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BEFORE THE
HOUSE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
SUBCOMMITTEE ON COAST GUARD AND MARITIME TRANSPORTATION

Strategic Petroleum Reserve Drawdown

June 27, 2012

Good morning (*Chairman LoBiondo, Ranking Member Larsen*), and Members of the Subcommittee. Thank you for the opportunity to discuss the Maritime Administration's (MARAD) role in determining vessel availability during Strategic Petroleum Reserve (SPR) drawdowns. I am pleased to appear before you today to highlight MARAD's role in supporting the U.S.-flag fleet in the case of an SPR drawdown.

The Jones Act is one of the strongest elements of U.S. maritime policy. It encourages investment in privately owned U.S. companies, shipyards, merchant vessels, and employment of U.S. citizens in the maritime industry. Congress and the Executive Branch have long viewed the sustainment of our domestic maritime industry to be necessary for our national and economic security. The Administration supports the Jones Act and the Maritime Administration takes seriously its responsibility to promote this industry in accordance with this policy.

Strategic Petroleum Reserve Background

Congress created the SPR in 1975 under the Energy Policy and Conservation Act, following the 1973-1974 oil embargoes. The Department of Energy (DOE) is responsible for managing the SPR and for initiating actions to release crude oil from the Reserve when directed by the President. The act of transporting crude oil from the SPR requires interagency coordination and is governed by the 1987 and 1990 Memoranda of Agreement between DOE, the former Customs Service now embodied as Customs and Border Protection in the Department of Homeland Security (DHS), and the Department of Transportation (through MARAD).

The process begins with a DOE action to announce a drawdown of the SPR, generally pursuant to a specific authorization from the President, pursuant to the Energy and Policy Conservation Act (42 USC 6240, 6241). The Secretary of Energy may draw down and sell petroleum from the SPR at a rate the Secretary of Energy determines and in accordance with established SPR competitive sales procedures.

DOE is responsible for issuing the official Notice of Sale to potential bidders. The Notice of Sale contains the amount of oil to be released, the terms and conditions of the sale, and specific instructions for preparation and submission of offers. Included within the Notice of Sale are Sales Provisions which establish how bidders are to submit their bids, the timeframe for delivery,

minimum delivery lot sizes, delivery points, terminal requirements, and vessel loading requirements.

Each bidder is responsible for its own analysis of available transportation options for loading at designated SPR terminals and arranging for transportation through direct negotiation with private transportation providers.

Since the establishment of the SPR, there have been three drawdowns authorized by the President associated with oil supply disruptions caused by Operations Desert Shield/Desert Storm in 1991, Hurricane Katrina in 2005, and instability in Libya in 2011.

Jones Act waivers are issued under the authority of the Secretary of the Department of Homeland Security (DHS), and are enforced by Customs and Border Protection (CBP). As part of DHS' deliberations, MARAD is required to determine if suitable U.S. flag vessels are available. The Department of Defense (DOD) may determine if a waiver is essential to the national defense.

Jones Act/Domestic Fleet Overview

When cargoes, including SPR oil, are moved by water between domestic points, the Jones Act, the commonly used reference for maritime cabotage law (46 U.S.C. § 55102), generally requires that the goods be transported on vessels that are U.S.-built, U.S.-flagged, and U.S.-citizen owned and crewed. The fundamental purpose of the Jones Act is to maintain reliable domestic shipping services and to help sustain a domestic maritime industry of shipbuilders, vessel operators, and merchant mariners. The Jones Act ensures that vessels sailing on our Nation's waterways meet American safety and environmental standards. Moreover, the Jones Act also ensures availability of additional vessel capacity and availability of trained mariners for the Ready Reserve Force in times of war or national emergency.

Our Jones Act fleet is comprised of the vessel types and carrying capacities that serve our Nation's domestic commerce along our coasts, the inland waterways and the Great Lakes. The domestic fleet consistently and reliably serves many diverse markets, both large and small. Whether cargo needs to move to Alaska or Guam, Houston or Cleveland – our domestic fleet delivers the goods. Even as the fleet continues to meet the needs of existing markets, it is also responsive to new opportunities. For example, the offshore supply vessel segment of the Jones Act fleet has grown rapidly to serve the requirements of the petroleum industry in the Gulf of Mexico. Much of our agricultural production is tied to our inland waterways transportation system, where tugs and barges move millions of tons of grain destined for domestic and overseas markets. Each year, nearly 870 million barrels of crude oil and petroleum products are also moved along our waterways by tugs and tank barges to power our industries as well as the vehicles we drive.

The Jones Act fleet is also a major source of employment for U.S. citizens in the maritime industry, generating jobs in shipbuilding and support activities across the Nation. Thousands of Americans work in our shipyards and aboard our ships. If called upon, many of the mariners sailing in the coastwise trades are available and capable of being mobilized rapidly to sail internationally in time of war or national emergency.

2011 SPR Drawdown

In the summer of 2011, the oil supply disruptions caused by the unavailability of Libyan light/sweet crude oil tightened gasoline and fuel oil markets, which were further aggravated by the loss of refined product exports from Japan following the Tohoku earthquake that damaged refineries earlier that year. The loss of Libyan crude oil created a risk of significant economic slowdown in the United States and around the globe, a slowdown that would have resulted in greater pressure on our economy and on American jobs. The magnitude of the Libyan disruption on global oil markets was much more significant than the market disruption that triggered the decision to release strategic stocks in the wake of Hurricanes Katrina and Rita.

President Obama authorized the SPR sale as part of a larger, coordinated release of petroleum by International Energy Agency (IEA) member countries in response to the disruption of oil supplies from Libya. On June 23, 2011, the President issued a finding that a drawdown and sale from the SPR were required by U.S. obligations under the International Energy Program implemented by the IEA, as provided in the Energy Policy and Conservation Act. The U.S. committed to provide 30 million of the 60 million barrels the IEA requested to be released by its member countries. Because of the urgency, the IEA sought to have all the oil to market within 30 days. Most U.S. loadings were complete by August 31, 2011. In total, 30.64 million barrels of U.S. SPR oil were sold; 24.31 million barrels were moved by tanker, 6.18 million barrels were shipped by pipeline, and 150,000 barrels were moved by a coastwise qualified U.S.-flag barge.

At this point, I want to make it very clear that this Administration did not conduct this SPR drawdown under a blanket waiver of the Jones Act, as has been typically done, and instead allowed the process to be carried out by considering individual waiver applications on a case-by-case basis, consistent with the Jones Act, in order to provide the best opportunity for U.S.-flag vessels to compete to move SPR crude oil. We believed this process would accomplish the goals of the Jones Act while meeting the key objective of moving oil to market quickly in order minimize U.S. petroleum product market disruptions. Waivers were thus only considered on a case-by case-basis, after evaluation of waiver requests, assessment of DOE's drawdown requirements and a review of Jones Act-qualified vessel availability. These actions were in accordance with established mechanisms governing waiver requests and existing interagency coordination processes.

The DOE is authorized to set terms and requirements of an SPR drawdown. To meet DOE's 31-day schedule of the 2011 drawdown, DOE released stocks from the SPR on an expedited basis. A complicating factor in an SPR drawdown is that its success relies on third-party bidders to purchase the oil. Buyers have the choice of using tanker, barge, or pipeline to best meet their individual requirements. The Jones Act does not apply to cargo movements by pipeline.

In addition, purchaser-traders can choose not to buy SPR oil if the terms are not suitable for their business. Of the crude oil cargoes moved on the water, most crude oil is shipped in large tankers (i.e., with a capacity of 500,000 barrels or greater), which take advantage of efficiencies and economies of scale. Many crude oil supply chains are structured to handle only these larger tankers, and do not have facilities or operations which can accommodate smaller barges. This is

consistent with efforts to maintain crude stock levels and to meet future refinery production schedules.

Moreover, in a 1985 study evaluating DOE's plans to sell oil from the SPR, GAO found that allowing many smaller purchases could impair DOE's maximum drawdown capabilities because it is easier to accommodate fewer large purchases per day than many small ones. GAO also found that the use of many small barges to deliver SPR oil could slow the loading rate, resulting in increased barge traffic, which could overwhelm the capacity of SPR terminals to handle them. This challenge is still true today, given that the delivery of SPR crude oil must be coincident with commercial activities at the DOE delivery points. [1]

MARAD announced information related to the drawdown on its website and sought specific information on the number, size, and type of available U.S. coastwise-qualified vessels to ensure maximum use of U.S.-flag vessels.

Due to the ordinary course of business booking schedules by qualified carriers, and the typical immediacy of release of the SPR stock in the 2011 drawdown, there was, as expected, limited availability of U.S.-flag vessels. Of the 55 tankers in the Jones Act fleet, none of the large tankers (350,000 barrels or greater, as referred to in the DOE SPR Notice of Sale) were available. Owners and operators advised MARAD that there were 30 U.S.-flag, coastwise qualified tank barges that were technically qualified and interested in carrying SPR oil for the 31-day drawdown window. The capacity range for the available barges was from 80,000 to 234,000 barrels. Although the barges exceeded DOE's minimum delivery lot size of 40,000 barrels, the drawdown could not have been accomplished within the DOE-prescribed timeframe using only these smaller barge vessels because they may take longer to load, have less capacity and have longer travel times than large tankers.

During MARAD's assessment of vessel availability, the owner of two large tankers initially expressed interest in carrying SPR oil in the 330,000-barrel range. At MARAD's urging and in consultation with DOE and DHS, DOE lowered the minimum lot size of its Notice of Sale to 300,000 barrels in order to increase opportunities for the U.S.-flag fleet. Nonetheless, the two coastwise qualified crude oil tankers that initially expressed interest were not in fact available. One was dry-docked and the other was under charter and required notice of at least 14 days to become available. Therefore, these tankers were effectively not available in the timeframe of the drawdown.

In the 2011 SPR drawdown, U.S.-flag carriers had the opportunity to participate in every shipment. During this drawdown, CBP, which enforces the Jones Act, asked MARAD for determinations of availability on 44 shipments. Most of the bidders opted to move the petroleum in lots of 500,000 barrels or more of oil, in accordance with industry preferences. In each case,

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[1]Evaluation of The Department of Energy's Plan To Sell Oil From The Strategic Petroleum Reserve, BY THE COMPTROLLER GENERAL Report to the Chairman, Subcommittee on Fossil and Synthetic Fuels, Committee on Energy and Commerce, House of Representatives of The United States, GAO/WED-85-80, JUNE 5.1986.

See http://www.gao.gov/assets/150/142896.pdf.

MARAD found no U.S.-flag tankers with capacity in excess of 300,000 barrels to be available. Approximately 25 million barrels of crude oil were transported as a result of waivers granted. In each case, Jones Act waivers were only granted by DHS after MARAD made a carefully-considered determination of non-availability. One buyer purchased one smaller lot of 150,000 barrels, which was carried on a U.S.-flag barge.

The optimal market condition for the tanker/tank barge industry is balance between vessel supply and demand, and we have found market conditions in the domestic petroleum trades are generally stable. Excess capacity is most likely to occur in the tug and barge segment, rather than in the larger self-propelled tanker segment of the tanker fleet. At any given time there will be some idle vessel capacity available for a limited time due to seasonal or other changes in demand. But generally, because the owners keep their vessels employed as much as possible, the size of the pool of idle vessels is small and is not likely to be sufficient to carry more than a fractional portion of a large, short-term surge in demand such as occurs in an SPR drawdown.

MARAD's Goal

MARAD's primary goal during an SPR drawdown is to ensure U.S.-flag fleet participation to the fullest extent possible consistent with the purpose of the Jones Act and the national objectives of the drawdown itself. Although MARAD makes every effort to maximize the use of the domestic fleet, the parameters of an SPR drawdown are established by DOE and carried out through private sector traders and transportation providers in an effort to successfully meet the expedited timeframe and objectives of the drawdown. The Administration does not believe that the Jones Act is inconsistent with the procedure necessary for a successful SPR drawdown.

MARAD's Role

MARAD's role is to determine the availability of U.S.-flagged vessels under the applicable statutory provisions authorizing Jones Act waivers and DOE's specific requirements for the drawdown, and to inform CBP of that availability relevant to requests for Jones Act waivers pending with DHS. MARAD determines availability by surveying the vessel owners of the U.S. coastwise-qualified industry to establish whether any have an ability or willingness to carry the cargo for which a waiver has been sought.

Jones Act Waivers

Congress has provided limited authority for waiving the Jones Act in 46 U.S.C. § 501. In the 2011 drawdown, if a purchaser of SPR oil chose to take delivery by vessel and was unable to find a suitable U.S. coastwise-qualified tank vessel, that buyer could request a Jones Act waiver.

Jones Act waiver requests are administered by CBP within DHS. Waivers may be issued by the Secretary of DHS. DHS consults with MARAD on the availability of U.S. coastwise-qualified vessels prior to making a decision to waive the Jones Act.

As implemented in 2011, upon receipt of a request, CBP committed to request within one day that MARAD determine the availability of suitable coastwise-qualified vessels to meet the waiver requestor's SPR contract commitment prior to making a waiver decision. To facilitate its

determination, MARAD consulted with all Jones Act vessel owners to advise them of the carriage opportunity. Jones Act vessel operators then had 24 hours from receipt of initial notification to respond to MARAD with the particulars of vessel availability and position. MARAD checked the requirements of each individual request with DOE to validate the requirements of the request, including the vessel type, size, and time frame of the cargo movement. Within 48 hours of referral by CBP, MARAD responded to CBP with an availability determination regarding U.S.-flag vessels capable of meeting the requirements and parameters set forth by DOE in the Notice of Sale, as well as the information by which availability was determined. CBP, as the final waiver authority, then acted to grant or deny the waiver request.

Implementing Future Drawdowns

Following the 2011 drawdown, new legislative language was included in the 2012 Consolidated Appropriations Act (P.L.112-74, Sec. 529) and the Consolidated and Further Continuing Appropriations Act (P.L. 112-55, Sec. 172) to require more information be included in Jones Act waiver determinations regarding SPR, and that MARAD provide additional information to DHS. Specifically, the Consolidated Appropriations Act prohibits Jones Act waivers from being issued unless the Secretary of Homeland Security takes "adequate measures to ensure the use of United States flag vessels." Additionally, the Consolidated and Further Continuing Appropriations Act of 2012 prohibits a finding of non-availability of qualified U.S. flag capacity "unless as part of that determination the Secretary of Transportation, after consultation with representatives from the U.S.-flag maritime industry, provides to the Secretary of Homeland Security a list of U.S.-flag vessels with single or collective capacity that may be capable of providing the requested transportation services and a written justification for not using such United States flag vessels."

Consistent with the new legislative requirements, MARAD, DOE, and DHS are working together to better coordinate their SPR related processes and procedures. MARAD has engaged in several meetings with its partner agencies (DOE, DHS and DOD) to better identify impediments to using U.S.-flag vessels during a drawdown, should there be one. These impediments include facility constraints, time constraints, competing commercial activity at SPR terminals impacting berth availability, SPR oil bidder preferences and business practices, and the implications these have for vessel availability. These improved procedures are designed to ensure the maximum participation of U.S.-flag vessels through consultation with the maritime community and to improve the transparency of the process.

MARAD believes that the important lessons learned during the 2011 drawdown will enable future SPR releases to provide additional opportunities for Jones Act carriers. We have identified a range of actions to encourage the use of U.S.-flag tankers, articulated tug barges (ATBs), and barges, while achieving the objectives of an SPR drawdown and are working with our federal agency partners to implement them.
I look forward to sharing more information on this subject with you in the near future.

Conclusion

SPR drawdowns by their very nature respond to national emergencies requiring Presidential action. The SPR drawdown of 2011 was accomplished without a blanket waiver of the Jones

Act and involved a U.S. Jones Act carrier for the first time in memory. We expect that with sufficient advance scenario planning, should future drawdowns be necessary, they will present even more opportunities for Jones Act carriers. The Maritime Administration seeks to ensure the maximum use of U.S.-flag vessels to carry domestic shipments in fulfillment of the requirements of the Jones Act. In 2011, the otherwise full employment of the U.S. tanker fleet and loading constraints resulted in limited opportunities for use of Jones Act vessels.

Despite these limitations, the Administration made significant efforts to expand opportunities for U.S.-flag transport of the petroleum released from the SPR. The Administration did not grant a blanket waiver of the Jones Act, and MARAD scrutinized each individual waiver request. In addition, the Maritime Administration worked with DOE and DHS to increase the opportunity for US-flag tanker participation.

With regard to a possible SPR drawdown in the future, MARAD is finalizing new procedures to ensure compliance with the 2012 Consolidated Appropriations Act and the Consolidated and Further Continuing Appropriations Act and is working closely with other agencies to achieve the maximum use of suitable U.S.-flag vessels.

Mr. Chairman, I wish to express my appreciation for the opportunity to present and discuss MARAD's role in the SPR drawdown process and for the Committee's continuing support for maritime programs. I am happy to respond to any questions you and the members of this Committee may have.

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