

# LNG Development and Financing in the US – Market Update

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Recent growth in domestic natural gas production, together with expectations of continued growth, has positioned the U.S. to be a significant gas exporter for the foreseeable future. The timing of this shift for the U.S. is opportune, as global appetite for liquefied natural gas (LNG) is on the rise. This environment has resulted in significant investment in new liquefaction facilities that convert natural gas to shippable LNG, as well as plans for future investment in additional such projects. Domestic developers currently have ample opportunities to raise capital for their projects, and we envision that those opportunities will continue to exist in the near term.

## Natural Gas and LNG in the US

Natural gas production in the U.S. has increased dramatically in the past decade, primarily as a result of significant — and successful — investment in shale gas extraction. The U.S. is currently the world's largest natural gas producer, with production forecasted to average 73.5 Bcf/d in 2017, up approximately 40 percent from an average 52.78 Bcf/d in 2007, according to the Energy Information Administration's (EIA) "[Short-Term Energy Outlook](#)," released on August 8, 2017. A consequence of this expansion in production is a dramatic reduction in the price of natural gas, from an average of approximately \$7/MMBtu in 2007 to a forecasted average of approximately \$3/MMBtu in 2017. The increased supply and reduced price of natural gas have led to increased reliance on natural gas-fired generation in the U.S., as well as efforts to monetize the abundant supply through liquefaction and export.

Natural gas liquefaction and exportation from the U.S. is essentially a new industry and is a consequence of the aforementioned increased supply and reduction in price. Prior to the development of Cheniere Energy's Sabine Pass LNG export terminal in Louisiana — which commenced operations in 2016 — no LNG export terminal had been built in the U.S. since ConocoPhillips' Kenai LNG export project in Alaska in 1969. Sabine Pass now has three liquefaction trains (*i.e.*, facilities that convert natural gas to LNG) in operation, with the fourth undergoing commissioning. Another six LNG export terminals are under construction, and there are more than 20 LNG export projects under varying stages of preconstruction development. The growth has been explosive and promises to continue for at least the next several years.

## Raising Capital for LNG Projects

The development of LNG projects requires intensive capital investment, and developers are seeking it from a variety of debt and equity sources throughout the life cycle of projects. Sources of capital include (i) equity raised in the capital markets, (ii) private equity investment and (iii) debt financing from a variety of credit providers and at various levels of the capital structure. Given the massive costs and risks associated with developing and constructing an LNG export project, developers often use a combination of some or all of these sources.

Developers often seek co-investment relatively early in the development process. For instance, NextDecade, which is developing the Rio Grande LNG project in Texas, was significantly funded by private equity from the outset and merged with a publicly traded special purpose acquisition company to raise cash from the public markets before owning any operating assets. More typically, developers have sold interests in their projects to private equity and similar investors during development but attempted to retain control of the project. Examples include Kinder Morgan's sale of 49 percent of its Elba Island project to funds managed by EIG, Blackstone's early-stage investment in Cheniere's Sabine Pass project and EIG's investment in Cheniere's Corpus Christi project.

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In addition to reducing the developer's exposure to the project, a key benefit of forming a joint venture at an early stage with an experienced, reputable equity investor is that it can give the project more credibility. This is particularly true in early-stage projects competing in a crowded field for off-take arrangements (*i.e.*, contracts for the sale of LNG) that are critical to raising debt financing for the project. As global LNG supply has grown, global LNG demand has increased in part through the arrival of new entrants to the market, not all of whom have favorable credit. These entrants also are finding themselves in a market that offers an ever-increasing number of suppliers. One consequence of supply and demand growth seems to be that competition among LNG exporters for financeable off-take arrangements is increasing and, accordingly, the intangible benefit of bringing in a strong co-investor — even if earlier than a developer might like — to get an edge in procuring the best off-take arrangements is valued highly.

Co-investment comes with conditions, as co-investors will insist on project oversight and protections, particularly while the project is in development and risk is greatest. Co-investors also expect to be compensated for taking early-stage development risk. Appropriately balancing the tension between spreading equity risk and gaining credibility, on the one hand, and the investor's desire for premium compensation and control, on the other, is an exercise we see developers and investors continuing to refine as additional projects move forward.

Debt financing also has been readily available for well-structured LNG projects, albeit typically not until the project is at least ready to commence construction. Given the capital requirements

of an LNG export project, debt financing is often spread among commercial banks, export credit agencies and the bond market, with no particular source having the appetite to fund an entire project. Critical to raising debt financing is for repayment to be supported by suitable off-take arrangements, as noted above. Provided that projects are able to procure such arrangements, we envision the market for debt financing and refinancing of LNG export projects continuing to be active for years to come.

## The Future

In its August 9, 2017, “[Today in Energy](#)” report, the EIA forecasted that the U.S. will have the third-largest LNG export capacity in the world after Australia and Qatar by 2020. Additionally, the International Energy Agency forecasted in a [July 2017 report](#) that the U.S. will be well on its way to challenging Australia and Qatar for global leadership among LNG exporters by the end of 2022. Over this relatively short term, the odds seem good that growth in the U.S. LNG export industry will remain strong. Longer term, the availability of financeable off-take arrangements with creditworthy buyers likely will dictate the success of the projects being built today and whether more will be built in the future. These arrangements are essential to attracting capital at all stages of a project's life cycle, and projects that are successful in procuring these arrangements should have ample capital available to them.

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