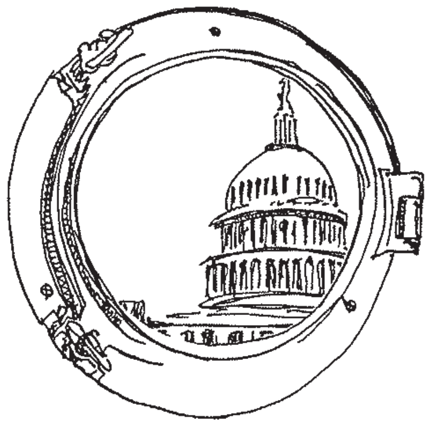
WINDOW ON WASHINGTON



Fracking Maritime Policy

By Bryant E. Gardner

Oil politics in Washington often intersect with maritime policy, and the sea change spurred by hydraulic fracturing ("fracking") technology, horizontal drilling, shale gas, and oil sands development is sure to be an area of developing interest in the coming years. Movements of oil have generated new challenges in the application of the Jones Act cabotage law, and brought new scrutiny to vintage petroleum export control regulations, many of which date back to the 1970s oil embargo and a time of simpler energy markets. In recent months, the debate on the surface has primarily focused upon the Department of Energy ("DOE") Office of Fossil Energy's failure to process applications to export LNG in a timely manner. However, crude export issues are also bubbling up in and around the beltway.

LNG Export

Rising U.S. natural gas reserves and low domestic prices by comparison to other regions have raised the prospect of significant natural gas exports, requiring new liquefied natural gas infrastructure and tankers to get it to market. However, section 3 of the Natural Gas Act ("NGA")[1] prohibits import or export of natural gas, including LNG, without approval from DOE.[2] Under the NGA, DOE approval shall issue unless it finds that the proposed exportation "will not be consistent with the public interest."[3] As a practical matter, export applications for countries with which the U.S. has a free trade agreement are granted as a matter of course, and the NGA provides that such exports are deemed to be consistent with the public interest, requiring that such applications be granted without modification or delay.[4] And still-applicable Reagan-era DOE policy guidance implementing the NGA provides that free market principles and limited government intervention should be the norm with respect to natural gas approvals.[5] Furthermore, there is also the possibility that the Energy Policy

[1] 15 U.S.C. § 717b.

[2] *See also* 10 C.F.R. Part 590.

[3] 15 U.S.C. § 171b(a).

[4] 15 U.S.C. § 171b(c).

[5] Policy Guidelines and Delegation Orders Relating to the Regulation of Imported Natural Gas, 49 Fed. Reg. 6,684 (Feb. 22, 1984).

Conservation Act of 1975 could be used to revoke or modify licenses.[6]

As of this writing, DOE has only cleared four applications, and 21 additional applications pend with DOE for permits to export domestically produced natural gas to non-FTA countries, representing a cumulative capacity of almost 50 percent of current U.S. production.[7] Each of the approved applications took several years to process, and some of the requests have been awaiting approval for almost two years in a first-come, first served queue administered by DOE. These delays have become a source of controversy. On one side are energy interests who want to develop these resources, and their political champions who see new energy exports as a way to stimulate the economy, create jobs, and foster energy security. On the other side are some environmental groups and also a group of energy-intensive domestic manufacturers who maintain that they benefit from a captive energy resource kept below global prices, which in turn helps provide lower cost goods and manufacturing jobs.[8]

In March 2013, a consortium of the major environmental groups, including Sierra Club and Earthjustice, among others, wrote to President Obama urging caution and an "informed assessment" of the environmental impacts of exporting LNG. In so doing, the groups leveraged the economic arguments made by the manufacturers about increased energy prices which will be harmful to the middle class and manufacturers.[9] Moreover, they expressed concern that the export market will lead to more fracking and to increased methane emissions and therefore global warming since the warming effect of methane is 25-times that of carbon dioxide.[10] Similarly, these groups have expressed concern that liquefying and transporting natural gas is an energy-intensive process which itself will generate significant carbon pollution. They challenged the largely pro-development economic assessment produced by DOE's contractor, NERA consulting, as biased and inaccurate, and further called for a full environmental impact statement for LNG export pursuant to the National Environmental Policy Act., which would likely add significant delay.[11]

Congressional support for LNG exports has been mixed, although generally Republican members have viewed it more favorably and Democrats have tended to encourage slowing down the process for more thorough review without actually coming out and opposing the exports. The Subcommittee on Energy Policy, Health Care, and Entitlements, House Committee on Oversight and Government Reform, held a hearing in March to probe DOE's failure to approve the export applications in the face of statutory standards requiring approval absent adverse public interest findings.[12] Opening the hearing, Subcommittee Chairman Jim Lankford (R-OK), expressed concern with the delay, noting that there is a limited demand window, and that the Department's delays risk depriving applicants of the opportunity to participate in the market.

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[6] Pub. L. No. 94-163, § 103, 89 Stat. 871, 877(1975), codified as amended at 42 U.S.C. §§ 6201 *et seq*. *See also* section 7 of the Export Administration Act of 1979, Pub. L. No. 96-72, 93 Stat. 503 (1979), codified as amended through Pub. L. No. 112-120, 126 Stat. 343 (2012), at 50 U.S.C. §§ 2401 *et seq.* (providing broad powers to the President to restrict the export of domestically produced crude oil, petroleum products, and certain petroleum products). Although the Export Administration Act expired March 30, 1984, the export controls in effect under that Act were maintained pursuant to a declaration of national emergency by the President under the International Emergency Economic Powers Act found in 50 U.S.C. §§ 1701 *et seq*. Pub. L. No. 94-163, n.1, 89 Stat. 871 (1975).

[7] Department of Energy, Office of Fossil Energy, Summary of LNG Export Applications (Aug. 7, 2013), *available at* http://energy.gov/sites/prod/files/2013/08/f2/Summary_of_Export_Applications.pdf (Dominion Cove Point LNG, LP permission granted September 11, 2013); Michael Ratner et al., U.S. Cong. Research Serv., R42074, U.S. Natural Gas Exports: New Opportunities, Uncertain Outcomes (2013).

[8] *See, e.g.*, Lake Charles Exports LLC, DOE/FE Order No. 3324, Order Conditionally Granting Long-Term Multi-Contract Authorization to Export Liquefied Natural Gas By Vessel From The Lake Charles Terminal To Non-Free Trade Agreement Nations, (Aug. 7, 2013), *available at* http://energy.gov/fe/downloads/fe-docket-no-11-59-lng.

[9] Letter from Center for Int'l Environmental Law et al. to President Obama, Mar. 11, 2013, *available at* http://www.ciel.org/Publications/LNG_Letter_Mar2013.pdf.

[10] *See also* U.S. Energy Abundance: Exports and the Changing Global Energy Landscape, Hearing Before the H. Subcomm. on Energy and Power, 113th Cong. (2013) (statement of James Bradbury, Senior Associate Climate and Energy Program, World Resources Institute) (citing the U.S. Environmental Protection Agency for projections that the scale of leaked methane from global natural gas and oil systems will be ten times greater than any carbon dioxide reductions resulting from a future with more abundant natural gas.).

[11] The Keystone XL Pipeline, which would bring Bakken crude down to the U.S. for refining or export, remains hung-up on environmental impact reviews encompassing over 1.5 million public comments.

[12] The Department of Energy's Strategy for Exporting Liquefied Natural Gas, Hearing Before H. Subcomm. on Energy Policy, Health Care, and Entitlements, 113th Cong. (2013).

More specifically, he cited concern that exporting countries with more efficient bureaucracy will beat U.S. producers to lock-up lucrative import contracts notwithstanding our country's head-start in new production technology. Chairman of the full Committee, Darrell Issa (R-CA) expressed support for LNG exports as an alternative to the hundreds of millions of tons of coal exported to China, and as a means for helping balance the U.S. trade deficit while also helping replace coal with a more environmentally friendly fuel. Ranking member of the full Committee, Elijah Cummings (D-MD), expressed a tentative optimism and interest in further investigating the benefits of LNG export, balanced with concern for domestic manufacturing jobs buoyed by low natural gas costs and the need to ensure environmental concerns are addressed.

During the hearing testimony, the chief opponent to surface in opposition was the Industrial Energy Consumers of America ("IECA"), which represents U.S. manufacturers who claim to consume approximately 40% of all natural gas. Although IECA's position was not to oppose LNG exports, they encouraged slowing down the process for further analysis. And the witness from the Office of Fossil Fuels, DOE, stated that DOE is "committed to moving this process forward as expeditiously as possible," whatever that may mean. Notably, the DOE witness indicated that the "public interest" determination would have to consider the "cumulative impact" of each of the pending applications building up into the queue—suggesting that those who did not arrive first may find themselves blocked from consideration because of the number of facilities already granted export authority. Moreover, the DOE witness asserted the Department's view that it has "considerable latitude" under the statute to determine what is in the public interest.

Then, during an April budget hearing before the Senate Committee on Energy and Natural Resources last Spring, ranking member Sen. Lisa Murkowski (R-AK) questioned these delays. The Administration witness, Deputy Secretary Daniel B. Poneman, pointed to the 200,000 comments they received regarding the requests.[13] Senator Barrasso (R-WY), also expressed concern that investors in capital-intensive LNG infrastructure would interpret the Administration's ongoing delays as a decision against LNG exports, undermining an important opportunity to shore-up energy security and much-needed employment for middle class families.

Rep. Ted. Poe (R-TX), Chairman of the Subcommittee on Terrorism, Nonproliferation, and Trade, House Committee on Foreign Affairs, also held a hearing on LNG exports in April. Not surprisingly, Rep. Poe took the opportunity to bash the Administration for its delay, citing to the lost jobs and economic opportunities for one project which would purportedly create 30,000 jobs and add $10 billion to the economy if DOE would only give it the green light. He also noted that U.S. allies, especially those in Eastern Europe and India, would benefit enormously from cost-effective, reliable U.S. gas imports, and even suggested that without U.S. gas, India might have to tap into the Iran-Pakistan gas pipeline. In other words, he suggested that the U.S. would no longer be beholden to states such as Russia, Venezuela, and the Middle East for its energy needs, but may be able to stand upon its own two feet and even assist allies in escaping the grip of countries which may not always have interests aligned with our own. Finally, he pointed out that restricting exports may run afoul of World Trade Organization rules—a point supported by the witness from the Congressional Research Service.

Although Rep. Kinzinger (R-IL) generally supported the Chairman's statements, he also expressed a note of caution that exports not be permitted to sap the nascent resurgence of American manufacturing in the heartland. Several witnesses, including one from NERA, expressed a real sense of urgency to get into limited demand markets, most notably Japan and Korea, before they enter into long-term contracts with other suppliers, or before additional LNG supplies come on line and further depress the global export price.

The House Subcommittee on Energy and Power, Subcommittee on Energy and Commerce, also held hearings last May to examine the changing landscape caused by new domestic hydrocarbon energy sources.[14] Although the members, including full Committee Chairman Fred Upton (R-MI) and Subcommittee Chairman Ed Whitfield (R-KY), generally expressed optimism regarding increased LNG and other energy exports for its economic and geopolitical benefits,

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13 Department of Energy Fiscal Year 2014 Budget, Hearing Before S. Comm. on Energy and Natural Resources, 113th Cong. (2013).

14 U.S. Energy Abundance: Exports and the Changing Global Energy Landscape, Hearing Before the H. Subcomm. on Energy and Power, 113th Cong. (2013).

others such as Rep. Henry Waxman (D-CA) remained cautious, adopting many of the arguments put forward by the environmental groups. Powerfully apparent, however, was the growing reach of energy production to the local constituent and congressional district. While states such as Texas, Louisiana, and Alaska have long had reason to support energy interests, the new production technologies have begun to draw support from the Dakotas, Montana, Illinois, Ohio, Oklahoma, Pennsylvania, Michigan, and even California, among others, who are looking at exciting new economic opportunities, creating a very different political landscape for the energy debates.

An outlier concern among Members of Congress has been that expressed by Rep. Ed Markey (D-MA) in his August 8, 2013 letter to President Obama regarding the importation and exportation of LNG, particularly with respect to the Everett, Massachusetts terminal, which is situated in an unusually densely populated area, requiring LNG tankers to sail through Boston Harbor and dock close to residential neighborhoods. In his letter, Rep. Markey questioned the wisdom of permitting the export of domestic LNG when we are still importing LNG from terrorist-harboring states such as Yemen, citing to a Yemeni terrorist who stowed away on an Everett LNG tanker in 1995 and was subsequently convicted of a plot to blow up Los Angeles International Airport.

By August, Democratic congressional resistance to the LNG export plan, which has been generally embraced by congressional Republicans, began to gel in the form of proposals issued by the Bicameral Task Force on Climate Change.[15] In that document, the task force recommended that "DOE conduct a thorough analysis of the climate change impacts of proposed LNG exports, including the effects of both domestic and overseas emissions." However, Democrats have also been conflicted since new energy resources have been cropping up in Democratic-controlled districts, providing much-needed economic stimulus and jobs. Even labor organizations have come out strongly in favor of new fossil-energy related jobs connected to fracking and horizontal drilling. Moreover, a bipartisan letter from the Chair and Ranking members of the Senate Committee on Energy and Natural Resources to President Obama called upon the Administration to provide greater clarity as to when and how it believed it could revoke or modify existing licenses.

Increased LNG exports, primarily by ocean vessel, could be a significant event for the maritime industry in the United States, and globally. While export permit applications pend before DOE for an amount of LNG equal to half of current annual production, the consensus is that only a few of these are likely to be economically sustainable. However, LNG exports are a sea change which will require major infrastructure build-out in shore-side terminals, pipelines, and vessels. Already, some observers are looking at LNG exports as a way to breathe new life into the U.S.-flag Merchant Marine, by possibly including U.S.-build requirements or U.S.-mariner, U.S.-flag requirements upon LNG exports.[16]

Supporters have suggested that such an approach may help strike a balance between manufacturing and environmental interests looking to curb exports, while also opening up the export market, building bridges to the United States' gas-consuming allies. The proposal would also garner active political support from the U.S.-flag maritime industry, which has in recent years been buffeted by the Administration's push to dismantle the P.L. 480 Food for Peace program, attacks on cargo preference and the Jones Act, possible sequestration of Maritime Security Program funding, and the looming draw-down in Afghanistan. Questioned about the Administration's plans to salvage the U.S.-flag in the face of these challenges, Deputy Secretary of Transportation John Porcari testified in May 2013 that the Administration wanted to focus on "things like energy transport where we believe in the future, there are growth opportunities in the industry for the U.S. flag fleet and U.S. mariners." While Mr. Porcari's

[15] U.S. Cong. Bicameral Task Force on Climate Change, Implementing the President's Climate Action Plan: U.S. Department of Energy (Aug. 6, 2013), *available at* http://democrats.energycommerce.house.gov/sites/default/files/documents/Bicameral-Task-Force-DOE-Climate-Report-2013-8-6.pdf.

[16] John A. C. Cartner, White Paper, Ten Points to Rationalize and Revitalize the United States Maritime Industry, Sept. 7, 2013, at 2,; Denise Krepp, Exporting LNG: Are U.S. Mariners Included?, Maritime Executive, June 25, 2013; Maritime Transportation: The Role of U.S. Ships and Mariners, Hearing Before the H. Subcomm. on Coast Guard and Maritime Transportation, 113th Cong. (2013) (testimony of Mike Jewell, President, Marine Engineers' Beneficial Association). Former Maritime Administrator Sean Connaugton, a Bush era political appointee and subsequently Virginia Secretary of Transportation, made approval of LNG facility siting applications contingent upon the employment of U.S. mariners to service the facilities.

comment may have been focused on Jones Act (domestic) trade, the door appears to be at least ajar, if not open, to explore LNG export participation for U.S. mariners if the Administration wants to get serious about revitalizing the industry.[17]

Crude Export

New domestic and Canadian oil supplies associated with revolutionary drilling technologies are also stirring changes in the movement of crude oil, including potentially exports. Although Washington has been less focused on the crude exports question so far, when it does float to the surface there are sure to be some nuanced differences from the LNG debate.

It's popular around town to think of and talk about the U.S. being oil dependent, primarily upon Saudi Arabia and other countries in the Persian Gulf, but it's a lot more complicated than that. Foreign source crude now composes 51% of the refinery slate, down from 67% in 2008.[18] And of that 51%, the largest foreign source of oil is Canada and the Western Hemisphere which provide 65%. Net imports of oil have fallen to less than 45% of U.S. oil consumption,[19] and U.S. oil production is at its highest level since 1992, with production doubling in Texas and tripling in North Dakota.[20] And production is accelerating.

More so than LNG, oil is characterized by well-integrated markets and a global price, due to better developed infrastructure and generally high competition among refiners.[21] So, even though U.S. and Canadian supplies might help increase global supply and thereby help keep the global price down, it is unlikely to have a dramatic impact upon U.S. consumer prices specifically. Given this global market, observes have opined that "energy independence" for fortress America is a chimera, since attempting to satisfy domestic oil demand in every corner of the country exclusively with domestic sources will be inherently inefficient.[22] The kinds of oil that U.S. refiners need are often not aligned with the type of oil that U.S. fields are producing, insofar as U.S. Gulf refining capacity is geared to heavy sour crude, and the light sweet crude coming out of the country may be more economically processed at less sophisticated refineries overseas.[23] In many cases, the infrastructure isn't in place to get the domestically produced crude to the domestic consumer in a cost-effective way. Moreover, new crude exports probably have even greater potential to benefit local economies and strengthen the United States' geopolitical advantage, and oil exports do not require the massively expensive retooling of LNG regasification plants to liquefaction plants. Therefore, the capital risk associated with moving to export will be much less. Nevertheless environmental advocates and domestic energy consumer interests are likely to raise some of the same concerns with respect to crude exports as they have raised in response to LNG export licensing. And there will surely be a louder din of concern about the national security implications of shipping our oil overseas, especially while the United States continues importing from a global source pool that includes some of the most unsavory national actors.

Relative to LNG, crude oil exports are governed by an onerous maze of statutory and regulatory restrictions that can be a trap for the unwary. Crude oil exports are generally prohibited by statute,[24] and there are additional restrictions on oil moving through pipelines benefitting from Federal rights of way,[25] originating on the Outer Continental Shelf, or drawn from the Naval Petroleum Reserve.[26] In order to export

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17 Maritime Transportation: The Role of U.S. Ships and Mariners, Hearing Before the H. Subcomm. on Coast Guard and Maritime Transportation, 113th Cong. (2013) (testimony of John Porcari, Deputy Secretary of Transportation, President, Marine Engineers' Beneficial Association). Notably, there is precedent for linking LNG to the U.S. flag.

18 The Swinging Pendulum: U.S. Oil, Hydrocarbon Eng'g, Mar. 9, 2013.

19 Neelesh Nerurkar, U.S. Cong. Research Serv., U.S. Oil Imports and Exports (2012), at 1.

20 Domestic Oil Production, Hearing Before the S. Comm. on Energy and Natural Resources, 113th Cong. (2013) (testimony of Adam Sieminski, Administrator, Energy Information Agency).

21 *Id.*; Domestic Oil Production, Hearing Before the S. Comm. on Energy and Natural Resources, 113th Cong. (2013) (testimony of Faisel Khan, Managing Director, Citigroup).

22 The Swinging Pendulum: U.S. Oil, Hydrocarbon Eng'g, Mar. 9, 2013.

23 Sieminski testimony, *supra* n. 20;; Domestic Oil Production, Hearing Before the S. Comm. on Energy and Natural Resources, 113th Cong. (2013) (testimony of Jeff Hume, Vice Chairman, Continental Resources).

24 41 U.S.C. § 6212. *See also* Energy Policy and Conservation Act of 1975, Pub. L. No. 94-163, 89 Stat. 877 (1975).

25 30 U.S.C. § 185(u).

26 10 U.S.C. § 7430.

crude, a license must be obtained from the Department of Commerce, Bureau of Industry and Security ("BIS").[27] However, licenses are generally available in a limited variety of instances which themselves can be very difficult to navigate.[28] For example, export to Canada is permitted if it can be shown that the export is for use in Canada, except that if the oil moved through the Trans-Alaska Pipeline the quantity will be limited and any ocean transportation must be by Jones Act qualified vessel. Canadian source crude, which must cross into the U.S. due to limited available pipeline routing and then back into Canada for loading on vessel to be shipped to the U.S. for refining, would then have to declare and enter through Customs when entering the United States (even though it should be duty-free under the North American Free Trade Agreement). However, as it flows back to Canada a license must be obtained from BIS, which will require a showing that it has not been intermingled with U.S.-source crude while in transit.[29] To say the least, there are regulatory and infrastructure challenges to the movement of the vast newly accessible hydrocarbon deposits.

As interest in crude export grows, like LNG export, a close look will have to be taken at regulatory reform to simply the process and to recognize the cross-border nature of the production infrastructure, refining capacity, and consumption markets. The opaque nature of the current regulatory regime governing crude oil exports and related uncertainty presents a significant barrier to getting the oil out of the ground and to market. Furthermore, exporters will have to clear the political hurdles to oil export which have shown up in the LNG permitting process. Reform of the export regime will likely require statutory changes—and passing any legislation has been a major challenge in the 113th Congress. Given the very tentative approach to LNG exports by the President and many congressional Democrats, it appears unlikely that the President can be expected to lead the charge forward in either crude or LNG export. Nevertheless, continued production increases will likely spark new oil and LNG movements, both domestically and with respect to exports. The U.S. maritime industry would be well-advised to keep abreast of these developments and explore ways to get out in front of them, even as long-established markets like inland waterways coal transportation are displaced by these new energy sources.

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[27] 15 C.F.R. § 754.2.

[28] *Id.*

[29] 15 C.F.R. § 754.2(b)(vii).