

Client Alert

Global Transactions Practice Group

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Recent FERC Orders Address the Jurisdictional Status of LNG Facilities Targeting Vehicular Fuel, Marine, High Horsepower Engine and Peak Shaving Markets

North America's new-found wealth in natural gas is driving energy industry participants to seek out new markets for the suddenly abundant fuel. Among these are markets for vehicular and marine fuels, other applications employing high-horsepower internal combustion engines and markets requiring supplies of natural gas to meet peak shaving or "off the grid" demands. Petroleum-derived fuels, principally diesel, currently dominate the vehicular fuel, marine and high horsepower markets. Natural gas, often converted into liquefied natural gas (LNG) for ease of transportation and storage, can be substituted for diesel and other petroleum-derived fuels relatively easily and, given natural gas' lower cost and lower emissions, can be extremely attractive to fleet operators and engine owners. Natural gas' price advantage is also enticing to large volume energy consumers not served by piped natural gas that instead rely on propane and petroleum-derived fuels.

Because facilities producing LNG for vehicular and high horsepower engine use and for use in peak shaving and remote markets would be engaged in the transportation and sale of natural gas, their proposed activities raise questions as to whether and the extent to which they are subject to regulation by the Federal Energy Regulatory Commission (FERC) under the Natural Gas Act (NGA). On September 4, 2014, in response to LNG project developer petitions, FERC issued two orders addressing such questions. These orders are significant because in them FERC held that it does not have jurisdiction over activities that are likely to be performed by LNG facilities serving vehicular fuel, marine, high horsepower and some peak shaving and remote markets.

In *Shell U.S. Gas & Power, LLC*, 148 FERC ¶ 61,163 (2014), FERC addressed a petition in which Shell U.S. Gas & Power, LLC (Shell) sought a determination that it would not be engaging in activities subject to FERC's NGA jurisdiction in producing LNG that it would import from Canada into the U.S. and would transport from U.S. LNG facilities by truck, train and waterborne vessels. Shell indicated that it is considering (1) installing a natural gas liquefaction unit at its manufacturing center in Ontario, Canada, with the intent to import LNG into the United States by means of truck, train, and waterborne vessels for use as fuel for vehicular and non-vehicular uses; (2) constructing an intermediate docking and storage facility near Detour,

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Michigan to transfer LNG imported from Canada directly from one moored ship to another, or to transfer Canadian LNG from ship to shore for storage and subsequent distribution by truck or train; and (3) constructing a liquefaction unit at its chemical plant in Geismar, Louisiana, which would liquefy domestically-produced natural gas, for loading into waterborne vessels for transportation to other waterborne vessels as fuel or to onshore storage facilities, including facilities in other states, for subsequent transfer to other waterborne vessels for use as fuel, or to trucks or trains for transport to fueling facilities. After considering the proposed activities, FERC found that Shell was not entitled to the wide-ranging exemption from NGA jurisdiction it claimed, but nevertheless will not need to apply for FERC authorization under NGA Sections 3 or 7 for any of its planned LNG facilities and LNG transportation and sale activities.

In the petition for declaratory order addressed in *Pivotal LNG, Inc.*, 148 FERC ¶ 61,164 (2014), Pivotal LNG, Inc. (Pivotal) indicated that it and its affiliates operate a total of five existing small scale LNG facilities which are currently not subject to FERC's NGA jurisdiction. Pivotal and its affiliates are considering expanding these LNG facilities' operations to include liquefaction of natural gas, and sales for resale of LNG, that will be delivered to end users by truck, rail, and other non-pipeline modes of transportation. FERC held that although they are not necessarily covered by the exemption from NGA jurisdiction Pivotal had claimed, the activities described by Pivotal would not constitute jurisdictional transportation or sales of natural gas in interstate commerce under NGA Sections 1(b) and 7 and that Pivotal's LNG facilities will not be deemed "LNG terminals" as that term is defined in the NGA.

The Shell and Pivotal petitions required that FERC consider its jurisdiction to regulate LNG facilities under NGA Sections 7 and 3, as well as the scope of the exemption under Section 1(d) for certain entities engaged in the sale or transportation of vehicular natural gas. FERC has jurisdiction under NGA Section 7 to regulate transportation and sales of natural gas in interstate commerce, and to require entities constructing facilities to be used in the transportation of natural gas in interstate commerce to seek and obtain authorization from FERC. NGA Section 3, governing the importation and export of natural gas, gives FERC jurisdiction over the siting and construction of LNG terminals and other facilities used for the importation or export of natural gas.

Shell and Pivotal each argued that their LNG facilities should not be subject to FERC's NGA jurisdiction because Section 1(d) of that Act exempts from NGA regulation the transportation and sale of natural gas, by persons not otherwise subject to NGA regulation, solely by reason of their involvement in such transportation and sale if the gas will be used as vehicular fuel. FERC generally dismissed Shell's and Pivotal's arguments invoking Section 1(d), finding that the Section 1(d) vehicular fuel exemption only applies if the involved entity is not otherwise a "natural-gas company" (e.g., a company engaged in the interstate transportation or sale of natural gas). It specifically rejected the proposition that the Section 1(d) exemption for vehicular natural gas also exempts all facilities, as well as the importation, sales and transportation of LNG for other end uses from all regulation under the NGA. Noting that Shell had acknowledged that some of its LNG production might be marketed for purposes other than the fuelling of vehicles, and that Pivotal had not represented that all of the LNG it would produce would be used *solely* as vehicular fuel, FERC held that the Section 1(d) exemption would not necessarily exempt the LNG-related activities the companies had proposed. It observed that undertaking any LNG-related sales or transportation activities not specifically exempted by Section 1(d) could make the entity performing them a "natural-gas company" subject to regulation as such under the NGA, a result that would invalidate the Section 1(d) exemption as to that entity.

In the *Shell* declaratory order FERC went on to conclude that the Section 1(d) exemption for vehicular natural gas, even where it does apply, is not relevant to the question whether it has jurisdiction under Section 3 of the NGA over the importation and export of natural gas. Noting that the reach of NGA Section 3 is not limited to entities that are "natural-gas companies," FERC held that Section 1(d), which prevents an exempt entity from qualifying as a "natural-gas company," does not establish any exemption from its Section 3 import/export jurisdiction for gas that will be used as vehicular fuel.

Having concluded that the activities which Shell and Pivotal proposed were not necessarily exempt from regulation under the NGA merely because they involved the production, transportation and sale of vehicular natural gas, FERC went on to consider whether it had jurisdiction to regulate Shell's and Pivotal's proposed activities and the facilities used to accomplish them under Sections 3 and 7 of the NGA. On the basis of an uncommonly exhaustive analysis, FERC determined that Shell's and Pivotal's proposed facilities are not subject to regulation under either Section 3 or Section 7.

As for the question whether the proposed LNG production and transportation facilities would be subject to regulation under Section 7, FERC noted that the facilities in question will not themselves transport natural gas. Rather, the purpose of liquefying natural gas they receive is to transform it into an end product for sale and delivery in its liquid state to an end user, with no intent for any of the LNG to be reintroduced into a pipeline. All transportation from the LNG facilities would be by non-pipeline means (trucks, trains, waterborne vessels). FERC noted that in other cases it has found it significant to determine whether regasified LNG might be introduced into a pipeline, as might occur, for example, if the LNG were used in LDC peak shaving applications. FERC noted that in order to avoid the potential for circumvention of FERC's NGA jurisdiction, it would consider the downstream injection of regasified LNG into an interstate pipeline to be an activity subject to its Section 7 jurisdiction. But because neither Shell nor Pivotal proposed reinjection of natural gas into an interstate pipeline, FERC was able to conclude that the two companies' proposed activities would not be subject to its NGA Section 7 jurisdiction.

FERC next turned its attention to its jurisdiction over natural gas imports and exports under NGA Section 3. In considering Shell's proposed LNG facility in Michigan, which would receive LNG from Canada by truck or waterborne vessels, FERC concluded that its Section 3 jurisdiction, like its Section 7 jurisdiction, is limited to circumstances in which natural gas, including LNG, is transported by pipeline. A majority of the Commissioners concluded that the proposed receipts of Canadian LNG would not be jurisdictional absent transportation of the LNG to the facility by pipeline. Commissioner Bay dissented on the basis of his reading of Section 3 as being applicable to all natural gas facilities located onshore or in State waters that are used to receive, unload, load, store, transport, gasify, liquefy, or process natural gas that is imported to, or exported from, the United States.

Because of an EPact 2005 amendment, FERC's Section 3 jurisdiction over LNG terminals includes facilities from which LNG is "transported in interstate commerce by waterborne vessel." FERC noted that LNG would be transported from Shell's proposed Geismar facility by waterborne vessel, but concluded that such transportation would not be a Section 3 jurisdictional activity because it would involve transportation to end use customers, rather than to a downstream transportation facility. In FERC's words, "[t]he Geismar facility will not serve to bridge pipelines divided by water." FERC opined that, in different circumstances, if its Section 3 jurisdiction is invoked because of the "transported in interstate commerce by waterborne vessel" provision, FERC would have jurisdiction over the facilities at both ends of the water route to avoid any "regulatory gap."

FERC conducted a similar Section 3 analysis for the Pivotal proposal and reached the same result – Pivotal's proposed activities would not render the facilities to be "LNG terminals" subject to FERC's NGA Section 3 jurisdiction. The Commission based this conclusion on its findings that Pivotal's LNG facilities will not be used to receive LNG by waterborne vessel for subsequent interstate transportation. Commissioner Bay issued a concurrence in which he argued that the term "onshore" found in NGA Section 3 is intended to limit Section 3 jurisdiction to LNG facilities located in coastal areas. He concludes that Section 3 should not apply to Pivotal's LNG facilities, noting that such facilities are all 150 miles or more inland.

FERC noted that Shell's and Pivotal's proposed activities each included the possibility of LNG sales for resale. It observed that its jurisdiction over natural gas sales for resale is limited to sales that do not qualify as "first sales," as defined in Section 2(21) of the Natural Gas Policy Act of 1978. It further noted that any jurisdictional sales for resale

by Shell or Pivotal would be subject to FERC's previously issued blanket certificate authorizing all persons that are not interstate pipelines to engage in such sales at market-based rates (*see* 18 C.F.R. § 284.402).

FERC's *Shell* and *Pivotal* decisions are part of a growing body of caselaw in which FERC has generally disclaimed NGA jurisdiction as to LNG facilities intended to serve vehicular and marine fuel markets, high horsepower engine markets and isolated markets not served by pipeline. *See, e.g., Gulf Oil Limited Partnership*, 148 FERC ¶ 61,029 (2014) (holding that the proposed liquefaction of Marcellus gas in Pennsylvania, to be marketed as vehicular fuel, high horsepower engine fuel, and as a source of supply for certain LDC peak shaving facilities, would not be subject to FERC's NGA Section 7 jurisdiction, even if some regasified LNG could occasionally and inadvertently displace natural gas supplies delivered by interstate pipeline). The absence of FERC regulation is, of course, good news for developers of small- and mid-scale LNG facilities targeting the growing vehicular, marine and high horsepower markets as well as niche markets for LNG. It should be noted, however, that each LNG project must be evaluated for jurisdictional purposes on its own facts. And, of course, that a proposed LNG facility may not be subject to FERC's NGA jurisdiction is not the end of the regulatory compliance inquiry – each LNG project developer must take care to ensure that its facility complies with all federal environmental and safety laws as well as state and local permitting requirements.

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