report this summer, which further delays the permitting process."*

To date, Mitt Romney, the Republican Party's candidate for President of the US, has not publicly commented on issues regarding LNG exports to non-FTA countries. However, in a recent debate between energy policy specialists representing the presidential campaigns for Mr. Romney and President Obama, the Romney campaign representative stated: *"We export timber, we export refined petroleum products, we export grain, yet somehow LNG is different and I'm not sure why."*<sup>8</sup>

The Democratic Party platform adopted in August 2012 strongly favors development of natural gas but is silent on the issue of LNG exports. President Obama has not publicly commented on LNG exports in his campaign, although, several administration officials over the past several months have expressed support for some level of LNG exports.

## **Political Support for Further Study and More Delay**

Not all political pressure is directed at speeding approvals for exports of LNG to non-FTA countries. The Sierra Club, a US NGO, has long argued that DOE and other US government agencies should conduct lengthy environmental reviews of the effect of LNG exports as they relate to increased production of unconventional natural gas supplies through hydraulic fracturing (fracking). For example, on September 6, the Sierra Club requested that DOE reconsider and suspend its issuance of an authorization to Sabine Pass Liquefaction LLC (SPL) to export LNG to non-FTA countries so that DOE could conduct an expansive environmental review. While DOE is expected to deny the Sierra Club's request, the Sierra Club could then seek court review of whether DOE properly followed US laws, including US environmental laws, when it granted SPL's export authorization. The Sierra Club has requested or is expected to request a similar environmental review for other applications for authorization to export LNG to non-FTA countries.

A group of 20 Democrats in the US House recently expressed support for the type of environmental review sought by the Sierra Club. In a letter to DOE Secretary Chu dated September 26, 2012, they called on DOE to prepare an environmental impact statement, as outlined under the National Environmental Policy Act (NEPA), before authorizing more exports of LNG to non-FTA countries or LNG terminal permits. They letter stated that they are *"concerned that exporting more LNG would lead to greater hydraulic fracturing, or 'fracking,' activity thus threatening the health of local residents and jobs"* and that *"increased natural gas production in communities across the nation could negatively impact farmers, residents and local property values."*

In the case of export authorization for SPL, the DOE has decided that a legally sufficient environmental review was already conducted by the Federal Energy Regulatory Commission (FERC) in cooperation with DOE and other government agencies. DOE has given no indication that it will not continue to rely on FERC environmental reviews for authorizations of LNG exports to non-FTA countries sought by other LNG export facilities.

In summary, the issue of whether additional LNG exports to non-FTA countries will be permitted, and to what extent, is on hold pending the November 6 presidential election as well as elections that will determine the make-up of the US Congress in 2013. Assuming that DOE does not opt for a lengthy environmental review, it is expected that decisions will be made concerning already pending applications for export authorization sometime in 2013 and that at least some level of additional exports will be authorized.

## **The Situation in Japan — and its Strategy to Satisfy its Energy Needs?**

Japan recently u-turned on a commitment to stop relying on nuclear power by 2040. At a recent press briefing, deputy prime Minister Katsuya Okada said: *"we aim to have zero nuclear power by the 2030s, but we have never said we will achieve zero by that date."* However he conceded that *"[zero nuclear power is] the wish of a large number of Japanese people."*<sup>9</sup>

Clearly there is and will be strong public pressure from the Japanese public on the government to rely on non-nuclear energy.

Japan's LNG imports have rapidly grown since last year's nuclear accident, shooting up from 70 million tons in 2010 to about 90 million tons expected in 2012.<sup>10</sup> LNG imports are and clearly will play a crucial part in the future energy mix of Japan.

Japan is already ramping up its drive to solve its energy problems since the Fukushima disaster. One strategy is to push for reform of the LNG futures market. In the US, LNG trades at about one-sixth of the price in Japan thanks to widespread shale gas use. At the world's first LNG Consumers and Producers Conference (LNG Conference) held in Tokyo on 19 September by the Ministry of Economy, Trade and Industry (METI), Yukio Edano said: *"as one means to secure stable procurement of LNG, the government will start studying this fall the creation of an LNG futures market."*

The government expressed its wish to investigate and review the current unbalanced liquefied natural gas pricing system, which is currently linked to crude oil prices, at this first meeting of the private and public sectors of LNG-producing and consuming nations in Tokyo.<sup>11</sup>

Although no agreement was reached, the government made it clear that it will repeatedly raise this issue at the conference on a yearly basis. Yukio Edano commented *"both [LNG-producing and consuming countries] should brainstorm new measures as an alternative to the crude oil-linked pricing system."*<sup>12</sup>

## **Does the US Want to Miss the Boat?**

By kicking the LNG export question down the road, will the US expose itself to the risk of Japan and other non-FTA countries looking elsewhere for a solution to their growing energy demands? While the ultimate winners and losers in the developing global competition for natural gas exports remains to be seen and will depend on a variety of factors, including price elasticities of supply and demand for natural gas and LNG across different countries and regions, export capacity constraints and costs for developing and utilizing new export capacity, and currency valuations, once firm commitments to non-US LNG export projects are made, US LNG exporters could lose potential market share for 10-15 years or longer. While it may be too early to come to conclusions — this is certainly a risk for the US that should be recognized.

## Conclusion

Whatever the outcome of the presidential and congressional elections in November, and whatever decisions are made regarding increased LNG exports to non-FTA countries, it is clear that pressure from other countries with the ability to export natural gas to Japan and other countries, the US natural gas supply and LNG sectors, Congress, and the Japanese government — will all be significant factors in shaping the outcome of if, when, and how much the US will increase its exports of LNG to Japan and other non-FTA countries.

### Endnotes

- <sup>1</sup> The US has entered into FTAs providing for national treatment of LNG exports with the following countries: Australia, Bahrain, Canada, Chile, Colombia, Dominican Republic, El Salvador, Guatemala, Honduras, Jordan, Mexico, Morocco, Nicaragua, Oman, Peru, Republic of Korea and Singapore. US DOE website: Natural Gas Regulation: [http://www.fe.doe.gov/programs/gasregulation/How\\_to\\_Obtain\\_Authorization\\_to\\_Import\\_an.html#LNG\\_Exports](http://www.fe.doe.gov/programs/gasregulation/How_to_Obtain_Authorization_to_Import_an.html#LNG_Exports)
  - <sup>2</sup> US DOE website: Natural Gas Regulation: <http://www.fossil.energy.gov/programs/gasregulation/index.html>
  - <sup>3</sup> Energy Information Agency website: [http://www.eia.gov/analysis/requests/fe/pdf/fe\\_lng.pdf](http://www.eia.gov/analysis/requests/fe/pdf/fe_lng.pdf)
  - <sup>4</sup> US DOE website: Natural Gas Regulation: <http://fossil.energy.gov/programs/gasregulation/>
  - <sup>5</sup> <http://online.wsj.com/public/resources/documents/ChuLetter.pdf>
  - <sup>6</sup> [http://www.lngfacts.org/resources/LNG\\_Letter\\_Final\\_with\\_Signatures\\_092412.pdf](http://www.lngfacts.org/resources/LNG_Letter_Final_with_Signatures_092412.pdf)
  - <sup>7</sup> <http://www.gop.com/news/research/all-of-the-above-unless-you-delay-all-of-the-above/>
  - <sup>8</sup> 11 July 2012, Newseum campaign energy debate: Linda Stuntz a partner at the law firm Stuntz, Davis & Staffier was speaking for and acting as representative for the Romney campaign.
  - <sup>9</sup> <http://www.guardian.co.uk/world/2012/sep/19/japan-2040-nuclear-power-exit>
  - <sup>10</sup> Minister of Economy, Trade and Industry, Yukio Edano, speech at LNG Producer-Consumer Conference, Tokyo, 19 September 2012
  - <sup>11</sup> LNG Producer-Consumer Conference, Tokyo, 19 September 2012.
  - <sup>12</sup> Id.
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