

# KIRKLAND & ELLIS

Blog Post

## 2020 Outlook for U.S. LNG Projects

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In 2010, Cheniere Energy Inc. proposed the first LNG liquefaction project on the U.S. Gulf Coast. In the ensuing decade, a fundamental revolution in U.S. gas production – driven primarily by new drilling and gas recovery technologies – upended the domestic and world energy economy and drove tens of billions of dollars of investment in U.S. LNG liquefaction infrastructure. In just 10 years, U.S. liquefaction capacity has gone from nearly nothing to consuming 7.68 Bcf/d of feedstock in December 2019, which is set to increase to 8.8 Bcf/d once a final round of nearly completed facilities reach substantial completion early this year. On January 27, 2020, Cheniere delivered its 1,000th LNG cargo in just four years of commercial operation between its two liquefaction facilities. Global demand for LNG continues to grow, with McKinsey predicting 3.6% annual growth through 2035 and the U.S. Energy Information Administration anticipating a more-than 100% increase in current U.S. LNG exports by 2025.

Looking ahead into 2020, we identify three prominent trends to watch in the industry: (i) completion of a “second wave” of U.S. liquefaction projects and final investment decisions on future projects, (ii) continued maturation of a global LNG market and its effects on the sale and marketing of LNG and (iii) increased M&A activity in the LNG sector.

### Second Wave U.S. LNG

Market observers discuss a “first wave” of liquefaction projects that were financed and began construction in the middle of the past decade and have achieved (or will shortly achieve) commercial operation. This first wave includes projects developed by Freeport LNG, Cheniere Energy, Cameron LNG (a joint venture among Sempra LNG, Mitsui & Co., Mitsubishi Corporation, Total and NYK Line), Kinder Morgan and Dominion Energy. With over \$60 billion in combined capital investment, this first wave set the stage for the U.S. market’s second decade of LNG exports.

We see a “second wave” of expansions and new projects being financed and beginning construction this year, with completion targeted for 2022–2025. The first portion of these second wave projects includes major expansions to existing facilities, including additional liquefaction trains at Cheniere’s Corpus Christi and Sabine Pass facilities, as well as Venture Global’s new construction Calcasieu Pass project. Golden Pass, a joint venture of ExxonMobil and Qatar Petroleum, achieved financial close early last year and is currently targeting commercial operation by 2024.

2020 will also provide clarity on the development of liquefaction capacity in the second half the coming decade, as developers make final investment decisions with respect to a large number of proposed projects. Among those projects that have received FERC approvals and continue to seek financing arrangements are Freeport LNG Train 4, Cameron LNG Phase 2 (including two additional trains), Sempra’s Energia Costa Azul and Port Arthur, Venture Global’s Plaquemines, Tellurian’s Driftwood LNG, Annova LNG’s Brownsville and NextDecade’s Rio Grande. Other projects – such as Jordan Cove, Alaska LNG and Commonwealth LNG, among others – have FERC applications pending.

As the U.S. LNG industry matures, we see potential emerging opportunities for alternatives to the Gulf Coast mega-projects. Elba Island, a first wave project, is notable both for its relatively small capacity and also its location on the mid-Atlantic coast. New Fortress Energy is taking an entirely different tack, with a proposal to build smaller-scale liquefaction capacity inland near Marcellus wellheads and ship LNG to a Delaware River port by tanker truck. In addition, JAX LNG operates, and Eagle LNG is developing, small-scale LNG bunkering facilities near Jacksonville, Florida, that provide LNG directly to ships for fuel.

## Maturing Global LNG Market

In 2018, nearly 25% of LNG imports worldwide were purchased on the spot market, rather than under long-term, fixed-price offtake agreements. Combined with a de-linking of gas prices to oil indices, a slow but steady revolution in the global LNG trade has taken hold. As an independent LNG market with pricing reflecting its own fundamentals grows, a burgeoning LNG derivatives trade is evolving alongside it. In the first quarter of 2019, JKM futures contracts – the most widely traded LNG derivative – traded at volumes 376% higher than the previous year.

With the flexibility provided by a deep and liquid market for both physical LNG and

contracts to hedge LNG prices, the market may see new models of LNG offtake agreements. As developers struggled in 2019 to find long-term, investment-grade offtakers similar to the offtake arrangements on which the first wave liquefaction projects were financed, the market continues to look for lenders with an increased tolerance for alternative purchasers – trading houses or other sub-investment grade entities, perhaps with limited credit enhancement. While we haven't yet heard a definite answer from credit markets, one recent example of this potential trend is Cheniere's financing of Train 3 of its Corpus Christi project, which achieved financial close in mid-2019. Over two-thirds of the contracted liquefaction capacity of Train 3 were sold to unrated offtakers (Trafigura, a trading house, and PetroChina, a division of the state owned Chinese National Petroleum Corporation).

## M&A Activity

With the continuing maturation of the U.S. LNG market, we see the potential for increased M&A activity. One recent transaction may signal the beginning of this trend: In October 2019, Brookfield Super-Core Infrastructure Partners acquired a 25% equity interest in Dominion Energy's Cove Point project for approximately \$2 billion.

There are a number of factors that could drive M&A activity in LNG. After a post-commercial operation shakedown of market participants, successful operators will solidify their market positions, while less efficient operators will become prime acquisition targets. In addition, as U.S. liquefaction continues to demonstrate its long-term viability, an increased universe of investors is poised to deploy capital aimed at LNG assets. While energy private equity funds were a regular source of equity and mezzanine financing for first wave projects, opportunity exists for construction phase and operating projects to sell upstream equity to financial investors looking for attractive risk-adjusted returns. With infrastructure funds holding an estimated \$200 billion of dry powder, we expect there to be meaningful demand for these assets.

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