

US crude exports and the tanker market

US policy makers are considering allowing domestic crude oil exports, which have been prohibited since 1975. If permitted, US crude exports could have a significant impact on both movements by Jones Act tankers, as well as the international fleet.*

Although US crude oil export restrictions were in place even earlier, the main barrier to crude oil exports is contained in the Energy Policy and Conservation Act of 1975. That Act prohibited crude oil exports except where the President determines it is in the “national interest.”

In contrast, US refined product exports are generally permitted. The Export Administration Act of 1979 granted authority to the US Government to restrict exports of refined products. But these restrictions were lifted in 1981 - except with respect to Naval Petroleum Reserve derived products.

There are current exceptions to the US crude oil export ban. Oil can be exported to Canada, for example, pursuant to a license if it is to be used there, or refined and re-exported to the US. Oil shipped through the Trans-Alaska pipeline (TAPS) can also be exported, but only under certain conditions and most particularly in a US-flag tanker - although the vessels can be constructed outside the US. Certain swaps of oil are also permitted and there are other narrow exceptions.

This 1970’s era policy did not come into focus as an issue until the US shale oil boom began to create a glut of certain types of oil

and in certain regions. The discount between oil sold at the Western Texas Intermediate (WTI) price and the international Brent price in particular has spurred examination of ways around the ban and consideration of changing, or eliminating the ban entirely.

Much of the technical focus on the ban has been on the regulatory definition of ‘crude oil.’ As defined by the US Commerce Department, crude oil is “a mixture of hydrocarbons that existed in liquid phase in underground reservoirs and remains liquid at atmospheric pressure . . . which has not been processed through a crude oil distillation tower.”

One thing that has caused consternation is that lease condensate, a very light hydrocarbon liquid, is defined as ‘crude oil’ by the US regulations – and so cannot be exported except in the case of an exception. But, as soon as condensate is processed through a crude oil distillation tower and meets a number of other factors, such as whether the process materially transforms the crude oil, then it is not ‘crude oil’ and can be exported.

The US Commerce Department issued a widely publicised ‘frequently asked questions’ on 30th December, 2014 to help, but the range of factors listed for determining whether lease

condensate is no longer ‘crude oil’ may only have confused matters further. There has been understandable confusion particularly since individual rulings indicating what is and what is not exportable lease condensate have not been made publicly available.

Refinery boon

The current ban has been a boon to the US refineries, which have been able to replace foreign sources of crude oil with cheaper domestic crude even taking into account pipeline, railroad, storage and tanker bottlenecks.

The ban has also been a boon to the US tanker market, as crude oil produced domestically has to be moved in the US – whether overland by pipeline, truck and rail, or seaways, by tank barges, or deepsea tankers. The Jones Act restricts the movement of any ‘merchandise,’ including crude oil and refined petroleum products, from one point to another point in the US to domestically-built, US-flag, US citizen owned and operated vessels.

There have been reports of MR-sized Jones Act tankers commanding rates as high as \$120,000 per day for a year’s timecharter by major oil companies. Although there are



The US flag, OSG-managed Jones Act MR *Overseas Chinook* has been converted into a shuttle tanker.

Photo credit - OSG.

currently a number of MR Jones Act tankers on order, these rates appear likely to remain strong.

Much of the US domestically-sourced crude has been exported as refined petroleum products, which has provided a freight rate bottom for the international MR tanker market in the Atlantic basin. However, given the level of tonnage oversupply in the international tanker market, the benefit of increased petroleum exports has not been as pronounced on the foreign-flagged tankers as on the Jones Act vessels. Overseas flagged MRs have been earning on average less than \$20,000 per day in the international tanker market.

The high Jones Act tanker rates has led to some thinking about offshore refining, or blending. Under US Customs and Border Protection rules and precedents, merchandise which leaves the US and is converted into a 'new and different' product onshore can be shipped to the foreign destination and back in non-Jones Act vessels. It has been well known since at least the 1970s that US origin crude oil could be shipped to an overseas refinery and refined into gasoline and other products without Jones Act implications.

In the spring of 2014, US Customs issued a ruling indicating that offshore blending without any refining converted the US source components into a 'new and different' product. Since then, US Customs has been reluctant to provide further specific guidance on what onshore changes must occur for blending to result in a 'new and different' product, thus leaving the issue muddled.

Not being enamoured of getting a discount to the international price of crude oil, many US upstream producers of oil have begun to lobby to lift the ban on crude oil. Although the ban can arguably be lifted by the Obama Administration under existing authority without any change in the law, the Commerce Department has not shown a desire to make any move in that direction.

So, the focus of activity has shifted to the US Congress. The first Congressional hearing on potential crude oil exports was held on 30th January, 2014 and testimony was taken both for and against relaxing the ban.

US domestic policies will likely hinge on whether the American public can be convinced that retail gasoline prices will benefit, or remain unaffected by the lifting of the crude export ban. If the average consumer becomes convinced that they will pay more when there are crude oil exports with the benefits going largely to US energy companies from such a policy change, then many politicians may turn

against lifting the ban.

During the last 12 months, a number of studies have been released analysing the likely price effects, including several finding that lifting the ban would lead to a modest reduction in US retail gasoline prices. These studies, however, and much of the lead up to the current debate, were undertaken before the worldwide crude oil price plunge.

Perhaps the leading opponent of relaxing the ban is a group of independent US refineries. They have argued that it would be unfair for foreign refineries to be able to purchase US crude at a delivered price lower than the domestic delivered price on the back of the high cost of Jones Act tanker charters. The result has been a coming together of the crude oil export ban with Jones Act reform discussions with some interests arguing that

the ban repeal should go hand-in-hand with a Jones Act repeal, or modification.

Amendments proposed

In the context of the Keystone pipeline legislation considered by the new US Congress, amendments were offered, but not voted on, both to modify the Jones Act (by Sen John McCain) and to repeal the crude oil export ban (by Sen Ted Cruz). Similar efforts can be expected to surface throughout the next two years.

Although the last two US Congresses have famously been unable to accomplish much of anything, the new Republican control of the US Senate when combined with Republican control of the House of Representatives could result in more legislating. This may be the case in the energy area, as both political

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parties appear to have objectives that could be moulded into compromise legislation.

Of particular importance is Sen Lisa Murkowski of Alaska. She is the new Chairwoman of the Senate Energy Committee and has made it clear that eliminating, or reforming a crude oil export ban is one of her top legislative priorities for the 114th US Congress.

The impact of any change in the crude oil export ban is hard to predict. There are several scenario permutations to be considered. Most likely, crude oil exports will occur on international flag tankers, which would likely be a positive development for the international tanker market overall unless some US-flag requirement is attached to the exports. Such a requirement has been proposed by US-flag interests in the context of the US Maritime Administration analysis of a future domestic maritime strategy.

Depending on the location of the buyers, different tanker segments would stand to benefit to varying degrees; Aframax and Suezmax markets will likely benefit the most if European refiners are to replace West Africa and Middle East high quality crude oil imports

with equally high quality US produced crude oil, while the VLCC market will be the greatest beneficiary if China is to be the biggest buyer of US crude.

Lifting the ban on exporting US crude will also benefit the international crude oil tanker market by potentially and paradoxically increasing the US crude oil imports: as WTI oil will be priced for the international oil market (possibly erasing the price discount due to the export ban). US refineries will opt to purchase crude oil grades –whether domestically or internationally – to maximise their refinery margins, which could boost import crude oil volumes, primarily from Venezuela and other producers of hugely discounted heavy and sour crude oil.

The lifting of the export ban may have a negative impact on the Jones Act tanker business in terms of market activity and freight rates, as domestic crude oil reaching (predominantly) the US Gulf Coast by pipeline can be loaded on foreign-flagged vessels and shipped overseas (assuming no US-flag requirement). Even if there is only a partial lifting of the ban, some ‘leaking’ of domestic oil to the international market may have an

impact on the Jones Act tanker trades given the outstanding orderbook and the heavy investments in rail tanker car ordering and pipeline construction.

More attention has been put on the US crude oil export ban in the last six months than probably has occurred in the almost 40 years during which the ban has been in effect. It remains to be seen, however, whether US domestic politics will align with the broad support for lifting the ban and whether there will be a legislative opportunity for the ban to be modified, or lifted.

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