

Paper #7-5

OPERATIONAL LIMITATIONS DUE TO COMPLIANCE WITH THE JONES ACT

Prepared for the
Technology & Operations Subgroup

On March 27, 2015, the National Petroleum Council (NPC) in approving its report, *Arctic Potential: Realizing the Promise of U.S. Arctic Oil and Gas Resources*, also approved the making available of certain materials used in the study process, including detailed, specific subject matter papers prepared or used by the study's Technology & Operations Subgroup. These Topic Papers were working documents that were part of the analyses that led to development of the summary results presented in the report's Executive Summary and Chapters.

These Topic Papers represent the views and conclusions of the authors. The National Petroleum Council has not endorsed or approved the statements and conclusions contained in these documents, but approved the publication of these materials as part of the study process.

The NPC believes that these papers will be of interest to the readers of the report and will help them better understand the results. These materials are being made available in the interest of transparency.

The attached paper is one of 46 such working documents used in the study analyses. Appendix D of the final NPC report provides a complete list of the 46 Topic Papers. The full papers can be viewed and downloaded from the report section of the NPC website (www.npc.org).

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Topic Paper

(Prepared for the National Petroleum Council Study on Research to Facilitate Prudent Arctic Development)

7-5

Operational limitations Due to Compliance with the Jones Act

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SUMMARY

The Jones Act requires that vessels transporting cargo between two U.S. points be built in the United States, crewed by U.S. citizens, and at least 75% owned by U.S. citizens. The law was enacted in 1920. Jones Act ships tend to be 3-times more costly to build and operate than vessels used by foreign-flag ocean carriers. Foreign-flag ocean carriers are less expensive because they can leveraging more competitive builds at foreign shipyards and hire crew members from countries where seafarers' wages are much lower than in the United States.

This topic paper describes the economic and operational impediments to prudent exploration and development posed by the Jones Act, and suggests that U.S. Government waivers/exemptions be considered for foreign-flagged support vessels during Arctic OCS energy exploration and appraisal phases. Once prospects are discovered and proven viable, industry can then produce the demand signal to U.S. shipbuilding to design, develop and produce requisite support vessels which meet Jones Act/Coastwise trade requirements.

PURPOSE

To provide an overview of US coastwise laws and key limitations associated with employing foreign flagged vessels in the US Arctic.

BACKGROUND

The Merchant Marine Act of 1920, otherwise known as the Jones Act (codified in 2006) was established to regulate cabotage (the coastal shipping of cargo and passengers) within the U.S. The Act requires cabotage in U.S.-flagged, constructed, owned and operated vessels. Coastwise qualified ice-class rated vessels capable of operating in the Arctic are not readily available. Few U.S.-flagged, ice-classed vessels are available for U.S. Arctic offshore operations. To use a non-U.S. flagged vessel within US waters either requires an exemption for vessels that are able to meet U.S. Arctic shipping standards, or economically unsustainable delays and costs.

Jones Act Overview:

- Coastwise laws generally prohibit the transportation of passengers or merchandise between points in the US in any vessel other than a coastwise-qualified vessel. The coastwise laws also apply to towing, escorting and dredging vessels, among others.
 - *Merchandise*: Goods, wares and valueless materials including scrap, rocks and mud. Equipment or supplies are not included in this category, though determinations as to what legitimately constitutes “equipment” is subject to case-by-case determinations by U.S. Customs and Border Protection (CBP), and has become controversial.
 - *Passenger*: Any person aboard a vessel that is not connected with the vessel’s operation, navigation, ownership, or business.
 - *Coastwise point*: Includes all points in the territorial sea, within 3 miles of the coast, and points in internal waters. Under the Outer Continental Shelf Lands Act (OCSLA), the coastwise laws are extended to structures attached to the U.S. outer continental shelf for the purposes of exploration, development, or production of resources (structures attached to the seabed, mooring systems, exploratory wells, etc.)
 - *Coastwise-qualified vessel*: US built, US flagged, 75% US owned and controlled, and never sold foreign.
 - *Penalties*: could include forfeiture of the merchandise or a fine up to the value of the merchandise or the actual cost of the transportation, whichever is greater. The CBP is responsible for interpreting and enforcing the coastwise laws.

DISCUSSION

Federal laws protecting shipping in the United States date back to 1789, with the coastwise law governing the transportation of merchandise, the Jones Act, enacted in 1920. The coastwise laws have evolved and expanded over the years and sentiment to protect the U.S. ship owners/operators, U.S. labor, and U.S. shipbuilding capacity remains strong. Any activities implicating the coastwise laws are closely scrutinized by CBP, the Coast Guard, the domestic industry, and Congress. As such, “the coastwise laws are highly protectionist... and are intended to create a “coastwise monopoly” in order to protect and develop the American merchant marine, shipbuilding, etc.”¹ Regrettably, the US has very limited capacity for ice management services and vessel operations in ice conditions which are an essential requirement for Arctic exploration and development. Contracting these services to a foreign-flagged operator is a solution, but the ability to leverage the full mission support capability of these vessels is unduly restricted and forces the costly contracting of additional vessels to safely operate in the Arctic environment. Lease operators contracting for purpose-built Jones Act vessels, and

¹ CBP Headquarters Ruling (HQ) 116630 (March 27, 2006), Re: Coastwise Transportation

financing their construction through long-term charters, is also an option, but it is neither a reasonable nor practicable option in the long run.

Foreign Vessel Constraints:

- Jones Act restrictions limit vessel flexibility and capacity to fully utilize assets under contract to ensure compliance. This is especially problematic in an emergency response situation or when planning for response actions. While waivers may be available in such situations, operating on the assumption that a waiver will be granted is not practicable.
- Equipment cannot be transferred from vessel to vessel or to alternative port locations other than the location it originated from. Loading and unloading must be completed at the same port and berth location.
- Mission Constraints. Jones Act restricts the ability for multi-mission, foreign-flagged vessels to operate within the full limits of their capabilities. Mobile Offshore Drilling Units (MODU) require constant consumables, waste, and personnel transfer which cannot be conducted by a foreign-flagged vessel in any case. This includes anchor handling. A foreign flagged ice-breaker operating in close proximity to the MODU would be prevented from carrying out any of these duties.
 - Once exploration transitions to development, Jones Act restriction further limits the use of which vessels can be involved in undersea infrastructure missions such as dredging, trenching and pipe-laying required for product movement. Dredging vessels, for instance, would need to be Jones Act compliant. If suitable vessels do not exist then they would need to be built.
 - A 2013 U.S. Department of Transportation Maritime Administration (MARDAN)² places an uplift factor of 2.7 times on the operational expenditure (OPEX) costs to use Jones Act compliant vessels and crews. Moreover, the observed capital expenditure (CAPEX) costs to build Jones Act compliant vessels are a comparable 3-times the cost as compared to foreign vessels. Prudent Development must factor these costs into the calculus which drives business decisions.
 - Tanker example. “According to oil shippers, the price for moving crude oil from the Gulf Coast to the U.S. Northeast on Jones Act tankers is \$5 to \$6 per barrel, while moving it to eastern Canada on foreign-flag tankers is \$2.”³
- Jones Act compliance can pose demobilization challenges. For example, if a foreign-flagged ice management vessel mobilizes from a port in the Pacific Northwest to receive onload of material and support capabilities prior to the operational season, then it must

² http://www.marad.dot.gov/library_landing_page/maritime_publications/Library_Publications.htm

³ **Shipping U.S. Crude Oil by Water: Vessel Flag Requirements and Safety Issues**
John Frittelli, Congressional Research Service, July 2014

return and demobilize after the season to the same port to offload remaining materiel and support capabilities before continuing on its voyage. In most cases, this forces the vessel to deal with more significant ice while transiting back through the northern passage due to the excessive transit distances to and from the Pacific Northwest support terminals.

- Financial implications of Jones Act compliance during exploration and appraisal operations are significant and limit the ability to fully leverage the multi-use of vessels capable of handling multiple tasks resulting in the need to contract additional vessels to perform those duties.
 - Ice Breaking Vessels have crew and storage ability as well as helidecks that can only be used to transport the vessels own crew.
 - Arctic exploration drilling operations from floating drilling units must be completed within a short time period limited by sea ice conditions specific to the region. Jones Act limits the venture's ability to multi-task foreign-flagged vessels to leverage their full capabilities and thereby reduces mitigation options when ice and weather conditions change abruptly as they often do in the Arctic.
- Another major logistical challenge is that there are no Jones Act compliant heavy lift or dry tow vessels, thus requiring drill rigs or other vessels, such as the containment barge, to be wet-towed through challenging Alaska and Arctic environments rather than dry-towed, which could be preferable in certain situations.

RECOMMENDATIONS

This topic paper is provided to inform the reader of the operational impacts to Outer Continental Shelf energy exploration and development that emanate from compliance to the Jones Act.

Keeping in mind that these operations, in and of themselves, demand significant risk mitigation strategies which are often more constrained by compliance.

Exemptions to some of the Jones Act requirements that would ease restrictions during these specific energy exploration and development operations are more likely to produce a much better outcome for all stakeholders (Federal, State and Local Governments; industry) interested in successful outcome of these operations.