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FERC Issues Declaratory Orders in Shell and Pivotal Proceedings Related to LNG Production Facilities

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On September 4, 2014, the Federal Energy Regulatory Commission (“FERC” or the “Commission”) issued declaratory orders in response to two petitions, each seeking a jurisdictional determination under the Natural Gas Act (“NGA”) for liquefaction facilities from which liquefied natural gas (“LNG”) will be transported in interstate commerce by truck, train, and waterborne vessel for end-use. The two petitions, filed by Shell U.S. Gas & Power, LLC (“Shell Petition”) and Pivotal LNG, Inc. (“Pivotal Petition”), each explain that their respective proposals do not include exports of LNG produced at the relevant facilities and, importantly, both affirm that they do not propose to regasify and reinject any of the LNG into pipeline systems downstream. In addition, one of the proposed transactions in the Shell Petition involves importing natural gas from Canada. In both declaratory orders, the Commission finds that the liquefaction facilities at issue would not be subject to its jurisdiction under either Section 3 or Section 7 of the NGA.

These decisions offer critical guidance as the U.S. LNG industry further develops beyond import and export facilities into more complex commercial arrangements for domestic use of LNG as a transportation and other end-use fuel.

FERC repeatedly has stated that jurisdictional determinations are made on a case-by-case basis. The Commission’s analysis in both the Shell and Pivotal orders is rooted in Commission precedent, describes broader policies, and, in at least one place, suggests the potential for application of the Commission’s rationale to proposals with substantially similar relevant circumstances. The main takeaways from these two orders are described in greater detail below.

I. Background

Sections 3 and 7 of the NGA

Under Section 3 of the NGA, FERC has exclusive jurisdiction under the NGA over the siting, construction, and operation of “LNG Terminals.” The definition of LNG Terminals, added to the NGA through the Energy Policy Act of 2005, is very broad and includes “natural gas facilities” that are used in relation with the import and export of natural gas, as well as transportation of natural gas in interstate commerce by waterborne vessel. In the two orders, FERC provides a more detailed explanation of its interpretation of the impact of the inclusion of “interstate transportation by waterborne vessel” in the definition of “LNG Terminal” on its jurisdiction under Section 3. The NGA currently prohibits FERC from regulating the rates and terms and conditions of service at Section 3 facilities. This prohibition will no longer be mandatory after December 31, 2014, and completely sunsets on January 1, 2030.

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Under Section 7 of the NGA, FERC regulates entities engaged in the transportation or wholesale sales of natural gas in interstate commerce. FERC has jurisdiction under the NGA to regulate the rates and terms and conditions of service related to Section 7.

Underlying Proposals in the Shell and Pivotal Petitions

Shell Petition

The Shell Petition is based on the following two proposed transactions:

- Canadian imports
 - Shell is planning to install a liquefaction unit at its Sarnia Manufacturing Centre in Ontario, Canada, on the shore of Lake Huron.
 - Shell plans to import LNG from the Sarnia liquefaction unit into the United States via truck, train, and waterborne vessel.
 - Shell plans for the imported LNG to be sold for end-use (in part as a vehicular fuel).
 - Shell is considering constructing intermediate docking and storage facilities on the Great Lakes in Michigan to allow for ship-to-ship transfers and for ship-to-shore transfers that then would be distributed by truck or train.
- Louisiana Liquefaction Unit
 - Shell is considering constructing a liquefaction unit along the Mississippi River in Geismar, Louisiana, that would liquefy domestically produced natural gas that would be transported to the plant by pipeline.
 - The LNG would then be loaded from the dock at Shell's existing chemical plant in Geismar to waterborne vessels.
 - The LNG then would be further transported (1) to other waterborne vessels for use as a fuel or (2) to onshore storage facilities in Louisiana and other states for transfer to other waterborne vessels for use as a fuel or to trucks or trains for transport to fueling facilities.

Pivotal Petition

The Pivotal Petition proposes the following transaction:

- Pivotal proposes
 - To source LNG from (1) its existing non-jurisdictional LNG production facilities; (2) one of its affiliates' existing non-jurisdictional LNG production facilities; (3) an existing jurisdictional LNG production facility; or (4) a third party
 - To transport or have one of its affiliates or a third party transport the produced LNG by non-pipeline means, including truck, rail, or waterborne vessel, in interstate or intrastate commerce
 - To have a third party then transport the delivered LNG in interstate commerce via waterborne vessel for resale and ultimate consumption in a non-contiguous U.S. state or territory (including consumption as a vehicular fuel)

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II. Summary and Takeaways from Shell and Pivotal Orders

As noted above, both the Shell and Pivotal orders include broad policy language that indicates the potential for extension beyond the specific facts implicated in each petition. Moreover, the analysis in the two orders is substantially similar despite the fact that the proposed transactions are varied, further suggesting that the Commission's rationale in these two orders could be extended to similar circumstances despite the Commission's repeated statements in prior orders that its jurisdictional determinations are on a case-by-case basis. Below, please find a brief summary of the salient portions of the Shell and Pivotal orders.

In the Shell and Pivotal orders, the Commission explains that it interprets and exercises its jurisdiction under Section 3 of the NGA in a similar manner to the way it has interpreted and exercised its jurisdiction under Section 7. Consequently, the Commission's discussion related to Section 7 is summarized first.

Section 7 of the NGA

- **Section 7 Applies Only to Transportation by Pipeline.** The Commission reiterates and affirms that its jurisdiction under Section 7 does not apply to transportation in interstate commerce by non-pipeline means, including trucking. In the Shell and Pivotal orders, the Commission further explains that legislative action would be required to extend its jurisdiction to the transportation of natural gas in interstate commerce by non-pipeline means.
- **Jurisdiction over Liquefaction Units Depends on the Purpose of the Liquefaction.** The Commission explains that its key concern when evaluating its potential jurisdiction over an independent LNG facility is whether denying jurisdiction would result in circumvention of the authority of the NGA over transportation of natural gas (in various forms) by pipeline. In the Shell and Pivotal orders, FERC evaluates whether such circumvention is likely by examining the purpose of the liquefaction. Where the purpose of the LNG production facility is to transform the gas into an end product and there is no intent to regasify and inject the LNG into a downstream pipeline, the Commission reiterates in the Shell and Pivotal orders what it has stated in prior orders—that it will not exercise jurisdiction over such an LNG production facility using its authority over natural gas transportation under Section 7 of the NGA. Moreover, the Commission states in the Shell order that upstream transportation on a jurisdictional pipeline to the LNG production facility would not alter this conclusion. By contrast, the Commission explains that where liquefaction is necessary to facilitate downstream pipeline transportation of the gas, the liquefaction unit is more analogous to a jurisdictional compressor station. For example, the Commission has exercised Section 7 jurisdiction over an LNG production facility in Alaska when the LNG would be transported via tanker from Alaska to Oregon, where it then would be regasified and injected into a pipeline system. In such a circumstance, the Commission found that the liquefaction service is necessary for the natural gas to reach the downstream pipeline system.
- **In the Absence of a Natural Gas Export Proposal, the LNG Production Facility is Regulated under Section 7, if at all.** In several places throughout the Shell and Pivotal orders, the Commission explains that the LNG production facilities at issue would be regulated under Section 7, if they are regulated at all. In the Shell order, the Commission

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states that its jurisdiction under Section 7 extends to existing and proposed facilities that would be used to send out LNG by waterborne vessel to another state where the LNG is regasified and injected into a jurisdictional pipeline, regardless of whether the facilities are “at a ship accessible waterside quay or at a land-locked inland location.” It is important to note that both the Shell Petition and the Pivotal Petition explicitly excluded exports of natural gas to foreign countries from their proposed transactions.

- **Jurisdiction over Wholesale Sales of Natural Gas that is Transported by Interstate Pipeline.** The Commission explains that it will examine both the upstream and downstream transportation of natural gas that is received by and sent out from an LNG production facility to determine whether there is interstate pipeline transportation at any point in the chain. If the natural gas was never in a U.S. interstate natural gas pipeline, then the Commission will not exercise jurisdiction under Section 7 over the wholesale sale of the natural gas or LNG in interstate commerce. However, upstream (and presumably downstream) transportation by an interstate natural gas pipeline could subject wholesale sales of such natural gas or LNG to FERC’s jurisdiction under Section 7. However, FERC explains, as it did in its recent order on the [Gulf Oil petition](#), that in the event such wholesale sales are jurisdictional, the entity would not need to apply for a Section 7 certificate because the Commission’s regulations provide for the automatic issuance of a Section 7 blanket marketing certificate that authorizes non-interstate pipeline entities to make wholesale sales of natural gas and to charge negotiated rates.

Section 3 of the NGA

As noted above, the Commission explains in the Shell and Pivotal orders that its interpretation and exercise of its jurisdiction under Section 7 has informed, to a certain extent, its interpretation and exercise of its jurisdiction under Section 3.

- **Section 3 Jurisdictional Facilities to Date Interconnect with Pipeline Grids.** In the Shell and Pivotal orders, the Commission explains that, to date, it only has exercised Section 3 jurisdiction over facilities that are interconnected with an interstate or intrastate pipeline grid. The Commission goes on to explain that these facilities have either been at the U.S. borders with Canada/Mexico or have been coastal LNG facilities. It draws on these prior decisions to conclude that Shell’s proposed facilities that will receive LNG imported from Canada will not be subject to Section 3 jurisdiction as import facilities because the proposed transaction does not involve the transportation of natural gas by U.S. pipeline at any point, and the facts presented do not lead FERC to believe that Shell’s intent is to circumvent the NGA.
- **Addition of Interstate Commerce to “LNG Terminal” Definition only Intended to Apply to Certain Receiving Facilities, Not Upstream LNG Production Facilities.** The Shell and Pivotal orders include a thorough analysis of the inclusion of natural gas facilities related to the transportation of natural gas in interstate commerce by waterborne vessel in the definition of LNG Terminal in the NGA and its impact on FERC’s jurisdiction under Section 3 of the NGA. The Commission notes that prior to the addition of the definition of LNG Terminal, which includes this interstate commerce component, its jurisdiction under Section 3 was limited to natural gas import and export terminals—neither of which are implicated in the Shell or Pivotal petitions. The Commission explains that the inclusion of the interstate commerce provision in the definition resolves a potential regulatory gap. Previously, if a facility in one state received gas by pipeline, sent

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the gas out as LNG by waterborne vessel to a facility in a second state, and the facility in the second state regasified the LNG and injected it into a pipeline for consumption wholly within the state, the Commission may not have had jurisdiction over the facility in the second state because it may have qualified as an exempt local distribution company or other NGA-exempt intrastate entity. The Commission goes on in the Shell order to explain that it believes when Congress added transportation in interstate commerce by waterborne vessel to the definition of LNG Terminal, the intent was to provide FERC with jurisdiction under Section 3 over LNG terminal facilities receiving the waterborne vessels where the natural gas is regasified and injected in a non-jurisdictional pipeline.

- In an opinion concurring in part and dissenting in part with the Commission's Shell order, newly confirmed FERC Commissioner Norman Bay notes that he disagrees with the Commission's finding that Shell's Louisiana project is not jurisdictional under Section 3 of the NGA. Relying on strict statutory interpretation, he explains his opinion that transportation of natural gas by pipeline—a requirement the majority imposes—should not be determinative of whether a facility is regulated as an LNG Terminal under Section 3.
- In a concurring opinion in the Pivotal order, Commissioner Bay explains that he agrees that Section 3 should not apply to the LNG production facilities that Pivotal proposes to use. Commissioner Bay notes that the definition of LNG Terminal is limited to “natural gas facilities located on or close to water or the coast,” and that the plants noted in the Pivotal Petition “all appear to be in excess of 150 miles from the nearest coast” and, thus, are not “onshore” under the plain reading of the NGA.

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