

REPORT TO THE STATE OF ALASKA
ON EXPORT LICENSE CONSIDERATIONS
FOR LNG EXPORT TERMINAL

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THE EXPORT OF LNG TO FOREIGN MARKETS CONFRONTS NUMEROUS REGULATORY AND NATIONAL SECURITY HURDLES, RENDERING THIS APPROACH UNLIKELY TO BE SUCCESSFUL

If, as has been suggested, Alaskan LNG is to be exported to foreign markets instead of transported to North American markets, the construction and operation of any such project will require authorizations by both DOE, discussed below, and FERC as described in a separate companion memorandum. The effort to obtain this DOE authorization will be very complicated, time consuming, and may ultimately be unsuccessful if directed towards Pacific Rim Asia.

Any LNG project sponsor in Alaska¹ would be required to obtain authorization from the DOE for the export of natural gas and for approval of the “place of export.” With respect to the LNG facility, this would be similar to FERC’s approval of the LNG facility siting, which must be consistent with the DOE “place of export” determination. The Natural Gas Act (“NGA”) requires that applications seeking to import or export natural gas from or to countries engaged in a free trade agreement with the U.S. are approved “without modification or delay.”² This allows projects on the borders of either Canada or Mexico to receive import/export approval in a timely manner. With respect to these import/export applications involving free-trade countries (i.e., Canada or Mexico), the DOE is required to presume that the requested import or export are not inconsistent with the public interest requirement of section 3 of the NGA.³

¹ This would also be true with respect to the pipeline proposed by TransCanada, for that matter.

² 15 U.S.C. 717b (2006).

³ This will greatly simplify and expedite any regulatory review for the TransCanada pipeline proposal.

For all other import or export applications, the approval process can take much longer⁴ as the DOE is required to ensure that the import or, the export, is consistent with the “public interest.”

While the DOE requires that applications for export be filed more than thirty days in advance of the proposed export date, only “free-trade” applications can generally be approved within this amount of time.⁵ Exports to other non-NAFTA countries could take up to three years to approve, and possibly longer, depending on the state of U.S. relations with the export country and the U.S. domestic demand for natural gas supplies. As an example, the ConocoPhillips/Marathon facility in Kenai, Alaska, which exports LNG to Japan, filed for renewal of its export permit approximately eight years prior to the proposed start date of export.⁶ The DOE granted the renewal approximately two and one half years after the application was filed.⁷ In the case of Yukon Pacific Company, L.P.,⁸ discussed below, the DOE took approximately two years from the time the export application was filed to grant export authorization. Yukon Pacific proposed to export

⁴ Thus, for example, Kenai LNG filed a renewal application for an existing export license at the end of 1996, but the order was not issued until April 1999, for the upcoming period 2004-2009. *Philips Alaska Natural Gas Corporation and Marathon Oil Company*, Order Extending Authorization to Export Liquefied Natural Gas from Alaska, DOE/FE Opinion and Order No. 1473 (1999).

⁵ Within the context of discussing export/import permits from/to Canada and Mexico, DOE states in its website that both short and long term permit applications take two to three weeks to approve. See http://www.fossil.energy.gov/programs/gasregulation/authorizations/More_Questions.html#q5. But see FN 4 and *Yukon Pacific Corporation*, DOE Opinion and Order No. 350, 1 FE ¶ 70,259 (1989) where both export applications to non-contiguous countries required over one year to approve and involved protests by other parties or rounds of comments solicited by DOE to aid in its analysis.

⁶ *Philips Alaska Natural Gas Corporation and Marathon Oil Company*, DOE/FE Opinion and Order No. 1473 (1999). Philips filed its export authorization renewal with DOE on December 31, 1996 for an export period to begin April 1, 2004.

⁷ *Id.*

⁸ Yukon Pacific filed its application with DOE under the name Yukon Pacific Corporation. Subsequently, in 1992, Yukon Pacific changed its business structure and filed with DOE for permission to transfer its permits to a new entity called Yukon Pacific Company, L.P.

LNG to certain Pacific Rim countries, triggering the DOE's responsibility to determine if such exports would be consistent with the public interest.⁹

Section 3 of the NGA creates a statutory presumption in favor of approval of export applications. Opponents of any export project bear the burden of overcoming this presumption and demonstrating that the proposed export will not be consistent with the public interest.¹⁰ In its 1989 ruling approving the LNG exports proposed by Yukon Pacific to Japan, South Korea, and Taiwan,¹¹ the DOE described its analysis of the public interest as a consideration of the domestic need for the gas proposed to be exported.¹²

Yukon Pacific Permit Issues

We anticipate that an LNG project sponsor might assert that, in order to address potential federal regulatory hurdles, it could simply purchase the permits of, or the company holding the permits for, the Yukon Pacific facility, and pick up where that failed project left off by making use of all authorizations issued to Yukon Pacific. This scenario, however, would face significant, perhaps insurmountable obstacles.

In particular, this approach would still require FERC review because FERC authorizations are non-transferable without prior Commission approval (*see*, 18 C.F.R. 153.9). At a minimum, a party would be required to advise the FERC of the transfer or change in ownership, which FERC must approve. 153.9(a) Similarly, this approach

⁹ The DOE also confirmed its prior determination on exports to Japan (as not inconsistent with the public interest) in the case of ConocoPhillips/Marathon.

¹⁰ *Yukon Pacific Corporation*, 1 FE ¶ 70,259 (1989).

¹¹ Contracts with these countries for LNG exports were never finalized and the proposed LNG facilities never built. Accordingly, no exports under this authorization have taken place.

¹² 1 FE ¶ 70,259.

would still require DOE review with respect to export permitting.¹³ Any change to the facts at the time of the application must be notified to the DOE and approved.

Additionally, the Yukon Pacific authorizations both from FERC and DOE, were for very specific projects. Any change to the facility design, volumes, or other characteristics as proposed originally to FERC would require new approval from FERC.¹⁴ Just as any change to the export conditions as originally presented to DOE will require further approval.¹⁵

In this context, it is notable that no exports have occurred under this DOE authorization for nearly 20 years. Given the passage of time and changes of market and economic conditions during this period, it is highly doubtful that DOE would simply allow the existing permit to be bought by a new party, and then exploited without detailed regulatory review. At the time the Yukon Pacific permits were issued, natural gas demand was much lower than it is currently in the lower 48 States. Were the DOE to review that export proposal today, it would likely review its prior determination that the exports proposed were not inconsistent with the public interest. In *Yukon Pacific*, the DOE's "public interest" determination was based on the domestic need for the natural gas proposed to be exported, including whether there was any reason the public interest would require the proposed exports be used to meet domestic need.¹⁶ Taking the current high demand for natural gas into consideration, and the inability to serve all of that

¹³ 10 CFR 590.405; 590.407.

¹⁴ *Yukon Pacific Company, L.P.*, 71 FERC ¶ 61,197 at 61,713 (1995). "Any major alterations to facility design shall be filed with the Secretary for review and written approval by the Director of OPR prior to initiation."

¹⁵ 10 CFR 590.407.

¹⁶ See *Yukon Pacific Corporation*, 1 FE ¶ 70,259 at part V.A.

demand with remaining domestic supplies, there is, at a minimum, a significant risk that the DOE would arrive at a different conclusion in a new review of this inactive export permit. Hence, a proposal simply to rely upon the extant approvals granted previously to Yukon Pacific may be unrealistic.

Export of LNG to Asia Presents Significant Energy Security and National Security Policy Issues

Whether the many regulatory permits and approvals for a project focused on export of LNG to Asia can be obtained is further impacted by a variety of concerns with respect to U.S. energy and national security interests. Generally speaking, there is no statutory requirement that either DOE or FERC consult with national security agencies (in particular the State and Defense Departments and the National Security Council) before addressing applications for authority to export LNG. Nonetheless, DOE and FERC can (and are quite likely to) initiate such consultations and adapt their evaluation of those applications to concerns raised by these agencies.

It is noteworthy that, at present, no federal export control prohibition would apply to the export of LNG from the North Slope. Nonetheless, the level of concern that such exports could raise among federal energy and national security authorities can be surmised from their treatment of other energy export sources.

For example, the U.S. Department of Commerce has imposed strict constraints on the export of natural gas liquids and other natural gas derivatives from the Naval Petroleum Reserves (“NPR”) (or available as result of an exchange of any NPR-produced or derived commodities).¹⁷ The U.S. government imposes these restrictions to maintain a

¹⁷ The Naval Petroleum Reserves are defined under the Naval Petroleum Reserves Production Act, codified at 10 U.S.C. § 7420. In 1976, in accordance with the Naval Petroleum Reserves Production Act, the 23

supply of petroleum reserves for emergency national security and defense reasons. Any export from the NPR requires a license from the U.S. Department of Commerce, Bureau of Industry & Security (“BIS”) for export to *any* country outside the United States. 15 C.F.R. § 754.1. The Export Administration Regulations (“EAR”) administered by BIS indicate that applications for export licenses for such commodities will be denied in most instances, 15 C.F.R. § 754.3. Given the stringent treatment of export of natural gas liquids from the NPR, and the clearance of temporary export to and through Canada only, (under Section 185(u) of the Mineral Lands Leasing Act, 30 U.S.C. 185), there exists a reasonable basis to believe that the responsible offices in FERC, DOE, and elsewhere within the federal government will not be favorably inclined to allow North Slope LNG to be exported outside North America, which strongly favors the TransCanada pipeline option.

This conclusion is reinforced by the export restrictions and licensing requirements imposed by BIS on the export of North Slope petroleum under the EAR, described above. Specifically, as implemented in Supplement 3 to Part 754 of the EAR, Section 28 of the Mineral Leasing Act, as amended by Section 201 of the Alaska Power Administration Asset Sale and Termination Act, 30 U.S.C. § 185, describes the specific treatment of vital energy sources derived from the Alaskan North Slope. While LNG is not specifically enumerated in the Mineral Leasing Act, the text clearly recognizes (and acts upon) the

million acre area on Alaska's North Slope, formerly known as Naval Petroleum Reserve No. 4, was transferred to the Department of the Interior, Bureau of Land Management, and renamed the National Petroleum Reserve in Alaska. As a result, this vast tract is not currently subject to the LNG export constraints of the BIS imposed on the NPR.

vital importance of energy resources derived from this Alaskan territory and the special treatment such resources should be afforded.

Nor have recent political and policy actions indicated any lessening concern over energy trade with foreign companies or countries. To the contrary, last year the U.S. Congress reinforced the connection that policymakers are required to recognize between U.S. energy resources and national security considerations. Specifically, Section 4 of the Foreign Investment and National Security Act of 2007 (“FINSAs”) at 50 App. USCA 2170, expanded the factors to be considered by the Committee on Foreign Investment in the United States (“CFIUS”) in its review of foreign direct investment. Among other steps, FINSAs amends Section 721 of Title VII of the Defense Production Act of 1950, 50 U.S.C. App. § 2170 (2000), (“Exon-Florio Provision”), which provides procedures for CFIUS to vet foreign direct investments in U.S. companies involved in business having national security implications, and now requires that the CFIUS review process address “the potential national security-related effects on United States critical infrastructure, including major energy assets,” FINSAs ¶6, and “the long-term projection of United States requirements for sources of energy and other critical resources and material.” FINSAs ¶10.

Although the export of LNG from the United States to a customer in Pacific Rim Asia does not fall within the jurisdictional ambit of a CFIUS review, the national security-related concerns over such exports, in particular the heavy investment in LNG infrastructure solely for the purpose of producing and distributing LNG for export to countries that may present a national security threat to the United States, such as China, cannot be discounted. At a minimum, this would likely be a subject of discussion within

the U.S. interagency committee as well as with those committees of the House and Senate that oversee the national security apparatus¹⁸.

Even if such a project would not fall within the scope of CFIUS review and policy consideration, we anticipate that, were the LNG project to be seriously considered, Congress could well object to such exports on the basis of national security and energy resource concerns beyond the FINSA provisions mentioned above, and enact further legislation to restrict or prohibit such exports. Senator Murkowski, for example, has expressed concerns over the import of LNG. The rationale behind these concerns would equally lead to resistance against any attempt to export LNG to Asia. In questioning Alan Greenspan in hearings before the Senate Foreign Relations Committee on United States energy dependence, Senator Murkowski made the following comments:

Right now, we're in a situation where our imports of LNG are at a pretty minimal level. I understand it's about 3 percent right now. But the increase of LNG imports has increased by 180 percent, but in the past several years, still accounting for only about 3 percent of our U.S. imports.

The concern that I have is that we go in the same direction with natural gas as we are with oil, being dependent on foreign sources for an extremely important resource for us here in this country, and a recognition that we can do something about it because we have that ability to grow that resource here....

We're trying to move a project down from Alaska to get Alaska's natural gas to the rest of the United States. That project is not moving as quickly as we would like. We recognize that the country is counting on Alaska's gas to come down. We're trying to make sure that, in fact, that happens.

I am very concerned that we take the approach with a resource like natural gas and say, well, we simply can't produce enough of it here in this country; we must look to foreign nations for that resource; and we must put ourselves again in that position of being vulnerable, of

¹⁸ In addition to these committees being advised of any possible LNG exports to these countries, the LNG export issue could be subject to additional scrutiny through the enactment of EPCA 2005 which requires the FERC Chairman to testify before Congress every six months on the status of developing energy projects in Alaska.

providing cash to those countries that, as you point out, might be our friend today but who knows where they're going to be next year¹⁹.

Any such concerns arising merely by reason of a proposed export of natural gas would be further heightened when the likely markets to which the LNG would be exported are considered. On the one hand, it is noteworthy that the U.S. Government currently does not maintain comprehensive sanctions against the countries we understand would be the most likely recipients of LNG exports in Pacific Rim Asia, namely Taiwan, China, Japan and Korea. On the other hand, however, the mere prospect of potential LNG export to China likely would itself be the basis for national security objections. The U.S. Government exhibits increasing distrust of China generally and its military activities in particular. Any activity that could be seen as a material contribution to the Chinese Government (even in the form of commercial sale of dual-use or civilian products, such as LNG) is deemed to have an impact on the overall integrity of the U.S. Defense Industrial Base Critical Infrastructure. *See* "U.S. Export Controls and the U.S. Defense Industrial Base"²⁰. Along these lines, the State Department maintains an arms embargo against China, pursuant to the International Traffic in Arms Regulations ("ITAR"), 22 C.F.R. Section 126.1, and the Tiananmen Square Sanctions, Title IX of Pub. L. 101-246, 104 Stat. 83, 22 U.S.C. Section 2151 (note). Although the embargo does not extend specifically to fuel, per se, it covers exports of defense articles, technology and services (including material support for the Chinese military). Hence, there seems no likelihood at present that a proposal focused on, or justified only in part by, the prospect of LNG sales to China would ever meet the objections of energy and national security agencies.

¹⁹ Congressional Transcripts, June 7, 2006, Senate Foreign Relations Committee Holds Hearing on Oil Dependence and Economic Risk, at 24.

²⁰ Available at: <http://www.acq.osd.mil/ip/>.

In addition, given the long-standing relationship between China and the Democratic People's Republic of Korea (North Korea), we believe that the U.S. Government would strictly scrutinize any proposed exports of LNG to China for the potential diversion risk to North Korea. Currently, the U.S. Government imposes a licensing requirement on exports and re-exports of all U.S. origin items to North Korea. 31 C.F.R. Part 500 (2008) and 15 C.F.R. Part 746.4. Few items are subject to a favorable determination, and there is no basis to believe that LNG would be among them.

Furthermore, aside from the tension with U.S. export controls and sanctions regulations, diversion of LNG to North Korea would undermine the U.S. Government's negotiating power vis-à-vis North Korea. While the Korean Peninsula Energy Development Organization ("KEDO") Agreed Framework for the development of a Light Water Reactor project to provide energy to North Korea was terminated in 2006 (due to North Korea's failure to perform the steps required under the Agreement), the impact of possible diversion of LNG to North Korea remains significant. In particular, energy resources supplied to North Korea outside the scope of the Agreement undermine the U.S. Government's ability to negotiate with North Korea, most directly undermining the Executive Branch's exercise of its foreign affairs power in this regard. Any attempt at unlawful diversion would be nearly impossible for the U.S. exporter of record to detect and could, under the right factual circumstances, create legal liabilities for that same exporter, given the U.S. Government's "strict liability" standard when enforcing its export control provisions.

CONCLUSION

In sum, a project to export Alaskan LNG to Asia (instead of transporting Alaska gas to North America through the TransCanada pipeline) would likely confront significant, expensive, and time consuming barriers by reason of the requirement for applications to, and approvals by, a host of federal agencies, including FERC and DOE in connection with the export elements of the proposal (and, in addition, DOT, the Department of Interior, the Coast Guard, and the Army Corps of Engineers in connection with the environmental and transportation elements, discussed in a separate memorandum), as well as potential delays to address anticipatable objections by the Departments of State and Defense, or the National Security Council. By contrast, the TransCanada Pipeline proposal confronts none of these issues, and is subject to statutorily-imposed presumptions that the proposal serves the public interest.