

PRODUCERS

# Bad Call

*The conventional wisdom said that the U.S. would soon become a big importer of natural gas. The conventional wisdom blew it.*

By Russell Gold

**I**N THE SUMMER of 2003, former Federal Reserve Chairman Alan Greenspan appeared before a congressional committee to share his thoughts about the U.S. natural-gas market. It might have been better for the industry, and some investors, had he kept those views to himself.

Recent price spikes, Mr. Greenspan said, were the result of increased demand chasing limited U.S. supplies. Natural gas heats about half of U.S. homes and generates 20% of the nation's electricity.

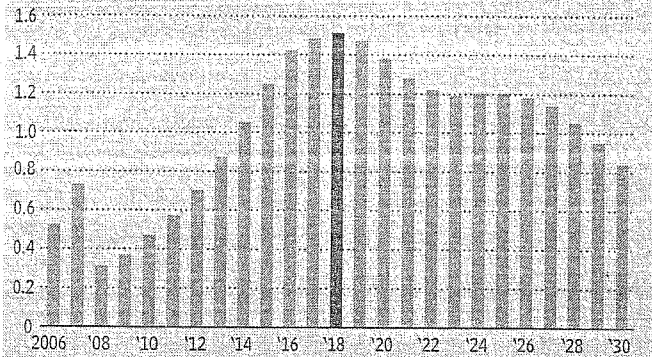
To stabilize the market, Mr. Greenspan said, the U.S. needed to become a major importer of liquefied natural gas, or LNG. Moreover, he added, "Access to world natural-gas supplies will require a major expansion of LNG terminal import capacity." New facilities would have to be built in the U.S. to handle the expected surge in imports.

Mr. Greenspan and the industry experts who shared this view—and there were many—couldn't have been more wrong. But within a year of his testimony, there were plans for 40 new or expanded LNG terminals under consideration in North America, according to a tally by the Federal Energy Regulatory Commission. By March 2005, the list had grown to 55.

Today only six have been built, and most of those sit idle. Weeks pass between visits from a tanker full of frosty LNG. Even before the economic slowdown, it was clear the nation had ample natural-gas supplies. Large-

## Headed Down

U.S. imports of LNG are expected to peak in 2018 (Figures are in trillions of cubic feet)



Source: U.S. Energy Information Administration's Annual Energy Outlook

scale imports simply weren't needed. And new reports suggest the U.S. won't need to turn into a massive importer of natural gas anytime soon.

How did the conventional wisdom get it so wrong?

### Shale Shock

Forecasts can swing abruptly when it comes to figuring out where natural gas is needed and how much. Expectations of future supply can change quickly, too. As this market grows and adjusts, once-lauded business plans can quickly be swept aside.

"There is still a lot of uncharted territory," says Bob Fryklund, vice president of industry relations at energy consulting firm IHS Inc. in Houston. "People are still trying to understand how this market works."

A few years ago, most people looked at U.S. natural-gas production and saw it entering a slow, terminal decline. But in fact, the opposite has happened. Rising prices and easy financing encouraged a horde of companies to develop "unconventional" gas fields such as the Bar-

nett and Haynesville shales, located, respectively, in north Texas and along the Texas-Louisiana border. These shale wells, once thought to be too costly and difficult to exploit, succeeded beyond everyone's expectations.

"We went through a period of high prices that allowed a higher-priced supply to mature enough that costs have come down," says Jen Snyder, head of North American natural-gas research for Edinburgh-based consultant Wood Mackenzie.

The unconventional wells are producing more gas with each passing season—and becoming less expensive to drill. Recently drilled wells in the Haynesville shale are starting off at 24 million cubic feet a day and are profitable even with natural-gas prices as low as \$4 per million British thermal units. "Huge," was the succinct appraisal of the Haynesville shale recently by a BMO Capital Markets energy analyst.

This surge of new gas has lowered domestic prices and reduced the need for imports.

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# LNG

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Meanwhile, companies that bought into the earlier vision of soaring imports and strings of new terminals went from being Wall Street darlings to also rans.

## Cheniere's Play

One of these is Houston-based **Cheniere Energy Inc.** Cheniere Chairman and Chief Executive Charif Souki was an early believer in the future of import terminals. He decided back in 2000 to pursue an aggressive LNG strategy, securing land and permits and building terminals. The plan was to build the entryway for imported gas and charge a fee to anyone who wanted in.

In 2004 and 2005, Cheniere made presentations to Wall Street analysts about how it would build a string of LNG terminals. It held options on land to develop terminals from Alabama all the way down to Brownsville, Texas, on the Mexican border. In some presentations, it used a map that seemed to suggest its terminals would dominate the western half of the Gulf of Mexico.

Investors responded positively to that vision and pushed Cheniere shares, which during 2004 had traded for around \$10, to a high of about \$44 in 2006.

But Cheniere was preparing for an incoming wave of imported LNG that hasn't arrived. It built the Sabine Pass facility, on the waterway straddling the Texas-Louisiana border, large enough to accommodate one LNG tanker a week. Only three arrived from the time the facility opened last April to the end of 2008. Cheniere's plans to build another LNG terminal in Corpus Christi, Texas, meanwhile, are dormant, as are plans for a terminal in Cameron Parish, La.

The company's miscalculation has hammered the stock. Its shares are trading for less than \$5, and the company has struggled with liquidity. Last April, it laid off more than half of its 360 employees in an effort to preserve cash.

"I underestimated price volatility," says Mr. Souki, who adds that he never expected natural-gas prices to rise as quickly as they did from early 2002 to mid-2005—the surge that made it profitable for other companies to tap into domestic supplies such as the Barnett and Haynesville shales.

ron Corp., global energy giants that wanted to ensure access to U.S. gas markets. But Cheniere kept the other half of the import capacity for itself, in hopes of buying spot cargoes and importing the gas itself.

If this flow of LNG does arrive, it will come none too soon for Cheniere, which hasn't turned an annual profit since it first issued stock to the public in 1996. It still owns half of the capacity at Sabine Pass, and unused terminal space doesn't generate revenue. In February 2008, the company needed to borrow to pay off debts and maintain liquidity.

"It was a miserable time to be raising money and a miserable time to be in the LNG business," says Mr. Souki. Accustomed to raising capital for borrowing costs of 7% to 8%, it settled for a \$250 million convertible equity deal in August for which it must pay 12% interest.

The \$250 million is enough to keep Cheniere afloat for another three years, according to the company. By then, Mr. Souki says he expects to have sold half again of the capacity Cheniere has held onto at Sabine Pass. ■■■