

Gas Regulation

In 30 jurisdictions worldwide

Contributing editors

David Tennant and Torquil Law



2015

GETTING THE
DEAL THROUGH 

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DEAL THROUGH 

Gas Regulation 2015

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Preface

Gas Regulation 2015

Thirteenth edition

Getting the Deal Through is delighted to publish the thirteenth edition of *Gas Regulation*, which is available in print, as an e-book, via the GTDT iPad app, and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the 30 jurisdictions featured. Our coverage this year includes new chapters on Hungary and Sweden.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to David Tennant and Torquil Law of Dentons UKMEA LLP, the contributing editors, for their continued assistance with this volume.

GETTING THE 
DEAL THROUGH 

London
March 2015

United States

Jennifer Morrissey, Jessica Lynch and David Shaffer

Dentons US LLP

Description of domestic sector

1 Describe the domestic natural gas sector, including the natural gas production, liquefied natural gas (LNG) storage, pipeline transportation, distribution, commodity sales and trading segments and retail sales and usage.

The US natural gas industry is open to competition and choice in all industry segments. Prices at the wellhead are not regulated, but are subject to supply and demand. Producers own the gas at the wellhead. Natural gas production and exploration companies in the US are privately owned and range in size and sophistication from large, vertically integrated global companies to small companies of just a few individuals with only a partial interest in a single well site. Gas may be processed at the field, or sent through gathering lines to a central location for processing prior to transportation via pipeline. Transportation across the more than 300,000 miles of pipelines in the US is subject to federal or state regulation, depending on whether the pipeline is interstate or intrastate. Interstate pipelines do not take title to the gas. An interstate pipeline must offer open access transportation to all similarly situated shippers. More than 400 natural gas storage fields are owned by pipeline companies, local distribution companies (LDCs) or individual gas storage service companies, although most of the working gas in storage is held under lease with shippers, LDCs or end-users.

Producers sell gas to LDCs, end-users or marketers. The natural gas marketing segment is highly dynamic, with frequent entry and exit. The vast majority of natural gas supplied and consumed in the US passes through gas marketers. Natural gas marketers act as intermediaries and offer bundled or unbundled services, and can facilitate the sale of gas, as well as contract for transportation and storage. Marketers may own the gas being transferred or may simply arrange transportation. LDCs offer bundled products to customers for the most part, although some states require retail unbundling for LDCs, which allows end-users to purchase gas directly from producers, marketers or from LDCs.

2 What percentage of the country's energy needs is met directly or indirectly with natural gas and LNG? What percentage of the country's natural gas needs is met through domestic production and imported production?

The US meets nearly 25 per cent of all of its energy needs with natural gas. After petroleum, natural gas is the second largest primary source of energy in the US. Approximately two-thirds of demand is from the industrial and electric power generation sectors, with the remaining third consisting primarily of residential and commercial uses. Only a small fraction of demand is transportation-related. Almost 25 per cent of US electricity generation is gas-fired, and this is expected to grow to 30 per cent over the next 15 to 20 years.

Net imports of natural gas into the United States have continued on a downward trajectory that began in 2007, falling approximately 14 per cent in 2013. Abundant domestic production is the primary factor contributing to the displacement of natural gas imports. According to the US Energy Information Administration, US dry gas production increases set a new record in 2013, increasing to 24,282 billion cubic feet (Bcf). In 2013, pipeline imports decreased by 6 per cent to 2,786 Bcf, and LNG imports decreased by 45 per cent to 97 Bcf. The natural gas pipeline systems of the US and Canada are integrated, and approximately 90 per cent of the US's natural gas imports come from Canada.

Total exports of natural gas decreased by 3 per cent to 1,572 Bcf in 2013, only the third time since 1997 that the nation experienced a fall in exports. Pipeline exports decreased by 1 per cent to 1,569 Bcf, while LNG exports, already lower than 2 per cent of total exports, decreased to 3 Bcf. This trend was due in part to the one operational LNG export facility electing not to renew its authorisation. However, this trend is expected to reverse course in the next few years as recently authorised LNG export facilities come on line.

Government policy

3 What is the government's policy for the domestic natural gas sector and which bodies set it?

Policy for the domestic natural gas sector is set at both the federal and state levels, involving the executive and legislative branches, with significant authority delegated to administrative agencies. At the federal level, the Federal Energy Regulatory Commission (FERC) and the Department of the Interior's Bureau of Ocean Energy Management, Regulation and Enforcement (the BOEMRE) (for certain aspects of offshore facilities) are the primary regulatory policy bodies for the oil and gas sector. The Environmental Protection Agency (EPA), the Department of Interior's Bureau of Land Management (BLM) and other federal agencies also have oversight roles.

Federal policies for the natural gas sector at present are focused on achieving a balance between maximising the benefits of abundant domestic natural gas supplies while addressing serious environmental, health, safety and energy security concerns related to the production of natural gas. Policies are also in place to foster and maintain competitive markets for natural gas in the US.

The states also play an important role in setting policy and in regulatory oversight of the natural gas sector. Because of highly varied geography, as well as differing economic priorities, state level oversight is critical to the development of the industry. Many states are members of the Interstate Oil and Gas Compact Commission, a multi-state government agency tasked with ensuring that the nation's natural gas resources are developed in a manner that also protects health, safety and the environment.

Policy and regulatory developments for the natural gas sector tend to lag behind industry developments, although this is not always evident from the national policy dialogue, which is significantly driven by increased public awareness of industry activity.

Regulation of natural gas production

4 What is the ownership and organisational structure for production of natural gas (other than LNG)? How does the government derive value from natural gas production?

Natural gas production companies in the US are privately owned under a variety of structures. There are thousands of oil and gas companies active in the US, although about a dozen of the largest entities account for nearly one-third of all production, and 40 companies produce more than half of all domestic gas. Among the largest players are both integrated international companies and independents that focus primarily on exploration and production.

The federal and state governments derive value from natural gas production in a variety of ways. In connection with natural gas production activities on federal lands, in addition to tax revenue, the federal government may be paid royalties, lease payments or bonuses. Federal revenues are also generated through federal filing fees paid in connection with

requests for federal authorisations or permits, or certain annual charges. States also derive value from similar sources for activities within the state, including, among other things, the imposition of licensing and impact fees, and increased tax revenues derived from local economic development that accompanies drilling activities.

5 Describe the statutory and regulatory framework and any relevant authorisations applicable to natural gas exploration and production.

Ownership of natural gas

Unlike most countries, the US allows for private ownership of minerals that have yet to be extracted from the ground, including oil and natural gas. State law governs the rights of mineral interest owners in the states, unless the US owns minerals in that particular state, in which case federal law supersedes state law.

In most states, the mineral estate can be severed from the surface estate. As such, two different individuals can own the surface and the minerals for the same tract of land. The mineral estate is also known as the dominant estate. This means that the surface owner must make accommodations to allow a mineral interest holder the right to extract its minerals.

Most mineral estate owners do not extract their own minerals. Instead, mineral interest owners will enter into a contractual agreement with gas extracting companies to drill wells and extract the natural gas. This contract is normally called an oil and gas lease. Despite being called a lease, US law specifies that the extracting company owns a fee simple determinable in the minerals, and the mineral owner owns a right to reversion to the minerals when the oil and gas lease terminates. Therefore, in essence, the gas extracting company owns the gas in the ground.

The BLM offers competitive leases to companies to drill on federal lands (although at times land may be leased through a non-competitive process). The lessee pays a royalty to the government on the amount or value of the gas (or oil) extracted from the leased land.

After extraction, the extracting company will sell the natural gas to a pipeline company or a shipper, which will then transport the gas downstream.

In the case of transport via an interstate pipeline, the party holding the pipeline capacity through which the natural gas is transported must have title to the natural gas to comport with FERC's open access regime (described in more detail below).

Regulation of exploration and production

Regulation at both the federal and state levels applies equally to the conventional and unconventional sectors. Nevertheless, heightened public awareness of unconventional gas production is driving a movement to revise or enact new regulations to address a host of issues that arise as a result of increased production and production in regions of the country that previously had little or no experience with the natural gas industry.

Outside of a few exceptions, the regulation of the exploration, production and transportation of natural gas is within the rights of the state where the natural gas is extracted. However, federal law governs several aspects of the natural gas industry.

State regulation

Producing states will have state laws related to the extraction and transportation of natural gas. Most state laws defer many of the permitting and monitoring activities to a specific state agency. These state agencies normally have broad powers to adopt regulations related to gas extraction and to transportation of natural gas by pipelines that do not cross state borders (known as intrastate pipelines). These regulations include the process that gas extraction companies must undergo to permit a gas well, the construction requirements of each well and limits to the amount of natural gas that can be extracted from a given well. They also include regulations related to construction and capacity for intrastate pipelines.

The timing and location of production may also be regulated at a state or local level. For example, a number of states, and municipalities within states, have enacted temporary moratoriums or even bans on hydraulic fracturing in certain areas. The legality of bans enacted by municipalities under zoning or other local authorities is currently being challenged in several states where there is a colourable argument that state oil and natural gas or mining laws pre-empt local action, while the laws of other states clearly allow municipalities to permit or prevent drilling within their jurisdictions.

Federal regulation

The federal government regulates the exploration, production and transportation of natural gas in several areas:

- FERC maintains jurisdiction over natural gas pipelines that cross state lines (interstate pipelines), as well as the construction and operation of transportation and storage infrastructure;
- the Department of Transportation (DOT), through the Pipeline and Hazardous Materials Safety Administration (PHMSA), sets safety standards for all interstate and intrastate natural gas pipelines; and
- four different federal agencies within the Department of the Interior manage minerals owned by the federal government and Indian tribes. The BOEMRE and the Bureau of Safety and Environmental Enforcement regulate offshore drilling on lands owned by the US government. The BLM regulates natural gas drilling conducted on federal onshore lands, except for lands owned by Indian tribes, which are managed by the Bureau of Indian Affairs.

6 Are participants required to provide security or any guarantees to be issued with a licence to explore for or to store gas?

Many states require the posting of a bond or other financial assurances as a prerequisite to issuance of a well permit or authorisation of other drilling or exploration operations. Security requirements associated with the storage of natural gas may also be included in the storage provider's tariff.

Regulation of natural gas pipeline transportation and storage

7 Describe in general the ownership of natural gas pipeline transportation, and storage infrastructure.

Natural gas pipelines and storage facilities in the US are privately owned.

8 Describe the statutory and regulatory framework and any relevant authorisations applicable to the construction, ownership, operation and interconnection of natural gas transportation pipelines, and storage.

Under the Natural Gas Act (the NGA), FERC must certify all interstate pipelines and gas storage facilities. Conversely, all intrastate pipelines and facilities are approved by state law. Both state and federal agencies are given broad approval and regulatory powers to approve these facilities. Pipelines that traverse a national border require a presidential permit.

9 How does a company obtain the land rights to construct a natural gas transportation or storage facility?

Following approval of the site plan by either FERC for interstate projects or the appropriate state agency for intrastate projects, the company seeking to build the facility must acquire the proper injection rights contractually from the private owners of the mineral estates where the project is located. However, in most circumstances, the storage company is granted a right of condemnation to obtain the proper rights to complete its project. The mineral estate owner will have a right to protest the condemnation in a court proceeding.

10 How is access to the natural gas transportation system and storage facilities arranged? How are tolls and tariffs established?

Natural gas extractors transport unprocessed natural gas through a gathering system that links the wellhead to the gas processing facility. After processing, the gas is sent to a transmission line, which will then transport the gas either into the storage or into a distribution system of retail sellers of gas to end-users - except that some power plants actually receive some of their gas supply through transmission lines with the approval of FERC. Gas storage companies work hand-in-hand with transportation companies that need locations to store excess supply until their customers purchase or are ready to accept gas to be delivered.

By FERC mandate, access to transportation and storage services and the price of such services must be made on a non-discriminatory basis and must be fair and not unduly restrictive. The prices charged by both transporters and gas storage companies are regulated through a FERC-approved tariff, which sets limits on the amounts that such companies can charge for their services.

11 Can customers, other natural gas suppliers or an authority require a pipeline or storage facilities owner or operator to expand its facilities to accommodate new customers? If so, who bears the costs of interconnection or expansion?

Through the NGA, FERC may require companies to expand to accommodate local distribution of natural or artificial gas if it is 'necessary or desirable in the public interest to do so'. However, FERC's power to make such a requirement is limited in the event that such an expansion will impair the company's ability to service existing customers. In the event that an expansion is ordered by FERC, the costs of such expansion will be considered in the rates that the company will be allowed to charge.

12 Describe any statutory and regulatory requirements applicable to the processing of natural gas to extract liquids and to prepare it for pipeline transportation.

Private companies are responsible for the processing of gas into market-ready products. These companies must adhere to certain state and federal environmental, health and safety standards, but there are few regulations or laws that apply specifically to gas-processing facilities that are different from the standards that apply to many other businesses in their operations.

13 Describe the contractual regime for transportation and storage.

Companies operating interstate pipelines and natural gas storage services must receive a FERC tariff; the tariff will include a range of rates that such companies may charge, as well general terms and conditions of service and typical forms of agreements that will be entered into with counterparties.

Companies operating intrastate pipelines and gas storage facilities may also have to obtain a tariff, but it would be obtained from a state agency as opposed to obtaining it from FERC.

Contracts for both transportation and gas storage will include the delivery points of the gas, how the parties may schedule and nominate quantities of gas to be delivered or transported, risk of loss and insurance requirements, balancing arrangements and quality and pressure requirements for the gas.

Regulation of natural gas distribution

14 Describe in general the ownership of natural gas distribution networks.

The ownership and transportation of natural gas have been separated, or unbundled, in the US since mandated by FERC in 1992. The natural gas distribution network in the US is made up of high capacity interstate and intrastate pipelines serving large industrial, commercial and electric generation customers directly, and LDCs serving consumers through small-diameter distribution pipelines. Customers who take natural gas directly from high-capacity pipelines generally do so through a contract with a natural gas marketing company. LDCs generally take gas from high-capacity pipelines at delivery points, usually referred to as the 'citygate', and from there deliver it to each individual customer's meter. LDCs can be investor-owned utilities, municipals owned by local governments, privately owned utilities or cooperatives.

15 Describe the statutory and regulatory structure and authorisations required to operate a distribution network. To what extent are gas distribution utilities subject to public service obligations?

Operation of the natural gas distribution network is regulated by both federal and state agencies. FERC regulates the siting and authority to operate interstate pipelines, and the DOT regulates pipeline safety. State regulatory agencies govern the operation of local distribution networks by LDCs with facilities located within that state's jurisdiction. Investor-owned LDCs are regulated by state public utility commissions. Municipally owned LDCs are typically governed by local government agencies to ensure that the needs and preferences of customers are met in a cost-effective manner. Just as FERC requires pipelines to apply for certificates of convenience and necessity for siting and operating authority, state authorities may require an LDC to obtain similar certificates to serve in the state and comply with all applicable safety regulations.

Service by pipelines and LDCs is generally required to be non-discriminatory by FERC regulation and applicable state statutes. Traditionally, LDCs have been awarded exclusive rights to distribute

natural gas in a specified geographic area, as well as perform services like billing, safety inspection and providing natural gas hook-ups for new customers. While each LDC retains the right to disconnect service for non-payment, most states temper those rights with regulations designed to protect consumers. Investor-owned LDCs in most states have an implied right to obtain a reasonable rate of return on their investments.

In the past, LDCs offered only bundled services, combining the cost of natural gas transportation and distribution into one price reflected on consumers' bills. However, many states have moved toward retail unbundling, following FERC's example at the wholesale level, and now offer customer choice programmes that allow customers to purchase natural gas from one supplier, and use the LDC only for service and delivery of the gas.

16 How is access to the natural gas distribution grid organised? Describe any regulation of the prices for distribution services. In which circumstances can a rate or term of service be changed?

Authority over access to the natural gas distribution grid is split between FERC, the DOT and state regulatory agencies. FERC has authority over the siting and abandonment of, and environmental issues related to, interstate natural gas pipelines and storage facilities. The DOT's PHMSA, acting through the Office of Pipeline Safety, administers a national regulatory programme to assure the safe transportation of natural gas by pipeline. LDCs are regulated by the states, and requirements regarding access to the distribution grid vary state by state.

17 May the regulator require a distributor to expand its system to accommodate new customers? May the regulator require the distributor to limit service to existing customers so that new customers can be served?

Although the specific statutory authority varies from state to state, state regulators generally can require an LDC to expand its distribution system to accommodate new customers, if the LDC has been granted an exclusive right to serve a specific geographic area. In their oversight of LDCs, state regulators are generally charged with ensuring adequate supply, dependable service and reasonable prices for consumers, while also allowing for an adequate rate of return for investor-owned LDCs. Regulators must balance those (sometimes competing) concerns when making determinations regarding the need for an LDC to expand its distribution system.

18 Describe the contractual regime in relation to natural gas distribution.

Contractual agreements for natural gas distribution are generally included in a pipeline's tariff on file with FERC, or established by bilateral service agreements, which may be filed with a regulator, or unfiled, and kept by the parties to the agreement. Although the service agreements may have some terms specific to the customer being served, such as gas quantity and the type of service contracted for (eg, firm or interruptible service), FERC requires pipelines to treat all shippers who are similarly situated equally. State regulations extend that rule, designed to promote non-discriminatory pipeline service, to contractual agreements between LDCs and their customers, resulting in very little negotiation flexibility for individual customers as to the specific terms of a distribution service agreement.

Regulation of natural gas sales and trading

19 What is the ownership and organisational structure for the supply and trading of natural gas?

The natural gas industry in the United States is highly competitive, with thousands of producers, consumers and intermediate marketers. While some producers market their natural gas and may sell it directly to LDCs, to large industrial buyers and to power plants, the majority of gas trading in the US is done by marketers. Marketers aggregate natural gas into the quantities requested by various buyers and then arrange to transport the gas to those buyers. Marketers can be producers of natural gas, pipeline marketing affiliates, LDC marketing affiliates, independent marketers or large-volume users of natural gas, although they are usually specialised business entities that focus solely on transactions in the physical and financial energy markets.

In the US there are both physical and financial markets for natural gas. These markets are regional, and prices will vary depending on supply and demand in a particular market. Physical trading involves an obligation to deliver or take delivery of natural gas in exchange for payment. Financial

trading is based on the movement of the price of natural gas. It is conducted only through financial instruments and does not involve physical delivery of gas, although pricing and settlement of the financial products are tied to physical natural gas.

Pricing and trading takes place at various locations across the country, primarily at the intersections of major pipeline systems known as hubs. There are more than 30 hubs, but the key trading hub used as a benchmark for the US natural gas markets is Henry Hub in the Gulf of Mexico region in Louisiana.

20 To what extent are natural gas supply and trading activities subject to government oversight?

There is a significant amount of government oversight of activities in the natural gas markets, although producers and marketers are not subject to direct regulation in the way that pipelines and LDCs are. Natural gas trading is market-driven, and those markets are considered to be highly price transparent. Nevertheless, there has been concern in recent years – most acute in the aftermath of the price spikes in the summer of 2008 – that manipulation and excessive speculation can occur.

Primary oversight of the natural gas markets is shared by FERC and the Commodity Futures Trading Commission (the CFTC). Some exchanges also play a role in market oversight. For example, the New York Mercantile Exchange (NYMEX) is both self-regulated and subject to CFTC oversight.

FERC is tasked with ensuring that the US natural gas markets are competitive and efficient. Pursuant to authority granted by the Energy Policy Act of 2005, FERC has implemented anti-manipulation rules designed to prohibit fraudulent or misleading practices or omission or misstatement of material facts in connection with natural gas trading activities subject to its jurisdiction. FERC does not need to show reliance, loss causation or damages to prove a violation of these rules. FERC's Office of Enforcement actively monitors the natural gas markets. Many of the manipulative schemes that FERC staff have investigated and prosecuted recently are cross-product schemes in which an entity engages in price-making trades in the physical market, often at a loss, to affect the settlement price of price-taking derivative instruments.

Under the Commodity Exchange Act, financial instruments that meet the statutory definition of a futures contract must be traded on a futures exchange regulated by the CFTC. The CFTC also has oversight of certain activities in the over-the-counter (OTC) derivatives market. This includes requirements that swap dealers and major swap participants be registered and meet capital and margin requirements. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), some swap participants who would otherwise be exempt from certain clearing and exchange trading requirements nevertheless are required to provide information to their swap counterparties that are required to register so that those entities may comply with the law.

21 How are physical and financial trades of natural gas typically completed?

The financial gas market, which does not involve physical delivery of natural gas, takes place through financial instruments such as exchange-traded futures, options and a variety of OTC swaps. Pricing occurs on a real-time basis on a broad range of derivatives that are available to all market participants. The largest volume of financial gas transactions takes place in the NYMEX natural gas futures contract. A large volume of swaps also clears on the Intercontinental Exchange (ICE). It is estimated that the value of trading that occurs on the financial market is at least a dozen times greater than the value of physical natural gas trading.

Physical contracts are negotiated between buyers and sellers over the phone or executed on electronic bulletin boards and e-commerce trading sites. The primary physical trading contracts available are swing contracts, baseload contracts and firm contracts. The prices in longer-term contracts are frequently indexed to prices that are regularly published in the trade press, although they may also reference the relevant NYMEX futures contract for delivery of natural gas and use the price that is finally settled on for delivery of gas under that standard monthly contract. Additionally, the US natural gas marketplace has a highly competitive spot market where brokers and others buy and sell natural gas daily. Trading in the spot market can occur 24 hours a day, seven days a week. There are also several publications that publish a daily price index, available the business day after the transactions used to compile the index. Natural gas storage also has a role in pricing in the physical markets, particularly in the winter, as it can be used to cover a gap between production and demand on a given day.

The largest volume of trading occurs in the last five business days of a month, known as bidweek, when producers are trying to sell their core production and consumers are trying to buy for their core natural gas needs for the upcoming month.

Many transactions take place pursuant to a standardised contract, such as the International Swaps and Derivatives Association Master Agreement, which can be used for physical or financial transactions. Standard contracts exist as well for ICE natural gas swaps (also known as the Henry Hub swap) and NYMEX natural gas futures. The standard contracts can be used for off-exchange bilateral transactions, as well as for transactions on the relevant exchanges. NYMEX and ICE offer clearing services for parties to off-exchange bilateral transactions that wish to reduce risk of non-performance by counterparties.

22 Must wholesale and retail buyers of natural gas purchase a bundled product from a single provider? If not, describe the range of services and products that customers can procure from competing providers.

Over a period of about 20 years, the natural gas industry went through a series of steps leading to the deregulation of interstate natural gas supply. This culminated in 1992 with a FERC order that directed pipelines to separate transportation and gas sales services so that customers could choose their providers for pipeline transportation, gas sales and gas storage services. In that same order, FERC required pipeline companies to offer a range of services to meet customer needs in an efficient and reliable manner. Customers can choose from a variety of transportation options, including firm service, interruptible service or, of particular use to LDCs and utilities to meet peak demand, no-notice transportation service. Customers may also release unused capacity for sale or lease to other shippers. To foster transparency, the pipelines maintain electronic bulletin boards where customers can see, and bid for, all available capacity, including released capacity.

Some states have required the LDCs to unbundle sales and transportation services to large industrial customers, which allows these customers to purchase directly from producers or marketers and to contract with the interstate pipelines for transportation and other services.

About half of the states have some form of customer choice programmes for residential and commercial natural gas customers. These programmes are at various stages of implementation, and some states offer a programme even though there are few suppliers. The competitive retail provider is typically a broker or aggregator who contracts with customers to aggregate their loads for purposes of purchasing natural gas. Often the unbundled services are rebundled by the competitive retail provider. If a customer does not choose a provider, the default provider is the regulated natural gas utility.

Regulation of LNG

23 What is the ownership and organisational structure for LNG, including liquefaction and export facilities, and receiving and regasification facilities?

LNG facilities in the US are privately owned. As with other energy facilities, the ownership structure will vary depending, inter alia, on the risk associated with the facility, project financing, contractual relationships between project sponsors, tax regimes, local laws, etc. For example, a project may have an integrated model where the investors own rights to natural gas reserves and together they build the infrastructure to produce, liquefy and market the gas. Typically, each investor will hold title to its share of the gas produced until the gas is sold to a third party, and will have an undivided interest in the LNG facility in proportion to its ownership interest in the rest of the project. A project could also be owned by a project company that owns the LNG plant, but usually does not have an ownership interest in the upstream gas assets (although affiliated related entities may hold those assets). Under a third structure, the LNG facility may operate as a tolling facility. Here, the company that owns the LNG facility generally does not take title to the gas that is processed, but instead is paid a fee to process gas that is owned by a producer or purchaser.

24 Describe the regulatory framework and any relevant authorisations required to build and operate LNG facilities.

The regulatory authorisations required to construct an LNG facility are similar for import and export facilities. FERC has exclusive authority under the NGA to approve or deny the siting, construction, expansion or

operation of onshore facilities for imports or exports of LNG. However, FERC's authorisation is conditioned on the developer's satisfaction of other statutory requirements for various aspects of the project. States have the ability to effectively veto an LNG facility by denying permits associated with the Clean Water Act, the Coastal Zone Management Act and the Clean Air Act.

Under the Coastal Zone Management Act, the project developer must certify that the proposed activity in a designated coastal zone complies with the enforceable policies of the affected state's coastal zone management programme. If the state does not concur with the certification, FERC will not grant construction approval. This applies to all federal permits and authorisations, including FERC and the US Army Corps of Engineers (the Corps).

The developer must also obtain certification under the Clean Water Act that the project complies with the state's water quality standards from the responsible state agency for any activity that may result in a discharge into navigable waters, including construction and operation of the facility. The facility cannot be constructed if this certification is denied. Once the Clean Water Act Certification is obtained, a permit must be requested from the Corps for discharge of dredged and fill material. Under the Clean Air Act, a permit is also required to operate a source of air pollution.

FERC establishes the schedule for all federal authorisations required for an LNG terminal, provided the agency respects any applicable schedules established by federal law. Federal, state and local entities are required to cooperate with one another and comply with the schedule that FERC establishes. To streamline the process, FERC typically sends notices to the relevant state and federal agencies to invite them to cooperate and contribute to the environmental review process under the National Environmental Policy Act. The US Coast Guard, the Corps, the Department of Interior, the Fish and Wildlife Service, the Environmental Protection Agency and the Office of Pipeline Safety, along with various state and local land, environmental and historic preservation agencies, are frequently among the cooperating agencies participating in the review process. In the event that an agency does not complete a proceeding for a required approval, the applicant may appeal to the US Court of Appeals for the DC Circuit. Challenges to agency orders that are issued, including an order denying a permit or other required approval, may be brought in the federal circuit court with jurisdiction over the location of a proposed LNG facility. The exception to this general rule are actions related to the Coastal Zone Management Act, which are brought before the Secretary of Commerce.

In addition to the environmental permits and certifications, FERC is required to enter into a memorandum of understanding with the Department of Defense to review whether the LNG terminal will affect an active military installation. Additionally, US maritime anti-terrorist regulations are applicable to US LNG terminals. All vessels and ports worldwide that engage in international trade must comply with the International Ship and Port Security Code, and foreign-flagged vessels entering US waterways must meet the security requirements of the Maritime Transportation Security Act.

If FERC finds the proposed LNG project to be in the public interest, it will issue a certificate of public convenience and necessity. After a project certificate is issued, FERC monitors the project, first to ensure that all pre-construction conditions are met, and subsequently, once construction is authorised, to ensure that all certificate conditions are met during the design, construction and commercial operation of the LNG terminal.

Members of the public are permitted to intervene in FERC process to protest a project. Interveners may petition FERC to rehear a decision authorising a facility, and may also challenge the decision in Federal Court. If a project is denied, the developer may petition FERC to rehear the case and may also challenge the decision in Federal Court.

For offshore LNG facilities, the Department of Transportation's Maritime Administration is the primary licensing agency, while the Coast Guard is the lead agency with respect to environmental aspects, safety and operations of a facility. Also involved in the process, among others, are the EPA, NOAA Fisheries and the National Ocean Service of the Department of Commerce, the Corps, the Department of the Interior's BOEMRE, the Department of Defense, the Department of Transportation's PHMSA, FERC and the relevant coastal state governor.

One significant difference in the regulatory scheme for LNG export facilities, as opposed to import terminals, is the requirement to obtain export authorisation from the Department of Energy (the DOE). Authorisation is required both for the export of US-produced gas and for re-export of imported gas. The DOE has a bifurcated process for analysing

natural gas export applications. Applications for exports to any of approximately 15 countries with which the US has a free trade agreement calling for national treatment in trade of natural gas are perfunctorily approved. Export to all other countries is evaluated on a case-by-case basis and is permitted only to the extent that it is found to be 'consistent with the public interest'. In an export authorisation, the DOE may reserve the ability to revoke, re-examine or condition its approval in the future, for example, if the cumulative impacts of export authorisations lead to a reduction of the supply required to meet essential domestic needs.

25 Describe any regulation of the prices and terms of service in the LNG sector.

In 2002, FERC issued a decision finding that LNG terminals are the end point in the LNG supply chain, and not a starting point in interstate transportation. Although the decision related to import terminals, the decision allows both import and export facilities to operate without complying with the open access requirements applicable to interstate pipelines. This means that the terminal developer or owner may have exclusive use, by itself or through its affiliates, of the entire capacity of the LNG facility (although the interstate pipeline transporting gas to or from an LNG terminal in the US still must comply with the open access rules). FERC also allows the charging of market-based rates for terminal services. Thus, the owner may offer access to customers at prices and on the terms and conditions that are agreed between the parties. There is a provision in the Energy Policy Act of 2005 that gives FERC discretion, starting from 1 January 2015, to decide whether to continue to allow non-open access in connection with new or expansion applications.

Mergers and competition

26 Which government body may prevent or punish anti-competitive or manipulative practices in the natural gas sector?

Regulations against anti-competitive and manipulative conduct are found at both the federal and state levels (antitrust laws), and include the Sherman Act (combinations in restraint of trade, monopolisation), the Clayton Act (mergers, exclusive dealing) and the Robinson-Patman Act amendments to the Clayton Act (discrimination on price and other terms of sale). These laws are enforced at the federal level by the antitrust division of the Department of Justice and the Federal Trade Commission (the FTC), which, in addition to the antitrust laws, also has authority to regulate unfair acts of competition pursuant to the Federal Trade Commission Act.

Public utilities are specifically regulated by other agencies that enforce their own rules, particularly FERC and the various state public utilities commissions. FERC has created its own Office of Enforcement (OE) tasked with identifying and taking action against fraud and anti-competitive practices in the electricity and gas sectors. Over the past few years, FERC's OE has been very active in investigating manipulation in gas trading.

FERC's rulemaking and enforcement authority under the NGA was expanded by the Energy Policy Act of 2005, which now allows FERC to prevent market manipulation. Competition principles are taken into account to aid these governmental bodies in reviewing and approving the rates and terms and conditions of tariffs for interstate and intrastate transportation and storage service.

Further, the Dodd-Frank Act delegates to the CFTC the authority to increase oversight of anti-competitive or manipulative practices with regard to commodities, which include natural gas. This oversight extends to the regulation of certain aspects of natural gas trading on the NGX, particularly with transactions that may be viewed as swaps.

In addition to the federal antitrust laws described above, many states have correlative laws, and many of these correlative laws specifically apply to petroleum products such as natural gas. These laws are enforced by state attorneys general, local governmental bodies and, in some cases, private parties injured by the prohibited anti-competitive and manipulative conduct.

27 What substantive standards does that government body apply to determine whether conduct is anti-competitive or manipulative?

The antitrust laws make distinctions between conduct that is highly likely to be anti-competitive and per se unlawful (ie, cartels), and anti-competitive conduct that may be justified through the surrounding circumstances. A 'rule of reason' is applied to determine whether the

anti-competitive conduct is lawful. This rule of reason takes into account the relevant geographical and product market as well as measures of industrial concentration within those markets.

Through the Dodd-Frank Act, Congress delegated to the CFTC expanded authority to regulate manipulative conduct with respect to certain commodities in interstate commerce, which include natural gas, as well as futures, derivatives and swap markets. The CFTC modelled its regulations on Securities and Exchange Commission (the SEC) Rule 10b-5 and similar standards already in place at FERC and the FTC. Rule 10b-5 is a widely known regulation covering manipulative conduct associated with the purchase or sale of publicly traded securities. The rule prohibits conduct such as deceit, fraud, manipulation and misrepresentation in association with the trading of securities, and authorises enforcement by both governmental and private bodies.

28 What authority does the government body have to preclude or remedy anti-competitive or manipulative practices?

All federal and state antitrust enforcement agencies are able to seek both monetary damages and equitable remedies for violations of the laws they are authorised to enforce. Many of these laws carry criminal penalties, and damages may be trebled or increased to incorporate punitive or exemplary damages. Federal and state agencies also have the power to revoke authorisations for market-based rate-making if an entity is found to have engaged in anti-competitive conduct. Violations of an unfair competition law are ordinarily subject to an injunction, but fines may also be appropriate, especially if injunctions are violated. Private parties may also seek damages for injuries that occur due to violations of the laws, and in some cases may bring class actions for others similarly injured.

FERC has been granted the authority to issue rules that inhibit market manipulation and facilitate price transparency in natural gas markets. FERC has instituted regulations that require certain gas market participants to annually report information regarding their wholesale, physical natural gas transactions, transactions to price index publishers and blanket certificate status. Other FERC regulations require interstate and certain major non-interstate pipelines to post capacity, daily scheduled flow information and daily actual flow information.

Through the Energy Policy Act of 2005, Congress provided FERC with enhanced authority to assess civil penalties for violations of the Federal Power Act, the NGA and the Natural Gas Policy Act. It is important to realise that a single action or course of conduct by a company or individual may be found to constitute multiple violations. Civil penalties of up to US\$1 million per violation per day may be imposed. Additionally, criminal penalties for violations may result in fines of up to US\$1 million per violation with up to five years' imprisonment. FERC may also seek injunctions prohibiting those who have engaged in energy market manipulation from further engaging in activities subject to FERC's jurisdiction.

Under the Dodd-Frank Act, the CFTC has similar authority to seek injunctions and penalise manipulative or anti-competitive behaviour.

29 Does any government body have authority to approve or disapprove mergers or other changes in control over businesses in the sector or acquisition of production, transportation or distribution assets?

Mergers and certain changes in control are subject to notification to the FTC and the Department of Justice under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended, with natural gas transactions usually regulated by the FTC. Further, state regulators may also have authority to review and approve mergers, such as in the context of public utilities.

Whether a transaction must be reported depends on the size of the transaction and the size of the parties engaging in the transaction. The jurisdictional thresholds for review of transactions are adjusted annually, based on the change in the gross national product. Typically the threshold for midstream and downstream transactions is lower than that for transactions of natural gas and oil reserves and associated production assets, such as gathering lines and tank farms. The structure of the transaction – whether a merger, contributions to an existing business or other forms – may also affect whether the transaction must be reported.

These reporting requirements allow the enforcement agencies to make sophisticated evaluations after reviewing the pertinent information needed to determine whether the transaction or a combination would violate the antitrust laws and to allow the time needed for the agency to seek an injunction in court barring the deal from proceeding, since parties ordinarily may not consummate the transaction until 30 days after reporting

(this 30-day period may be extended by the enforcement agencies in order to request additional information).

It is typical for enforcement agencies to allow for early termination of the waiting period in the case of non-controversial transactions, such as is typical in the upstream sector, whereby a merger may be completed in two weeks from the filing. However, controversial transactions may require the parties to enter into sustained negotiations or litigation that occupy months unless the parties enter into a consent decree conditioned on certain divestitures or promises to engage or refrain from engaging in certain acts. Of further note is the situation where the agencies forego the opportunity to enjoin the merger and instead challenge it long after the deal has closed, a scenario that has occurred several times in the energy sector.

In certain circumstances, an agency is required to take action upon learning of a merger. For example, FERC has limited grounds for reviewing mergers in the natural gas sector, but in certain cases must act to issue or revise certificates of public convenience and necessity, or for abandonment of assets under the NGA, after the fact.

30 In the purchase of a regulated gas utility, are there any restrictions on the inclusion of the purchase cost in the price of services?

States may regulate the purchase of gas utilities. For example, when a state regulated utility is purchased, most states will set rates based on the net book value of facilities instead of the actual purchase price. Additionally, states typically prohibit the inclusion of any acquisition premium in retail rates. Similarly, inclusion of acquisition premiums are typically excluded in federally regulated wholesale rates.

31 Are there any restrictions on the acquisition of shares in gas utilities? Do any corporate governance regulations or rules regarding the transfer of assets apply to gas utilities?

With the repeal in 2005 of the Public Utility Holding Company Act of 1935, federal laws no longer prohibit specific entities from owning a gas utility company or require registration with the SEC. However, acquisitions of assets that have been dedicated to use by public utilities are often subject to review and approval by the state commission with jurisdiction.

International

32 Are there any special requirements or limitations on foreign companies acquiring interests in any part of the natural gas sector?

In general, there are no special requirements or limitations on foreign companies acquiring interests in the US natural gas sector; however, foreign ownership of US natural gas assets may be subject to disclosure and review under some circumstances.

There are disclosure of ownership requirements in connection with applications to FERC for a certificate or for authorisation to transfer of certain facilities that are subject to FERC regulation.

The Committee on Foreign Investment in the United States (CFIUS) reviews transactions that could result in control of a US business by a foreign person or entity to determine the effect of such transactions on the national security of the United States. Companies proposing to be involved in an acquisition by a foreign firm are supposed to voluntarily notify CFIUS of proposed or pending transactions, but CFIUS can review transactions that are not voluntarily submitted. If CFIUS finds that a covered transaction presents national security risks and that other provisions of law do not provide adequate authority to address the risks, then CFIUS may enter into an agreement with, or impose conditions on, parties to mitigate such risks, or may refer the case to the President for action, including blocking the investment.

In 2012, the SEC adopted disclosure rules for resource extraction issuers (ie, oil, natural gas and mining companies that file annual reports with the SEC); however, the rules were vacated by a US District Court citing numerous errors committed by the agency in crafting the rules. Under this rule, disclosure would have been required for payments made to the US government and foreign governments for the purpose of the commercial development of oil, natural gas or minerals. Payments made in connection with ancillary or preparatory activities to commercial development, such as payments in connection with mining and oilfield service and equipment companies, were not covered by the rule, nor were transportation activities (such as natural gas transmission pipeline operations). However, payments with respect to post-extraction field processing of natural gas to

Update and trends

Federal government policy and regulation

During the first part of 2014, high oil prices proved a greater constraint on activities in the natural gas sector than any regulatory developments. Higher returns in oil caused some investment to be redirected away from natural gas production. Now, with oil prices falling, investments are shifting once again. All of this takes place at a faster pace than regulatory developments.

EPA regulations for new and existing power plants, though not yet finalised, are having a significant impact on the electric generation sector, with derivative effects on the natural gas sector as natural gas-fired combined-cycle combustion turbine generators displace less efficient and more polluting generation resources. The EPA is also poised to issue a strategy on achieving reductions in methane emissions. This was expected during the autumn of 2014, but was pushed back so that the agency could consider numerous issues related to what might become additional regulations on the production, transportation and refining of oil and gas. In an announcement in early January 2015, the EPA announced plans to propose regulations in the summer of 2015 that will cut methane emissions in oil and gas operations by up to 45 per cent from 2012 levels by 2025. Heavy industry pushback is expected, as emissions have already dropped by approximately 10 to 12 per cent from 2011 levels by some reports.

LNG exports

DOE revised its process for reviewing and approving applications to export US LNG. Rather than reviewing applications in the order received and issuing conditional authorisations irrespective of an applicant's progress with other regulators, DOE will now issue only final determinations once an applicant has obtained FERC authorisation to construct and operate an export facility. This process is expected to go further towards ensuring that export authorisations are granted to applicants with a reasonable likelihood of obtaining financing and actually constructing an export facility.

State regulation

On the state front, this year New York issued a ban on high volume hydraulic fracturing after several years of a moratorium while state environmental and health authorities studied the impact of the practice. Ballot measures to ban the practice failed in other states. In addition, the relationship between local authorities to ban or regulate oil and gas drilling activities and state statutes governing oil and gas production are being decided in court actions and in legislative deals in a number of states.

remove chemical impurities from the gas and ready the gas for entry into the transportation pipeline would have been included. For covered activities conducted in the US, only payments to the federal government were required to be reported. Payments to states, counties or other sub-national governments within the United States, were excluded from the reporting. A company that is at least majority-owned by a foreign government would fall within the definition of a foreign government. It is expected that the agency will initiate a new rulemaking to reissue the rules.

The Mineral Lands Leasing Act prohibits direct foreign ownership of mineral leases on federal lands. Formation of a US corporation to make the acquisition will usually suffice to meet the statutory requirement. Alternatively, a foreign entity can enter into a purchase agreement for the gas rather than taking direct ownership interest in the infrastructure.

An acquired US company may need to obtain a licence from the Department of Commerce to export technology. Defence-related technologies used in energy projects may be subject to this requirement.

Restrictions on foreign investment are a matter of federal law since, under the US Constitution, states may not discriminate against foreign commerce.

33 To what extent is regulatory policy affected by treaties or other multinational agreements?

The US incorporates its treaty obligations into its policies, laws and regulations. In the natural gas sector, certain free trade agreements affect imports and exports of natural gas. The North American Free Trade Agreement allows for tax-free imports of gas between the three treaty parties (the US,

Canada and Mexico). The extent to which other free trade agreements (FTAs) between the US and other countries calls for national treatment in the trade of natural gas will affect the decision process of the DOE when evaluating requests for export authorisation.

Obligations arising from US participation in international environmental treaties may also affect the natural gas industry. These obligations will be incorporated into the relevant laws and regulations that are enforced by environmental, health and safety, wildlife, and other federal and state agencies, and will be taken into account in the context of reviews conducted, for example, in connection with a permit or certificate to construct or operate a natural gas facility.

34 What rules apply to cross-border sales or deliveries of natural gas?

Imports or exports of natural gas to and from the US require authorisation by the DOE. Imports of LNG into the US are subject to US Coast Guard and US customs regulations. Additionally, as described above, ships carrying LNG are subject to US maritime anti-terrorist regulations and other security requirements.

Exports of natural gas must be approved by the DOE. The DOE will approve an export application if the exportation in question is found to be consistent with the public interest. If the US has entered into an FTA that requires national treatment in the trade of natural gas, then the export is deemed to be in the public interest, and review of a request for export authorisation is relatively perfunctory. The US currently has FTAs with provisions calling for national treatment in trade in gas with 18 countries:



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Australia, Bahrain, Canada, Chile, Colombia, Dominican Republic, El Salvador, Guatemala, Honduras, Jordan, Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru and Singapore. The US also has FTAs with Costa Rica and Israel, although these two agreements do not require national treatment for the trade of natural gas, and it is untested whether LNG exports to these countries would be deemed consistent with the public interest. A handful of other trade agreements have been signed but not yet implemented, and the US is in negotiations for a regional Asia-Pacific trade agreement. To the extent that these FTAs require or would require national treatment for the trade of natural gas, it is possible that the DOE would deem exports to these countries consistent with the public interest; however, this, too, is uncertain at present.

A presidential permit is required for construction, connection, operation or maintenance of certain facilities at the borders of the United States with Canada and Mexico. Permits are required for the full range of facilities at the border, including land crossings, bridges, pipelines, tunnels, conveyor belts and tramways. This authority applies to all new border crossings and to all substantial modifications of existing crossings at the international border. For natural gas pipelines, the permit application is made to FERC, while applications for most other facilities at the border are reviewed by the Secretary of State working together with other federal agencies, including the DOT, the Department of Homeland Security and the EPA.

Transactions between affiliates

35 What restrictions exist on transactions between a natural gas utility and its affiliates?

FERC requires interstate natural gas pipelines with affiliates that engage in gas marketing functions to comply with FERC's standards of conduct rules. These rules are designed to ensure that pipelines treat all customers, affiliated and non-affiliated, on a non-discriminatory basis with respect to the transportation of natural gas in interstate commerce, but also ensure that the reliability and integrity of transportation systems are not compromised.

To achieve that purpose, the standards of conduct rules fall under three main categories:

- independent functioning, which requires a pipeline's employees handling gas transportation and employees engaging in marketing and sales functions to operate separately and independently;
- the no-conduit rule, which generally bars the disclosure of non-public transportation function information between transportation function and marketing function employees; and
- transparency, which requires pipelines to publicly post transportation information to make it possible for FERC and customers to monitor for discrimination or preference in favour of a pipeline's affiliates.

36 Who enforces the affiliate restrictions and what are the sanctions for non-compliance?

FERC enforces its regulations regarding affiliate restrictions, and may impose sanctions for non-compliance, including restrictions or revocation of a pipeline's authority to operate. FERC also has the authority to impose civil monetary penalties.

Getting the Deal Through

Acquisition Finance	Dispute Resolution	Life Sciences	Real Estate
Advertising & Marketing	Domains & Domain Names	Mediation	Restructuring & Insolvency
Air Transport	Dominance	Merger Control	Right of Publicity
Anti-Corruption Regulation	e-Commerce	Mergers & Acquisitions	Securities Finance
Anti-Money Laundering	Electricity Regulation	Mining	Securities Litigation
Arbitration	Enforcement of Foreign Judgments	Oil Regulation	Ship Finance
Asset Recovery	Environment	Outsourcing	Shipbuilding
Aviation Finance & Leasing	Foreign Investment Review	Patents	Shipping
Banking Regulation	Franchise	Pensions & Retirement Plans	State Aid
Cartel Regulation	Gas Regulation	Pharmaceutical Antitrust	Tax Controversy
Climate Regulation	Government Investigations	Private Antitrust Litigation	Tax on Inbound Investment
Construction	Insurance & Reinsurance	Private Client	Telecoms & Media
Copyright	Insurance Litigation	Private Equity	Trade & Customs
Corporate Governance	Intellectual Property & Antitrust	Product Liability	Trademarks
Corporate Immigration	Investment Treaty Arbitration	Product Recall	Transfer Pricing
Cybersecurity	Islamic Finance & Markets	Project Finance	Vertical Agreements
Data Protection & Privacy	Labour & Employment	Public-Private Partnerships	
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