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Commerce Issues Guidance Regarding Restrictions on Crude Oil Exports

*By Edward L. Rubinoff, Stephen D. Davis, Gabriel Procaccini, and Christian C. Davis**

This article provides background regarding crude oil export restrictions, a detailed analysis of the Department of Commerce, Bureau of Industry and Security's frequently asked questions and related answers on crude oil export restrictions, and a discussion of their impact on the debate over lifting the export restrictions on crude oil.

On December 30, 2014, the Department of Commerce, Bureau of Industry and Security (“BIS”) issued long-awaited frequently asked questions (“FAQs”) and related answers in an attempt to provide guidance on restrictions on crude oil exports. Most significantly, the FAQs attempt to clarify the “processed through a distillation tower” test for determining whether crude oil has been transformed into a petroleum product and to identify the factors BIS considers in applying this test. The guidance likely will encourage more companies to submit classification requests (“CCATS”) to BIS and/or to self-classify their products, which is also legally permissible, because it provides a demonstrable basis for making these determinations. The FAQs also address commingling foreign and domestic crude oil in the context of license applications for the export of foreign crude.

This article provides background regarding crude oil export restrictions and prior developments, a detailed analysis of the FAQs, and a discussion of their impact on the debate over lifting the export restrictions on crude oil.

BACKGROUND

BIS administers the Export Administration Regulations (“EAR”) that, among other things, restrict the export of crude oil (including lease condensate) from the United States. While crude oil exports are largely prohibited without a license that is only available in narrow circumstances and for limited periods of time, the same rules do not apply to crude oil that has been processed through a distillation tower. The resultant product is considered to be a “petroleum product” that is generally not subject to export restrictions.

In the summer of 2014, BIS issued classification rulings to a U.S. oil producer and a large midstream company that received significant attention because they apparently determined that “lightly” processed condensate was considered to be a petroleum product that can be exported to non-embargoed destinations without a license. In the wake of the rulings, BIS faced questions from Congress and industry

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groups on whether the rulings were tantamount to a policy change that provided a way to circumvent export restrictions on crude oil. Although BIS received additional classification requests from companies last summer, it apparently did not issue any further classification rulings until December 2014. A primary question that consequently remained for companies was what level of processing was sufficient to transform crude oil into a petroleum product.

Separately, BIS indicated that it would issue FAQ guidance to provide exporters with its interpretation of the export restrictions surrounding crude oil and what constitutes sufficient processing to convert crude oil into a petroleum product. This guidance was issued on December 30, 2014, when BIS also released rulings on a number of related CCATS.

FAQ GUIDANCE

Two of the FAQs issued provide new guidance regarding crude oil exports: (i) one (FAQ #4) attempts to clarify what constitutes “processed through a distillation tower” and the factors it uses in making that determination, and (ii) the other (FAQ #6) discusses the commingling of foreign and domestic crude oil in the context of a license application for exports of foreign crude oil. This new guidance is discussed in further detail below.

FAQ #4—“Guidance on What Constitutes Processing through a Distillation Tower”

FAQ #4 provides the following threshold guidance:

- Distillation is “the process of separating a mixture of components according to their differences in boiling points.”
- “Material” processing must occur in the distillation tower to be sufficient processing to transform crude oil.
- Processes that utilize pressure reduction alone to separate vapors from liquid or pressure changes at a uniform temperature, such as flash drums with heater treaters or separators, are insufficient processing to transform crude oil.

BIS also identifies a non-exhaustive list of factors that it considers in making a determination whether crude oil has been processed through a distillation tower. Applications submitted to BIS for classification requests, as well as company self-classification determinations, should address each of these factors:

- Whether the distillation process materially transforms the crude oil, by using heat to induce evaporation and condensation, into liquid streams that are chemically distinct from the crude oil input;
- Whether the streams resulting from distillation have purposes other than allowing the product to be classified as exportable petroleum products, such as use as petrochemical feedstock, diluent and gasoline blendstock;
- Whether the distillation process utilizes temperature gradients and has significant internal structures, such as trays or packing, and differentiated

output streams; and

- Whether the distillation uses towers with more mechanical complexity and heat, higher residence time, internal structures that promote condensation and better separation, and consistent quality liquid streams (also called cuts or fractions) than equipment used to separate vapors and liquids for transportation needs.

Additionally, the FAQ identifies other factors that are information requirements, such as:

- The change in API gravity of the products between the input to the process and the output of the process; and
- The change in percentage of different types of hydrocarbons between the input and output of the process.

However, because the FAQ does not mention any embedded standards or thresholds, it is unclear what BIS's position is on these factors, including the quantitative criteria for what constitutes "distillation." In the context of a self-determination, these factors carry some risk of misclassification without further information from BIS.

In sum, this FAQ attempts to provide companies with a basis to either submit CCATS to BIS or self-classify products using these criteria. Consequently, it is likely that more companies will take one of these paths and position themselves to export petroleum products to the extent that their business operations align (or could align) with this guidance. Should a company decide to self-classify, it bears the legal risk that its determination is incorrect, which can result in large fines and other penalties. As noted, the risk could be exacerbated because some of the factors are information requests without stated thresholds or standards. Moreover, the legal risk increases to the extent a company electing to self-classify its exports relies upon its counterparties; for example, in the case of a producer, its gatherers and processors, downstream transporters and purchasers, to take adequate measures (e.g., not commingling "petroleum products" resulting from a distillation process with non-exportable condensate) to support such determination.

FAQ #6—"Commingling of Foreign and Domestic Crude Oil"

FAQ #6 provides new guidance with respect to license applications for the export of foreign-origin crude oil. Specifically, BIS acknowledges that there may be minimal mixing of products due to incidental contact in pipelines and/or storage tanks when foreign-origin and U.S.-origin oil is sequentially transported or stored in the same pipeline or tank. In such cases, BIS encourages applicants to include an explanation of the precautions taken to ensure that U.S. crude oil is not mixed with the foreign-origin crude, other than incidental contact.

The guidance may address some companies' questions regarding *de minimis* commingling of products and related information that should be included in a license application, and is also instructive for similar commingling issues that may occur outside of foreign crude issues (e.g., commingling of domestic crude and "petroleum products" that have been processed differently).

IMPACT ON EFFORTS TO LIFT EXPORT RESTRICTIONS ON CRUDE OIL

Following these BIS developments, administration officials commented that the White House believes that these actions essentially resolve the debate regarding lifting the ban on crude oil because there is “not a lot of pressure to do more.” Nevertheless, Rep. Joe Barton (R-TX) has introduced a bill to lift the export restrictions on crude oil on which a House Subcommittee was set to vote at the end of March 2015. Certain industry groups also have continued to lobby for lifting the ban in the months since BIS issued the FAQs and CCATS determinations, including providing testimony before the Senate Energy and Natural Resources Committee. These groups have stated that these agency actions are not sufficient to address the issue and that legislation to repeal that ban is still needed.