

GREENFIELD LNG IMPORT TERMINAL APPROVALS

Philip R. Weems and Kevin D. Keenan,
King & Spalding, U.S.A.

It used to be NIMBY -- “Not In My Back Yard.” Today, two of the slogans bantered about include NOPE (“Not On Planet Earth”) [1] and BANANA (“Build Absolutely Nothing Anywhere Near Anything”) [2]. As the new slogans suggest, public opinion against development of greenfield LNG import projects -- fueled principally by misinformation and/or lack of information in regard to the properties and propensities of LNG and the excellent safety record of the LNG industry -- is perhaps more important today than it was in the past. Across a number of locales and jurisdictions, public opinion remains a significant obstacle to overcome in obtaining project approval. In addition, regulatory regimes worldwide continue to increase in complexity, requiring more documentation and more time to surmount an ever increasing number of hurdles. Indeed, public opinion and significant regulatory hurdles remain two of the issues which project developers and their counsel (together, “*Developers*”) cannot afford to overlook or underestimate when embarking on an LNG import project almost anywhere in the world. Failure to surmount such obstacles has doubtless killed some LNG import projects, among them one in California and another on the west coast of Italy. This article will discuss both of these ill-fated projects and the reasons for their eventual demise, along with lessons to be learned from each of them and from other LNG import projects in the context of surmounting difficult issues related to public opinion and regulatory requirements.

New LNG import terminals are now being considered in numerous countries, including Canada, the United States, Mexico, The Bahamas, The Dominican Republic, Honduras, Brazil, Spain, Portugal, Italy, Turkey, Taiwan, China, Japan, India, and The Philippines. In most of

these countries, Developers must recognize the potential for fundamental changes in the proposed project structure and economics resulting from adverse public opinion and the permitting process (more specifically, failure to obtain the required permits and other approvals).

One particularly instructive example is the fundamental shift in the LNG trade resulting from the failure of a 1970s California project to reach fruition. Because an LNG sale and purchase agreement (an “SPA”) had already been executed to supply LNG to California, the ultimate scuttling of the import phase of the project, as discussed below, resulted in LNG from Indonesia’s Arun facility eventually making its way to Japan. In the Italian example, Nigerian LNG originally slated for delivery in Italy ended up in France and gas under contract for delivery in France by Russian suppliers wound up in Italy following difficulties in obtaining permits for an LNG import terminal in Tuscany. At the end of the day, what Developers must not overlook is that the macroeconomics of the energy market are not the only drivers in the transaction and that controlling or at least mitigating the risks associated with the non-economic drivers can be accomplished with the right amount of effort and forethought.

The California Experience

In 1973, Pacific Gas & Electric and Pacific Lighting Company, through a joint venture they called Western Liquefied Natural Gas Terminal Associates (“WLNG”), sought approval to build an LNG receiving and regasification terminal on the California coast. Initially, WLNG proposed three sites for the planned facility -- Los Angeles Harbor, Oxnard, and Point Conception.

At the state level, the California Coastal Commission (“CCC”), the California Public Utilities Commission (“CPUC”), and the California Energy Commission (“CEC”) all had a role in the approval process and, because of a difference in the mandate given each agency, all had

differing views on the major issues presented by the proposal. The CCC, which had ultimate state authority to grant a permit for the proposed facility, was concerned more with environmental and human safety issues. On the other hand, the CPUC focussed more on the financial aspects of the proposed project, as did the CEC to a certain extent. What resulted following WLNG's application, as one might imagine, was an inter-agency dispute which undermined the entire approval process -- not only at the state level but, because the CPUC and the CEC appeared during the permitting process before the Federal Power Commission (now the Federal Energy Regulatory Commission or "*FERC*"), at the federal level as well. After more than three years following the initial request for approval, WLNG was faced with an impasse. Los Angeles's city council wanted the LNG facility but FERC would not grant the permit for various reasons, not the least of which was the proposed location in a major metropolitan area. Point Conception, while a remote site, would require a long and costly approval process with no guarantee of success. In addition, FERC had expressed concerns about fault lines in the Point Conception area. While FERC appeared to be in favor of Oxnard, other federal agencies and lawmakers challenged that position. Moreover, even if federal approval were received for Oxnard, it did not appear as though the CCC would grant its approval. For the CCC, even Oxnard was too populated an area for the construction of an LNG facility.

What followed was a massive lobbying effort on the part of WLNG which resulted in the passage, in the California state legislature, of the California LNG Terminal Siting Act of 1977 (the "*Act*"). The Act wrested ultimate approval authority from the CCC and gave it to the CPUC, but provided that the CCC was to select and rank a number of proposed sites, in cooperation with the potential developer. However, despite the CCC's role in the selection of proposed sites, the CPUC would have the ultimate decision. Of the eighty-two sites originally

proposed by the CCC, only three sites survived the Act's rigorous selection standards which included prohibitions on locating sites in major metropolitan areas (ruling out most sites in southern California) and in areas where prevailing weather patterns made marine navigation dangerous (ruling out most sites in northern California where fog is prevalent). While being among the three remaining sites, Camp Pendelton was rejected at the request of the United States Marine Corps which operates a base there. Rattlesnake Canyon was rejected because of the need, in that location, for the construction of a large and costly breakwater. Deer Canyon, the last of the three remaining sites, was rejected because of public safety concerns. That all eighty-two sites were eventually rejected for one reason or another was tantamount to a prohibition on building LNG import terminals in California [3].

In one last attempt at saving the project, WLNG took advantage of a provision in the Act which allowed it to select a site for the CPUC's consideration even if it had previously been rejected by the CCC. Once again, Point Conception was proposed. However, by this time it was likely clear to WLNG that the proposal was dead in California because a U.S. Federal District Court had already determined that Point Conception didn't meet FERC's seismic siting criteria due to the presence of fault lines [4]. Under the Supremacy Clause of the United States Constitution, an adverse federal decision in this area overrides any state or local approval. As a result of federal opposition to Point Conception, and the opposition and inter-agency disputes that arose in connection with the other proposed sites, WLNG abandoned its proposal more than eight years after initial applications were filed.

The WLNG facility was never built and LNG originally under contract for delivery to California from Arun was eventually shipped to Japan. It is noteworthy that in the WLNG SPA with PERTAMINA, signed in September of 1973, the parties agreed on a number of conditions

precedent, one of which included the following, in pertinent part: “On or before September 6, 1975, the appropriate authorities in the United States shall, on conditions considered acceptable to [WLNG], have issued the required authorizations permitting the import and sale of LNG subject to this Contract...” That WLNG was still pursuing such permits eight years later strongly suggests that Pertamina waived the above condition. However, the fact that WLNG was nonetheless careful in the SPA to provide for itself a way out in the event such permits could not be procured is not only instructive -- as something Developers should incorporate into their key project documents -- but it is also quite likely the reason no contract dispute ever arose in connection with the SPA when WLNG finally resigned itself to defeat and scrapped its plans to import LNG into California. Clearly, the lesson learned needs no further explanation.

The Italian Experience

The Italian state electric utility, ENEL, decided in 1996 not to build an LNG receiving terminal on the coast of Tuscany and attempted to cancel its LNG sales contract with Nigeria LNG Ltd. The impetus behind ENEL’s cancellation was, of course, not merely a desire by ENEL to build elsewhere or to simply get out of the deal struck with Nigeria LNG, but significant difficulties in the permitting process culminating in a veto of the proposed site and an alternate site by a newly-elected “greener Italian government” [5]. What resulted was a breach of contract suit against ENEL for U.S.\$13 billion (reportedly the largest claim ever brought under English law). While ENEL claimed the force majeure clause of the contract afforded relief from its obligations thereunder as a result of the government veto -- an event beyond its control -- the merits of that argument were never decided upon because the case was settled and the parties agreed that Nigerian LNG would be shipped to France instead of Italy, in exchange for Russian gas diverted by French buyers to Italy [5]. What this case highlights, however, and

what ENEL's argument implicitly suggests, is that force majeure provisions in such contracts should contemplate the permitting process, the expenses associated with securing permits and other governmental authorizations, and the potential inability to go forward with the project due to a failure to obtain the same. In addition, it suggests that prudent Developers should condition the effectiveness of key contracts on the successful procurement of such permits and authorizations.

Local Opposition to LNG Terminals

Despite LNG's enviable safety record and the low environmental impact of LNG facilities, significant local opposition can and does arise in response to proposals to build new infrastructure. One key example is the significant local opposition to El Paso's proposed Radio Island, North Carolina import terminal where opposition groups maintain that "[t]he industrialization of aesthetically beautiful and environmentally fragile Carteret County will totally change the character of the county and destroy the basis for its strongest industries—tourism, commercial fishing, recreational boating, and retirement living. No longer will the public be able to enjoy the atmosphere of a clean and relaxing maritime environment" [6].

Existing facilities are not immune either. Following the September 11, 2001 terrorist attacks in New York and Washington, DC, unfounded but often-articulated fears regarding the safety of LNG have resulted in a number of concerns being raised in respect of the safety of the Cove Point LNG terminal in Maryland, given its proximity to nuclear power facilities [7], and regarding the temporary closure (and possible permanent closure) of Boston harbor to LNG deliveries [8]. While the Cove Point safety questions were ultimately resolved in favor of reinstating FERC's earlier approval to reopen the facility [9], that result was not without significant effort and expense on the part of The Williams Companies, the facility's ultimate

owner, and other players in the U.S. LNG industry interested in ensuring that unfounded public fears do not have a larger detrimental effect on the status of LNG in the United States. In addition, while Cove Point won final approval despite post-September 11 concerns, the long-term fate of Tractebel's facility in Everett, Massachusetts is yet undetermined [10]. Unlike the Italian example discussed above (where ENEL's argument focussed attention on the need to include permitting failures as events of force majeure), these U.S. examples focus attention on the need to treat a failure to maintain permits and approvals in a similar fashion.

To be sure, possible adverse public opinion impacting import terminal approvals is not unique to the United States. Two recent Italian examples can be found at Brindisi, where a proposed site for an onshore terminal to be built by British Gas came under fire locally, and in Veneto, where Edison was reportedly forced, following local objections, to relocate certain onshore pipeline connection facilities to Caverzere [11]. It is interesting here to note that the Po River facility being constructed by Edison is an offshore receiving and regasification terminal -- having as at least one of its engineering goals the mitigation of perceived risks associated with an on-shore facility in close proximity to population centers. In spite of this, public opinion as a factor in the development of the facility is still not without impact -- both in terms of timing and financial outlay.

In addition to problems related to local opposition and the political pressure that can be brought to bear during the permitting process by local citizen groups and others, the regulatory requirements alone may (depending on the country involved) be arduous at best. Again, taking the United States as an example, in order to build an LNG facility anywhere in the United States, its territories or possessions, Developers must secure (at the federal level alone) permission from the following key agencies:

- Federal Energy Regulatory Commission
- United States Environmental Protection Agency
- United States Army Corps of Engineers
- United States Coast Guard
- United States Fish and Wildlife Service
- Federal Aviation Administration
- Advisory Council on Historic Preservation

Of the four LNG receiving terminals now existing in the United States, each one of them provides significant insight into the length of time required for permitting under FERC alone. By way of illustration, Tractebel (formerly Distrigas) waited twenty-five months for FERC's Natural Gas Act ("NGA") Section 3(a) approval of its terminal in Everett, Massachusetts. The Williams Companies' application to reopen the Cove Point, Maryland LNG import terminal required more than twenty-one months under Sections 3(a) and 7(c) of the NGA and, as discussed above, underwent further reconsideration due to perceived national security concerns following the events of September 11. CMS Trunkline, owner and operator of the Lake Charles, Louisiana import facility, waited forty-two months for FERC to approve its terminal under Section 7(c) of the NGA. The reactivation of Elba Island, Georgia by El Paso Energy's wholly-owned subsidiary, Southern Company, required more than seventeen months for FERC approval.

Clearly, regulatory and other required approvals are a significant element of and have the potential to seriously impact overall business transactions. In fact, it is likely that the proposed LNG facilities in The Bahamas, Mexico and, to an extent, Canada, all have at their root the inherent benefit accruing to project sponsors and Developers from minimizing the necessity of obtaining certain FERC and other approvals in the United States. That is, Developers believe that if they can successfully complete LNG import projects in any of these three countries, it will significantly cut the cost, time and uncertainty associated with commencing an approval application in the United States and provide to the Developer benefits accruing from the

implementation of an LNG import project outside of FERC jurisdiction. Because FERC recently rejected Dynegey's claim that FERC does not have regulatory authority over LNG [12] -- yet another attempt to short circuit the approval process -- it is likely that siting an LNG facility outside the territorial boundaries of the United States will remain a popular option available to Developers as they seek to shorten the time and resources required to develop LNG import projects by avoiding full-blown FERC and other U.S. regulatory applications and jurisdiction. As discussed above, the problems and risks associated with not obtaining such approvals are not unique to the United States.

Conclusion

In many developed countries, the ever-present potential for adverse public opinion, the prevalence of misinformation or lack of information surrounding the safety of LNG, and the increasingly complex matrix that has become common among permitting and regulatory approval processes across different jurisdictions make for significant hurdles in any Developer's path toward successful construction and implementation of a LNG import project. Moreover, such hurdles have the potential, if not dealt with appropriately and in a timely manner, to become insurmountable roadblocks leading ultimately to the abandonment of the project and the shouldering by the Developer of potentially significant losses. What steps can be taken to ameliorate such risks?

First, Developers should ensure that key project documents are drafted in a manner that reasonably protects the Developer from the risk of failure associated with permits and approvals. Toward this end, Developers should consider a definition of force majeure in the SPA and other project documents which makes reference to delays resulting from government action or inaction and failure, after the exercise of reasonable efforts, to procure the permits, authorizations and

approvals required to successfully construct and operate an import facility. Developers should also consider making the effectiveness of key contracts conditional upon the procurement of all necessary permits, authorizations and approvals within a specified period of time and carefully monitor any actions which could have the effect of waiving such conditions. Finally, key contracts should require or, at very least, encourage the parties to communicate and, to the extent they can agree, coordinate their efforts in obtaining the required approvals and in surmounting public relations challenges.

Second, while it goes without saying that Developers should undertake their own assessments of site suitability (both as a means of identifying favorable sites and as a means of being prepared to counter objections to the planned development), Developers must have sufficient foresight to consider alternative means of keeping a LNG import project alive in the event the preferred approach must be abandoned. In this regard, Developers should consider in the total mix of project possibilities alternatives such as additional onshore locations, the feasibility of floating offshore regasification terminals, and any other emerging marine technology that avoids the necessity of on-shore regasification facilities, any of which might keep an LNG import project alive in the event the preferred onshore option becomes infeasible due to difficulties in surmounting public opinion and/or the approval and permitting process.

Endnotes

- [1] Stephen Schneider, Chevron Overseas Petroleum, *LNG's Role in North American and Caribbean Gas Supply*, Washington, DC, June 2001.
- [2] Keith Meyer, CMS Panhandle Pipe Line Companies, *World LNG Summit*, Rome, December 2001.
- [3] New York, on the other hand, had already imposed an absolute moratorium on all activities involving the siting of new LNG facilities and intrastate transportation routes in the state. While New York's moratorium was enacted in 1978 and originally applied

state-wide, it was amended in 2001 to apply only to sites within cities having in excess of one million inhabitants. The moratorium, as amended, is effective through April 1, 2003. Thus, while California is an example of a jurisdiction having a complex maze of regulatory hurdles which proved, for WLNG, impossible to navigate, New York is an example of a jurisdiction where the state government at one time imposed an absolute ban on LNG construction within its borders, without regard to the merits of the project itself.

- [4] Hollister Ranch Owners' Ass'n v. F.E.R.C., 759 F.2d 898 (D.C. Cir. 1985).
- [5] *\$13 Billion Damages Claim Settles at 11th Hour*, International Commercial Litigation, Euromoney Publications, March, 1998.
- [6] <http://www.c-cape.org/alert.htm>.
- [7] On October 12, 2001, FERC approved the reopening and expansion of the Williams Companies' Cove Point, Maryland LNG receiving terminal. On November 9, 2001, FERC issued an order indicating that it would, on its own motion, reconsider that decision due to national security concerns that the facility could be subject to sabotage that would threaten the nearby Calvert Cliffs nuclear facility in southern Maryland (3.5 miles from Cove Point). While FERC indicated in its November 9, 2001 order that it was reopening the proceeding on its own motion, the decision closely followed on the heels of a November 7, 2001 letter from U.S. Senator Barbara Mikulski to FERC's Chairman "demanding in the interest of national security" that FERC review its prior order approving the Cove Point facility.
- [8] After the September 11, 2001 terrorist attacks, the U.S. Coast Guard imposed a ban on LNG tankers entering Boston harbor while it studied safety issues with federal, state and local officials. The Coast Guard lifted its ban on October 16, 2001 after studying the facility and becoming satisfied that sufficient measures were in place there to address the perceived threat.
- [9] On December 19, 2001, FERC issued an order "affirming, after reviewing the additional evidence received concerning national security, that certification of the Cove Point LNG facilities is in the public interest."
- [10] Boston Mayor Thomas Menino has pending before a federal court an action to permanently prohibit LNG tankers from entering Boston harbor -- a move which would effectively close Tractebel's Everett LNG receiving terminal and regasification facility. Despite approvals by the U.S. Coast Guard and Massachusetts Governor Jane Swift, the resulting October 16, 2001 order lifting the ban on LNG ships entering Boston harbor, and an unsuccessful attempt by Menino at obtaining a federal injunction barring Tractebel's LNG tankers from docking in the harbor following September 11, 2001, Menino remains concerned that no detailed plans exist to cope with an explosion or other disaster on the ship. *Boston Mayor Seeks to Bar LNG Tankers*, Intertec Publishing Corporation, January 17, 2002.

[11] Po River's difficulties in obtaining public approval for the limited onshore facilities associated with this offshore regasification project demonstrate the potential for delays and extra expense inherent in *any* LNG import project. Clearly, onshore facilities like Brindisi, further south on Italy's Adriatic coast, have the potential for far more opposition than do floating facilities like Po River.

[12] 97 FERC ¶ 61, 231 (2001).

Suggested Caption Quotes:

“That all eighty-two sites were eventually rejected for one reason or another was tantamount to a prohibition on building LNG import terminals in California.”

“In addition to problems related to local opposition and the political pressure that can be brought to bear during the permitting process by local citizen groups and others, the regulatory requirements alone may (depending on the country involved) be arduous at best.”

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