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LNG in Chile: The 10th anniversary of Chile's natural gas crisis and the continued operation of LNG terminals

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I. LNG in Chile

Approximately ninety percent of Chile's natural gas is imported¹. Currently, the majority of the natural gas imported to Chile is liquefied natural gas (LNG), delivered to the country's only two LNG terminals. Most LNG imported to Chile comes from Trinidad and Tobago, Qatar and Yemen².

Chile's LNG imports are a recent phenomenon, caused by the so-called "gas crisis". Prior to the development of the two LNG terminals in Chile, the country imported natural gas from Argentina. The first imports of natural gas from Argentina to Chile began in 1997, after Chile and Argentina executed an international treaty called "Gas Integration Protocol". The execution of the treaty was expected to satisfy at least eighty-two³ per cent of Chile's natural gas consumption. Major investments in infrastructure were made in the 90's to transport the natural gas into Chilean territory, including four trans-Andean pipelines strategically placed across the Argentinean-Chilean border. Chile made political and economic commitments in good faith to welcome the Argentinean gas supply to Chilean territory. Unfortunately, for the reasons detailed below, that supply was interrupted.

¹ Audio visual material posted on Latin America & Caribbean Program of Energy, Environment & Sustainability of University of Texas at Austin web site, available at : <http://www.jsq.utexas.edu/lacp/outreach-events/chile-energy-sector-opportunities-industry-roundtable/>

² U.S. Energy Administration, available at <http://www.eia.gov/countries/country-data.cfm?fips=CI>

³ Nunez F. and Munoz U: Country Brief-Chile [2008] I.E.L.R., Thomson Reuters, available at http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CCEQFjAA&url=http%3A%2F%2Fwww.nam.cl%2Fassets%2F08IELR06Pressfinal.pdf&ei=JcrqU-n3A9WcygTdyoCgAg&usq=AFQjCNE6nzmX1JZfY4XJnWT_ESEIzvEI3A&sig2=pj3IHn2y0S3QHfAMkv54RA&bvm=bv.72938740,d.aWw

In 2001, only a few years after Chile's first import of natural gas from Argentina, the Argentinean Republic faced an economic crisis which led its government to freeze the gas tariffs. As a result of the tariff restriction, the Argentinean natural gas industry suffered from investment disincentives, leading to a shortfall in the exports of natural gas to Chile. Additionally, in 2004, natural gas volumes intended to be exported from Argentina, some of which were destined to be imported to Chile, were reassigned to the domestic market.

Due to the restrictions imposed on the natural gas industry by the Argentinian government, Chile developed two LNG terminals, LNG Quintero and LNG Mejillones. LNG Quintero is the first of its kind in South America and has been supplying for the natural gas needs of Central Chile since 2009. LNG Mejillones started its operations in 2010 and mostly supplies natural gas for the energy needs of the mining industry in Northern Chile. The LNG terminals have unequivocally been the greatest progress of the natural gas industry in Chile; a valuable legacy provided by the undermine Gas Integration Protocol. So far, LNG plants have proven to be a secure and reliable source of natural gas in the Chilean energy sector. The LNG business has very strong projections in Chile due to the development of shale gas in developed markets and Chile's need to increase its energy supply.

II. LNG terminals in Chile

a) Models

LNG Quintero is owned by the national oil company Empresa Nacional del Petroleo ("ENAP") (20 percent), Endesa Chile (20 percent), Metrogas (20 per cent) and the joint companies Enagás-Omán Oil (40 per cent). LNG Quintero's operations are based on a "merchant model", where the terminal company purchases LNG and then markets the regasified gas to customers. Under this model, the terminal owners hold title to the LNG until it is sold and delivered to the terminal's customers in accordance with long-term gas supply agreements (GSA), which support the terminal's financing. Normally long-term GSAs include take or pay provisions. Currently, British Gas is the sole supplier of LNG to LNG Quintero.

LNG Mejillones is owned by Codelco (37 percent), a Chilean state company and the largest copper producer in the world, and GDF Suez (63 per cent). LNG Mejillones is currently operating under a "tolling model", where the company owning and operating the terminal provides regasification services of LNG (or "tolls" LNG) for shippers in return for a fee known as the "regasification fee". These regasification services are provided on a take or pay basis under a tolling agreement entered into between the company owning and operating the terminal and the shipper. Under this model, shippers, on a separate and independent basis, enter into their own agreements for the purchase of LNG (LNG sales and purchase agreements or SPAs) and the sale of regasified gas to customers (GSAs). Therefore, the company owning and operating the terminal does not purchase the LNG, avoiding assuming

the risk of LNG prices variations. Moreover, title to the LNG and regasified natural gas at all times remains with the relevant shipper.

b) Open access

In Chile, only gas transportation is subject to open access rules⁴. Nevertheless, there have been discussion about the limits of third party access to the LNG Quintero terminal. Third parties have argued that they have a right to access the terminal because it is an essential facility. The terminal owners have counter argued that LNG Quintero is a private project with considerable investment and plans to engage potential clients as long as regasification and storage capacity is available.

Unlike LNG Quintero, LNG Mejillones took steps to open the terminal to third parties in a sort of voluntary open access regimen. Under this schema, LNG Mejillones provides regasification and storage services to any interested party, as long as the interested party finds the supply of LNG.

c) Pricing

In the LNG market of Chile there are no specific rules for pricing. Therefore, the pricing for LNG sales or purchases, and LNG regasification and storage services is subject to the negotiation of the parties. However, in the recent months the government has publicly announced that LNG market is under current study, with special consideration being given to facility access and pricing of services. The study's purpose is to incentivize competition among the relevant players in the LNG market.

d) Permits

In terms of the safety regulations for LNG facilities, in 2007, the Chilean state enacted the Supreme Decree 277 (DS 277), which contains the requirements for the design, construction, operation, maintenance and decommissioning of LNG facilities. The DS 277 standards are similar to the U.S. NFPA 59A-2006 standard. The Superintendence of Energy (SEC) of Chile, is the agency legally entitled to ensure that entities comply with this security norm.

Additionally, the construction of LNG plants in Chile require a favorable environmental impact assessment in accordance with the Chilean Environmental Assessment Law (Law 19,300). The procedure established in Law 19,300 to approve LNG facilities is similar to the environmental assessment procedure provided by the United States's National Environmental Policy Act of 1969.

In addition to these highlighted permits, other permits are required, such as zoning approvals from the competent municipality.

III. Potential projects and imports

⁴ Open access rules are defined in Regulation DS No.263.

Currently, the natural gas supplied by LNG plants in Chile account for fifteen per cent of national consumption. However, Chile's Ministry of Energy recently announced government policies that look to promote LNG and natural gas. The government is aiming to increase LNG/natural gas national consumption to approximately thirty-five percent.

In an effort to achieve the targeted level of consumption, in June 2014, almost ten years after the first cut-off of natural gas import to Chile from Argentina, the U.S. Department of Energy and the Chilean Ministry of Energy agreed to sign a Joint Statement on Enhanced Energy Cooperation. The statement will promote oil and gas development between the two countries.

Additionally, in July 2014, the Minister of Energy publicly announced that ENAP signed a long-term contract with British Gas to import shale gas from the United States in the form of LNG starting as early as 2016. The LNG would be provided from the Sabine Pass terminal located in Louisiana. Since Chile has entered into free trade agreement with the United States, the LNG will be imported to Chile without tariffs.

Recently, the current president of Chile, Michelle Bachelet, announced that the Chilean government is backing plans to construct a third LNG import terminal in the central-south region of Chile. This announcement aligns with the new energy plan for Chile launched by the Ministry of Energy in May 2014. The project includes a floating storage unit. Hoegh, Colbún and AES Gener are moving the project forward. Cheniere Energy Inc. has also hinted at another potential LNG project in Chile.



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