

**EIA 2014 Energy Conference
July 14, 2014
Crude Exports Session**

Jake Dweck Presentation (20 minutes, about 2,500-3,000 words)

OPENING SLIDE

Thanks, Lynn, and thanks to Adam Sieminski and the rest of the good folks at EIA for extending me the invitation to present today.

Lynn and John did an excellent job describing economic data and projections, and Jason ably discussed policy realities and options.

Any solution to our crude export paradigm, however, must be implemented through laws and regulations – and this is what frames my comments this morning.

What crude can be exported? What are the required legal processes for allowing or determining exportability?

The law also dictates when regulations have to be amended, as well as the degree of discretion afforded the Executive Branch in implementing and interpreting existing rules.

SLIDE 2: AGENDA

I've organized my comments into 3 parts:

First, I'll frame the current crude export control laws and procedures at a high level. What are the governing principles?

Second, I'll summarize developments in the export of Canadian crude oil from the U.S.

Third, I'll discuss the allowed exports of processed condensate under the recent rulings by BIS.

SLIDE 3: BASICS BREAK SLIDE

First things first.

SLIDE 4: PRESIDENT CALLS THE SHOTS

The power to act under the governing 1975 statute, the EPCA (which stands for the Energy Policy and Conservation Act) is with the President. The Executive Branch calls all the shots.

The EPCA prohibits the exports of crude oil, but it vests the President with the power to allow them if he or she finds them to be in "the national interest."

The President also can impose export restrictions on petroleum products -- a power no president has exercised since the 1980s.

Since the 1980s, three presidents have issued a total of 4 executive orders allowing the export of crude under specified conditions.

In today's market, the most notable are allowed exports to Canada, which now stand at 250,000 bpd moving mostly by vessel from the gulf to refineries in Eastern Canada.

The President is not required to follow a particular process in making a "national interest" determination.

But it is quite interesting to note the depth of deliberations within the White House in each case, which is reflected in FOIA documents we obtained from the three presidential libraries.

Congress has no role in this process, unless the law is rewritten – and the chances of that happening are nil.

The courts also have no role to play. A “national interest” determination is effectively non-reviewable.

SLIDE 5: ALLOWED EXPORTS

Sorting out whether a particular petroleum oil is exportable requires a multi-step review, the results of which I try to capture in this slide.

The green barrels depicted here stand for exportable products, for which no license is required. The blue barrels represent crude oil that can be exported pursuant to a license.

First, you need to decide if your barrel is “crude oil” or a “product.”

If it’s a product, you can export it all day long. The U.S. today exports over 4 million barrels per day of oil products – more than any other country.

Here you’ll note one green barrel for traditional petroleum products and one for exports of processed condensate approved in the recent BIS rulings.

If the barrel is crude, you need to determine whether your export is permissible under one of the “national interest” categories – for example, again, crude exports to Canada – or whether it is uncommitted foreign (namely Canadian) crude that can be exported from US ports.

But you're prohibited from exporting crude if it falls outside any "national interest" category or is not segregated Canadian oil.

SLIDE 6: BIS CONFIDENTIALITY AND LICENSING AND RULING PROCESSES

Let me turn next to the BIS processes for determining whether oil can be exported.

These processes apply to all products and technology where export restrictions may come into play; they are not unique to oil exports.

By law the BIS must operate with strict confidentiality. To put a fine point on it, this is an agency that participates in making national security determinations regarding the export of sensitive technology.

So whatever you file with the BIS, your communications with BIS, and BIS' determinations are not subject to public disclosure.

With respect to crude oil exports, there are two processes that I would like to highlight.

First, where an export of crude may be allowed under a license, you must obtain a license before you engage in the export.

The license can only be used by the exporter to which it is issued and it sets forth the terms and conditions for compliance.

Second, you can seek a ruling from BIS that determines how your product should be classified under the export regulations. Is it exportable? Is a license required?

The condensate rulings, for example, determine that condensate distilled in a certain manner is not crude oil but an exportable product.

While a ruling is confidential, and is sometime referred to as a “private” ruling, it applies to the described commodity and can be relied on by any exporter, not only by applicant, as long as what you’re exporting is the product falling under the classification ruling.

SLIDE 7: CANADIAN BREAK SLIDE

With these basics in mind, let me turn next to what happened in the crude oil export space over the past year or so, starting with the export of Canadian crude from the US.

SLIDE 8: REQUIREMENTS FOR THE EXPORT OF CANADIAN CRUDE OIL

BIS regulations provide that foreign crude – namely Canadian – can be exported from the U.S. with a license as long as it is not commingled with U.S. crude oil.

The key here, therefore, is to segregate the Canadian crude.

SLIDE 9: SEGREGATION IN VARIOUS MEANS OF TRANSPORT

Late last year and earlier this year, the BIS, at the request of industry participants that we worked with, in effect developed the criteria for establishing when exported Canadian crude is not commingled with U.S. crude oil.

These cover rail, pipeline and terminal tankage.

The BIS did this through license-specific determinations, not by regulation or through the publication of some sort of guidelines.

Today, companies are generally aware of the segregation requirements, and many have obtained licenses to export Canadian crude from the U.S.

In adopting these criteria, while rigorously enforcing its regulations, the BIS has displayed a reasonable and commercially-realistic approach to the issue of segregation.

The industry, in turn, is in the process of implementing segregation procedures that would comply with the agency's standards.

SLIDE 10: MARKETPLACE FOR CANADIAN OIL EXPORTS

In the marketplace, this has presented players with the option of exporting Canadian crude.

Whether this option is exercised and when would depend on commercial factors – logistics, competition and price.

SLIDE: EXCHANGE WITH MEXICO

I do not plan to cover in any depth import-for-export swaps or exchanges with Mexico because there have not been any noteworthy developments or activities in these areas.

The rule has long been on the book that crude-for-crude exchanges with Mexico are allowed for transportation efficiency or for convenience. Such an exchange should be much simpler to accomplish than a swap.

But in truth there has been an important development –on the other side of the border -- involving potential exchange-driven exports of US crude to Mexico.

Until Mexico's energy reforms were adopted late last year, Mexico could not import crude from other countries.

Now, Pemex is looking to balance its crude mix with some imports of light oil from the United States.

Exchanges of US light crude for Mexico's heavy and mid-grades seems in the cards.

SLIDE 12: EXPORTS PURSUANT TO SWAPS

For swaps, I've included a slide that summarizes the legal requirements for transaction to be licensed.

The hurdles posed by the rule thus far have proven substantial. We've worked with a number of companies and they do keep on trying.

This is an area where the BIS has a good deal of discretion and it is my belief that they will exercise it reasonably

Maybe this will be a more robust export topic for next year's EIA conference.

BREAK SLIDE 13: INTRO TO PROCESSED CONDENSATE DISCUSSION

The most widely-reported development in recent weeks has been of the issuance by the BIS of classification rulings to Enterprise and Pioneer involving processed condensate.

Our law firm has represent Enterprise in this matter and we of course are bound by privilege not to discuss any of the specifics of its ruling or other confidential information.

With that said, I firmly believe the rulings were correctly decided; they were issued and arguably required under the regulations.

These rulings also are quite reasonable in terms of regulatory intent and policy.

The WSJ and other media outlets described the rulings as a major policy shift by the Obama Administration to liberalize crude exports for the first time since the 1970s.

Whatever the market impact of the rulings, however, the reality of how they came about is quite different.

For Enterprise, this was a technical and legal exercise.

We felt confident that the regulation would allow Enterprise to export processed condensate, but we wanted to confirm our reading with the BIS.

So we filed a request for a classification ruling in the normal course, and following established procedures, and the BIS acted on our request in a timely manner.

In short, the ruling was issued because we asked for it -- and we happened to ask first.

The BIS made its decision with a full deck. It had before it a good deal of information regarding the request, detailing every step from the reservoir to the export product.

And the BIS had able professionals with ample technical knowledge to fully analyze our request.

With that, the best place to start is the controlling regulation: BIS' definition of crude oil.

SLIDE 14: CRUDE OIL DEFINITION

The EPCA does not define "crude oil."

When it was enacted in 1975, the Commerce Department borrowed essentially the same definition that was used in the petroleum price and allocation regulations.

For those of you who remember, after the 1973 Arab oil embargo and until Reagan's election in 1980, federal rules governed how much you can charge and to whom you can sell – from the wellhead to the gasoline pump.

The rules that defined crude oil at the time were not concerned with exports.

Rather, a critical component of this definition was to count each barrel of crude only once if it was distilled in any manner. Once a barrel was "run to stills," it was no longer crude oil.

Hundreds of millions of dollars exchanged hands every month among all U.S. refiners, under the a government-administered program called the Entitlements Program, that depended on each refiner's crude oil runs to stills reports. Double counting or miscounting was a serious violation of federal law.

I spent a good deal of time as a young lawyer litigating issues in this area.

The definition is in two parts:

The first part or sentence defines "crude oil" in term the physical, production and processing of the hydrocarbon mixture.

The second and third sentences are in effect a listing of petroleum oils that are or are not “crude oil.”

If you zero in on the first part, you’ll note that once you process the hydrocarbon mixture in a “distillation tower,” it is no longer crude oil.

I just explained the historical reason for this requirement.

The rule is unambiguous about the classification of the mixture, assuming it had been processed in a distillation tower.

The second part plainly says that “lease condensate” is treated as crude oil.

So putting these two parts together: It is clear that lease condensate “processed through a distillation tower” is not crude oil.

Under the export regulations, any petroleum that is not “crude oil” is a product. In other words, a product is a non-crude oil hydrocarbon mixture.

A product does not have to be a finished petroleum product. Nor are you precluded from processing or refining it further.

Additional evidence of that is found the third sentence of the regulation.

“Topped crude oil,” for example, is not considered crude oil. Topped crude oil by definition is a hydrocarbon mixture from which lighter fractions have been removed.

The regulation also specifically says that “unfinished oils” are excluded from the definitions of crude oil.

Finally, in the EPCA itself, petrochemical feedstocks are not crude oil.

SLIDE 15: RULINGS DEAL WITH LEASE CONDENSATE FEEDSTOCK, NOT CRUDE OIL

We know that the rulings deal with lease condensate as the feedstock.

Lease condensate is not crude oil and these rulings do not address crude oil feedstock.

Lease condensate is a light hydrocarbon stream recovered predominantly from natural gas and condensate wells, and it is typically in gaseous state in underground reservoirs.

Eagle Ford condensate has an API gravity ranging from 48 degrees all the way to 80.

Lease condensate consists primarily of ethane, propane, butanes, pentanes, and a significant percentage of heavier hydrocarbons, mainly C6-C10, mostly in the naphtha and gas oil range.

Lease condensate is much lighter in color than crude oil and sometimes looks like water.

SLIDE 16 : RULINGS INVOLVE PROCESSING IN A DISTILLATION TOWER

The regulations says that a hydrocarbon mixture, here lease condensate, is not crude oil if it is processed through a distillation tower.

While there are many different distillation-based equipment and technologies, at its essence a distillation tower involves the use of heat, evaporation and condensation

to fractionate the lease condensate into separate petroleum products. The equipment includes trays or packed columns and a reboiler.

These facilities have been referred to as splitters, stabilizers and various other names, and each may carry different and sometime confusing connotations.

I refer to these facilities as “Condensate Distillation Facilities” or CDFs.

First, the CDF process covered by the Enterprise ruling amply meets the letter and the spirit of the regulation. Akin to the front end of a refinery, it is a substantial distillation process.

Second, distillation in the CDF produces separate and different streams -- each a petroleum product.

Third, the lease condensate feedstock is markedly different from the processed condensate product, in terms of hydrocarbon configuration, suitability for sale and marketing, and potential uses.

SLIDE 17: STABILIZATION

Stabilization is not distillation.

Stabilization refers to the removal of volatile hydrocarbons from crude oil to reduce pressure and enable transport and storage of the crude safely in unpressurized equipment.

There are different technologies to stabilize crude, and historically most did not employ distillation. A separator or flash tank are common examples.

It is true that one of the results of the CDF distillation process is to stabilize the processed condensate.

But CDF distillation under the Rulings does much more than stabilize the product.

It alters the essential characteristics of the condensate stream and creates separate hydrocarbon products suitable for various uses.

SLIDE 18: SUITABLE PRODUCT USES FOR PROCESSED CONDENSATE

The rulings hold that processed condensate is a product, not crude oil.

Under the regulation, it is a product by virtue of being distilled in the manner described in the rulings.

In addition, however, it is noteworthy that processed condensate is a petroleum product that's suitable for various uses.

These include petrochemical feedstock, diluent for bitumen and heavy oil, utility fuel, and possibly gasoline blendstock as well as splitting or as part of a refinery feedstock stream.

For example, as an export product, processed condensate could be used as petrochemical feedstock in Asia, in competition with naphtha where it may have a price advantage.

In fact, Lyondell has used Eagle Ford processed condensate as a petrochemical feedstock for its plants in the United States.

From a regulatory perspective, these uses illustrate that the distillation in the CDF produces a product -- processed condensate -- which is distinctly different from the lease condensate feedstock.

SLIDE 19: PC COMPETES WITH OTHER PRODUCTS

Current law restricts the export of crude oil, while allowing freely the export of petroleum products.

Processed condensate is much like other, readily exportable products.

The table on the slide demonstrates the suitable uses of processed condensate as compared to other products as well as crude oil.

It is a sister product to pentanes plus, also called plant condensate, produced in a gas processing plant.

And it's hydrocarbon configuration closely resembles naphtha.

The fact that processed condensate also could be used for splitting or as part of a refinery stream does not alter its "product" designation.

A number of "products" can be used for such purposes, including gas oil, topped crude oil, certain naphthas, and other unfinished petroleum fractions.

SLIDE 20: POLICY CONSIDERATIONS

While I have not discussed policy today, I'd like to close by saying that the rulings indeed are good policy.

They allow for the export of condensate, where the U.S. market is most over-supplied and where producers suffer the steepest discounts, relative to world prices.

Exporting processed condensate allows producers and other industry stakeholders the opportunity to capture the true market value of their commodity.

And I hope I have convinced you that exports are fully supported by the law . . .

SLIDE 21: THANK YOU

EIA 2014 Energy Conference
Washington D.C., July 14, 2014

U.S. Crude Oil Exports

Developments in the Regulatory Trenches

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Crude Oil Exports: Covered Subjects

Regulatory Principles and Processes



Exports of Processed Condensate



Exports of Canadian Oil



Crude Oil Export Law: Basic Principles and Processes

Executive Branch Calls the Shots on Crude Exports



to →



to →



- EPCA 1975: Crude exports prohibited unless President allows them in the “national interest” – determination effectively not reviewable by courts
- Executive Orders permit exports of (under specified conditions):
 - US crude to Canada (Reagan 1985)
 - 50,000 barrels per day of TAPS to Canada (Reagan 1988)
 - 25,000 barrels per day of California heavy (Bush 1992)
 - Unlimited TAPS crude (Clinton 1996)
- EPCA also empowers President to impose export controls on petroleum products – authority never exercised

Permissible Categories of Oil Exports From US



License Required



No License Required



License May Be Required

SUTHERLAND

BIS Issues Licenses and Classification Rulings

Entirely Confidential Processes



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Exports of Canadian Crude Oil

Requirements to Export Canadian Crude from US

1. The oil is not of US origin, and
2. Has not been “commingled with oil of US origin.”

Proof “based on written documentation satisfactory to BIS”

Canadian & U.S. Crude Oil Pipelines - All Proposals

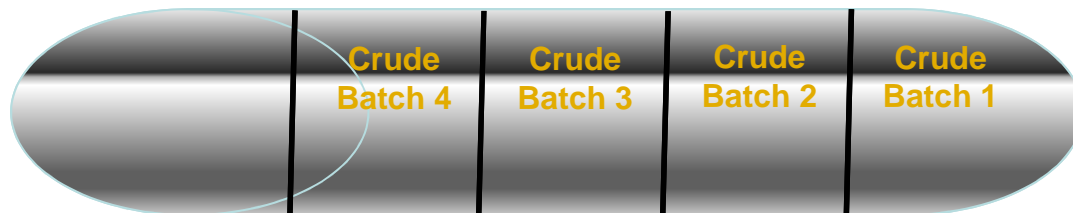


Segregation Criteria for Canadian Crude While in Transit and Storage in U.S.



Rail Is Easy Segregation Case

Segregation and the Need to
Address Tank Bottoms: Think
Cushing



Managing Interface in
Pipeline Transport



Exchange with Mexico (Adjacent Foreign State)

- Export of crude oil exchanged for similar quantity for
 - “Convenience” or
 - “Increased efficiency of transportation”



US Crude



Mexican Crude



Showing Required for “Swap” of Export for Import

Single “Overall Transaction”

HARDER TO SHOW FOR EXPORT LEG

Exported crude
[1] cannot be
reasonably
marketed in US
for
[2] “compelling”
economic or
technological
reasons”



EASIER TO SHOW FOR IMPORT LEG

Import of equal or
greater quantity and
equal or better quality of
crude oil

or
Import of petroleum
products that is no less
than would be derived
by refining the exported
crude oil

Export cannot be OCS crude
or transported on an MLA Pipeline

Exports of Processed Condensate

BIS Definition of Crude Oil

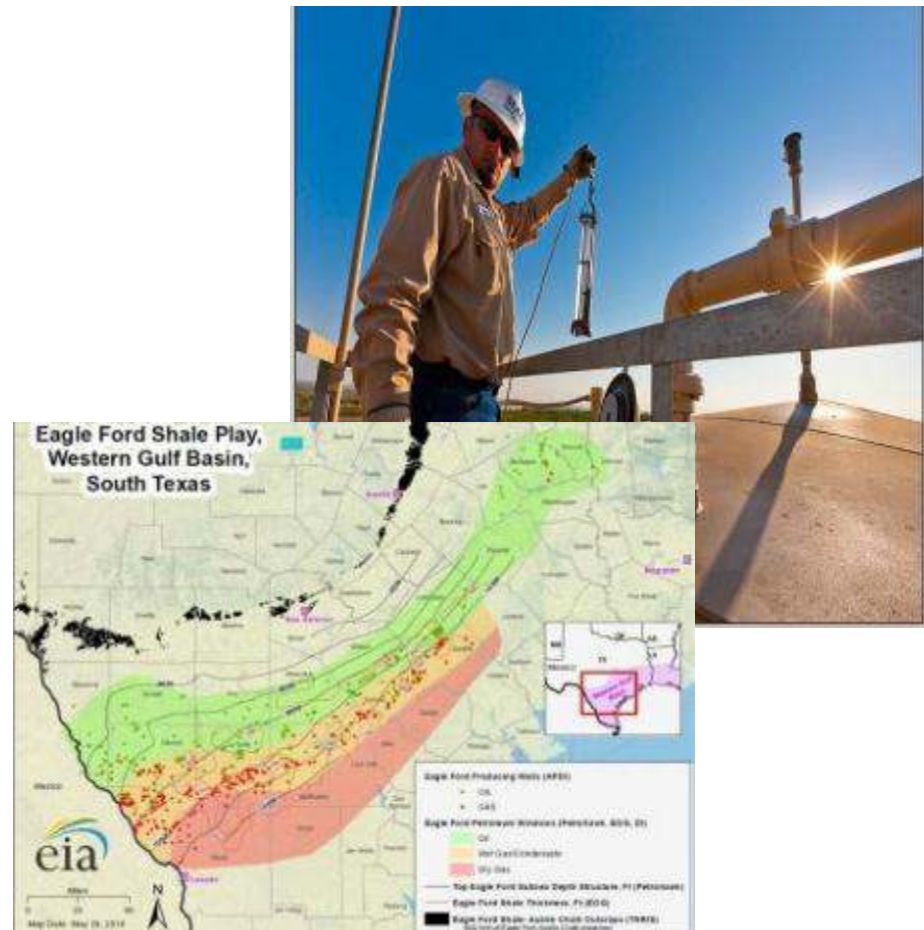
“Crude oil” is defined as a mixture of hydrocarbons that

- *[i] existed in liquid phase in underground reservoirs and*
- *[ii] remains liquid at atmospheric pressure after passing through surface separating facilities and*
- *[iii] which has not been processed through a crude oil distillation tower.*

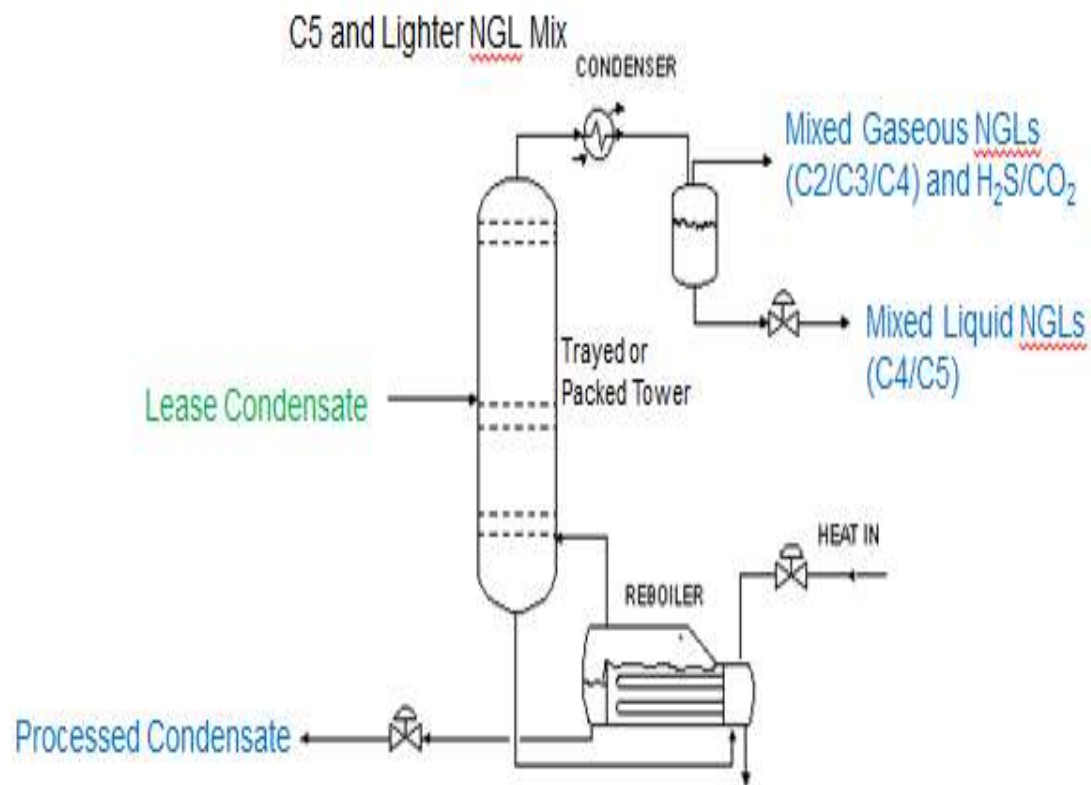
Included are reconstituted crude petroleum, and lease condensate and liquid hydrocarbons produced from tar sands, gilsonite, and oil shale. Drip gases are also included, but topped crude oil, residual oil, and other finished and unfinished oils are excluded.

Rulings Apply Only to Lease Condensate Feedstock

- Condensate is a mixture of light liquid hydrocarbons recovered from predominantly natural gas wells, commonly in gaseous state in underground reservoirs
- Eagle Ford unprocessed condensate has an API gravity ranging from a low of 48 to high of 80
- Current production at 1.2M bpd; projected 1.8M by 2020



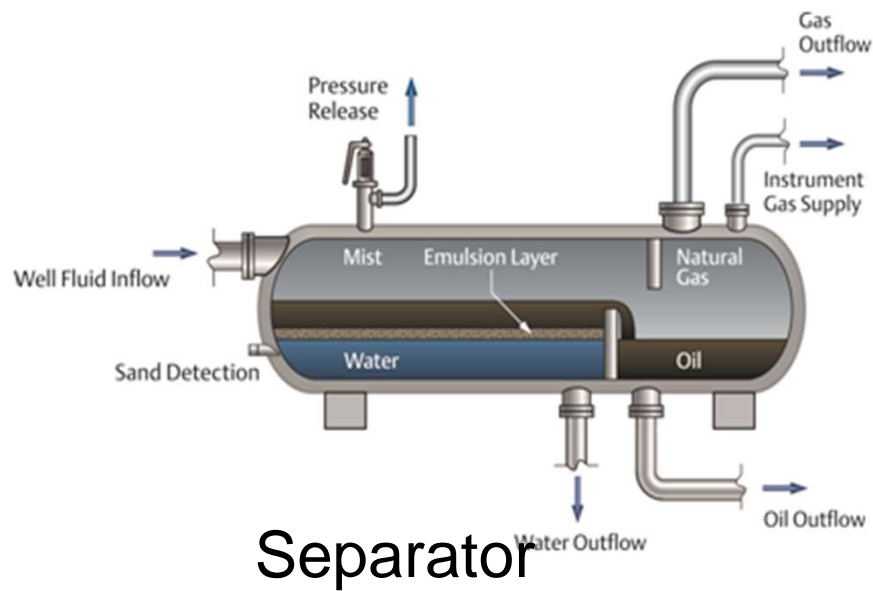
Rulings Apply to Lease Condensate Processed in a Distillation Tower



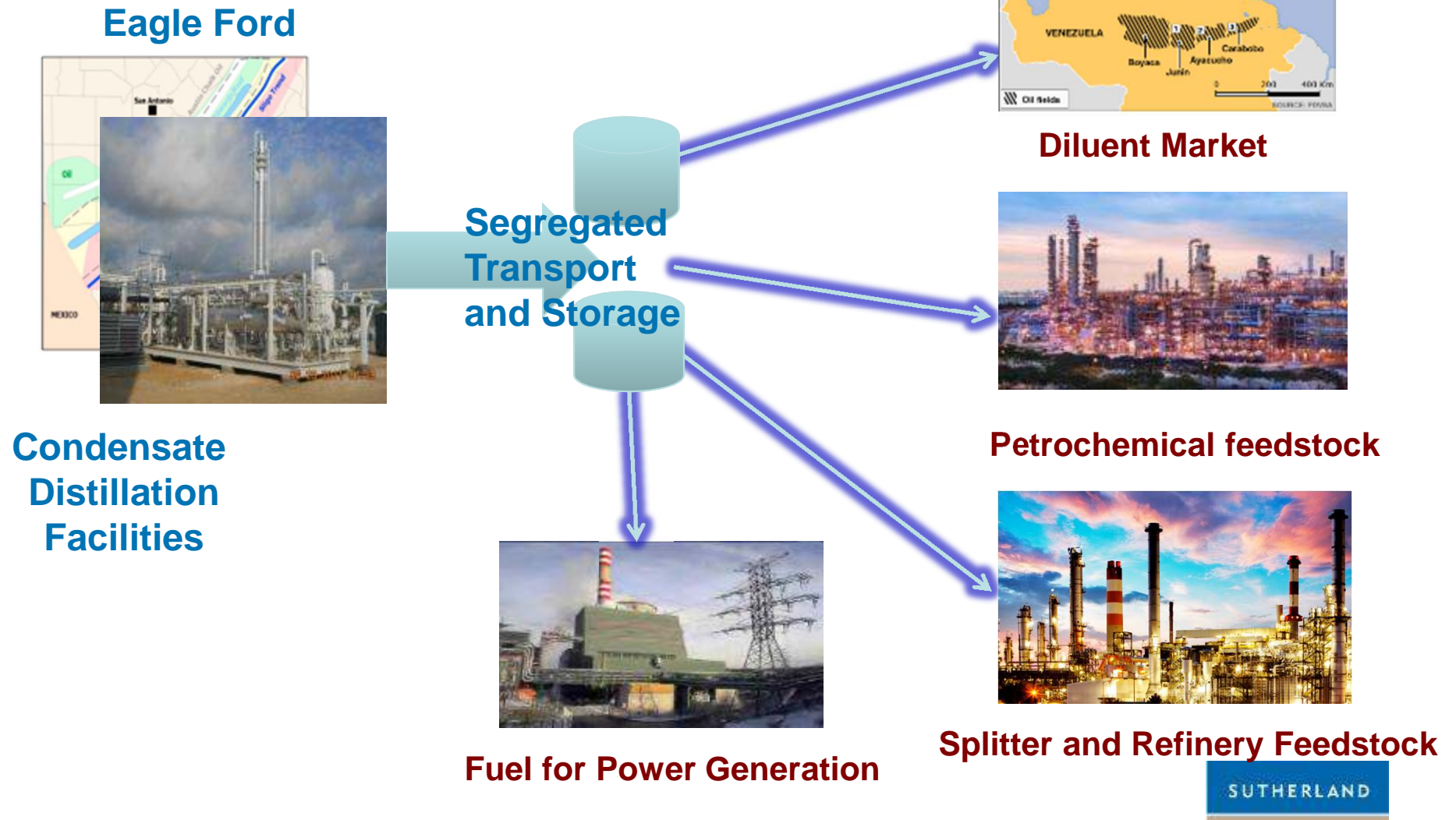
Condensate Distillation Facility



Distillation Is Much More Than Stabilization



Potential Product Export Markets for Processed Condensate



Processed Condensate Is Similar and Competes with Other Exportable Products

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Market	Crude Oil	Refinery Naphtha	Pentanes Plus (Plant Condensate)	Processed Condensate	<i>Other Products in Market</i>
Petchem Feedstock	No	Yes	Yes	Yes	Ethane, LPG
Diluent for Heavy Oil	No	Yes	Yes	Yes	None
Gasoline Blending	No	Yes	Yes	Yes	Various Petroleum Blending Components
Power Gen Fuel	No	Yes	No	Yes	Fuel Oil, Natural Gas
Condensate Splitter	No	No	No	Yes	Lease Condensate
Refinery Feedstock	Yes	No	No	Yes	Crude oil

It's a Good Thing to Let Our Processed Condensate Go . . . ²⁰
And It's Correct Under the Law . . .



Thank you

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