

## IMPACTS OF PROPOSED LEGISLATION THAT WOULD CURTAIL THE USE OF FOREIGN FLAGGED VESSELS AND FOREIGN BUILT FACILITIES IN OFFSHORE ENERGY ACTIVITIES

### POTENTIAL IMPACT OF THE LEGISLATION: AN OCS MORATORIUM WITH NO END IN SIGHT

It could drive the fleet of vessels required to support Outer Continental Shelf (OCS) development out of U.S. waters, resulting in the following unfavorable consequences:

- *There would be a significant loss of American jobs nationwide – over 40,000 in Louisiana alone;<sup>1</sup>*
- *Heavy lift and construction vessels would not be available; exposure of workers to lifting risks would increase, endangering U.S. workers;*
- *The most productive OCS activity and offshore energy development would come practically to a halt;*
- *Oil and gas production would decline along with associated royalties, rentals and lease sale dollars to U.S. Treasury;*
- *U.S. energy security would be jeopardized as reliance on imported oil and tanker traffic would increase;*
- *Negative impact to local and national economies would be tremendous – a loss of \$15 million per month in direct tax revenues to Louisiana alone, and significant job losses;<sup>2</sup>*
- *A change to 75% U.S. ownership would cause economic hardships and jeopardize viability of companies. Additionally, it would require refinancing of vessel construction loans and hurt global competition. Specialty vessels and deepwater drilling rigs, and a number of other MODUs, would likely leave.*

### WHAT WOULD THE LEGISLATION DO?

It would require that all vessels involved in exploration, development and production activities in the U.S. Exclusive Economic Zone (EEZ), a 200-mile wide area extending seaward from the U.S. territorial sea, be U.S. flagged vessels, owned 75% by U.S. citizens, and crewed with U.S. citizens. These include Mobile Offshore Drilling Units (MODUs), pipelay vessels, construction and specialty vessels that are essential to OCS operations and mostly foreign flagged.

- *Currently, specialty foreign flagged vessels (with both US and foreign crews) can generally operate in the Gulf in support of OCS operations without a U.S. ownership or U.S. build requirement. They still must meet U.S. safety and navigational requirements.*
- *It would also require that a vessel engaged in any “other activities” be U.S. flagged, 75% owned by U.S. citizens and crewed with U.S. citizens (as long as this requirement would not be prohibited by customary international law). Broadly interpreted, this requirement would*

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<sup>1</sup> Sen. Mary Landrieu: Deepwater Horizon Oil Spill Commission Hearing testimony, New Orleans, LA, July 12-13

<sup>2</sup> Michael Hecht: Deepwater Horizon Oil Spill Commission Hearing testimony, New Orleans, LA, July 12-13

*make many offshore activities and projects – including alternative energy projects, lightering operations, freight carriage or cruise lines – economically impractical and operationally impossible.*

#### **WHAT DOES THE PRESENT OFFSHORE FLEET LOOK LIKE?**

The majority of vessels working on the OCS in support of oil and gas exploration and production (E&P) operations are supply vessels and crew boats that are U.S. flagged and coastwise (Jones Act) compliant. However, many of the vessels involved in the delivery of specialized services offshore are foreign flagged, because they require a global market demand to be economically viable.

- The **overwhelming majority of seismic vessels** that work worldwide are **foreign flagged**.
- The **majority of the offshore drilling rigs that work on the OCS are foreign flagged**. Of the worldwide fleet of MODUs that can drill in water deeper than 400 feet, **only one is U.S. flagged** and it is presently on contract outside the U.S.
- MODUs that are capable of drilling in water depths greater than 250 feet, both worldwide and in the Gulf of Mexico, **are predominantly foreign flagged**.
- Specialty vessels (pipelay, heavy lift, sophisticated dive support, etc.) used in construction and support of the offshore industry are foreign based, work worldwide, and are **predominately foreign flagged**.

#### **ARE FOREIGN FLAGGED VESSELS LESS SAFE THAN U.S. FLAGGED VESSELS?**

Legislative proposals and comments made during legislative hearings have suggested, without evidence, that **foreign flag vessels and crews are unsafe, not well inspected, and operate to different standards than U.S. flag vessels. This is absolutely not true.** Currently, all foreign flagged drilling rigs must undergo inspection by the U.S. Coast Guard (USCG) to secure a Certificate of Compliance prior to operation on the OCS. Further, the major “open registries” adhere to standards that are at least equal to, and in many cases exceed, those applied to U.S. flagged vessels. These registries require the same compliance with the following widely applied international standards:

- International Convention for the Safety of Life at Sea (SOLAS), including the International Ship and Port Facility Security Code and International Management Code for the Safe Operation of Ships and for Pollution Prevention;
- International Convention on Load Lines;
- International Convention on Standards of Training, Certification and Watchkeeping for Seafarers;
- International Convention for the Prevention of Pollution from Ships, as modified by the Protocol relating thereto (MARPOL);
- The Code for the Construction and Equipment of Mobile Offshore Drilling Units;
- Code of safe practice for the carriage of cargoes and persons by offshore supply vessels (OSV Code); and
- Code of Safety for Special Purpose Ships (SPS Code).

Compliance with these international Conventions and Codes is routinely accepted by USCG in permitting foreign flagged vessels to enter U.S. ports and engage in international passenger and cargo trade, as these requirements are implemented to enhance safety. The respected Paris MoU rates U.S. flagged

vessels as “grey” based on the higher number of inspection citations issued to them while they were in foreign ports compared with vessels flagged in other countries, suggesting that foreign flagged vessels’ safety adherence may sometimes eclipse that of U.S. flagged vessels, rather than vice-versa.<sup>3</sup>

Due to the prolonged delays of the regulatory process in the U.S., and domestic resistance to the imposition of “international” standards, the provisions of many of these standards have not been implemented under applicable U.S. regulations and are thus not applied to U.S. vessels in domestic service. As a result, some U.S. vessels are required to comply with less stringent requirements.

#### **CAN WE RELY ON INSPECTIONS CONDUCTED BY “RECOGNIZED ORGANIZATIONS” IN LIEU OF USCG?**

One of the criticisms levied against the open registries is that they rely upon “recognized organizations” (*i.e.*, classification societies) to undertake inspections on behalf of the foreign registries. However, USCG’s “Alternate Compliance Program”<sup>4</sup> is applied to many U.S. flagged vessels and relies upon these same organizations as “authorized classification societies” to perform inspections on behalf of the USCG. It is also paradoxical that some legislative proposals contain provisions that would require the USCG to train its vessel inspectors to the standards of the classification societies.

#### **IS THERE A BENEFIT TO REQUIRING THAT FOREIGN FLAGGED VESSELS BE RE-FLAGGED IN THE U.S.?**

- **Re-flagging is a complex process, takes a long time and provides no clear benefits that outweigh its substantial downsides.** Requiring reflagging of the OCS fleet would create a crippling delay in offshore E&P activities as vessels await approvals. All reflagged vessels would require a USCG regulation equivalency analysis, which could take up to two years for specialized offshore service vessels. Compliance with potentially mandated modifications may take an additional six months.
- **It provides no greater U.S. oversight for safety, because USCG already has the authority to set inspection and operation standards for all vessels operating on the OCS and engaged in energy production activities.** It has exercised this authority with respect to MODUs for over 30 years. It is a matter of policy that USCG has chosen not to exercise this authority over other vessels engaged in OCS activities.
- **It would not result in increased taxes to the U.S., because the U.S. tax liabilities of vessel owners engaging in activities on the OCS are the same, irrespective of the flag of the vessel they operate, subject only to exemptions under applicable tax treaties.**
- **U.S. registry is widely recognized as uncompetitive in the global marketplace.** Re-flagging would hurt the competitiveness of vessels globally. Vessels flying U.S. flags face higher costs, liabilities, fees and taxes and less regulatory flexibility than their competitors flying foreign flags, as detailed in the background paper prepared by the staff of the U.S. House Committee on Transportation and Infrastructure.<sup>5</sup> Once flagged as a U.S. vessel, there is no assurance that a vessel could be reflagged back to other countries’ registries when needed elsewhere, thereby making these increased costs and inflexibilities apply globally.

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<sup>3</sup> See latest annual report at [www.parismou.org](http://www.parismou.org)

<sup>4</sup> 46 C.F.R. 8.400, et seq. See [www.uscg.mil/hq/cg5/acp/](http://www.uscg.mil/hq/cg5/acp/)

<sup>5</sup> Dated July 19, 2010, and prepared for July 20, 2010 hearings.

- Approval of the Maritime Administration (MARAD) is required to exit the U.S. registry. This approval is not automatic, but is subject to administrative and other delays (e.g. EPA-required surveys to prevent “export” of regulated substances contained in the vessel, such as PCBs). Further, MARAD routinely places restrictions on its approval, including the requirement that the United States may “requisition” a vessel back into the U.S. flag, and the U.S. itself, at any time during an emergency. This greatly increases the burden placed on the vessel owner and could pose uncertainties that undermine the continued global competitiveness of these specialized vessels.
- Global market demands are required to make financially viable many of the specialized vessels that support E&P operations in the Gulf of Mexico. These vessels must be able to operate with the lower costs and greater flexibility available under foreign flag registries to remain competitive in the international marketplace and make them viable for use in the Gulf of Mexico. Vessels involved in deepwater operations, in particular, move between international locations in response to market conditions and cannot have their flexibility of movement undermined by restrictive U.S. regulations. As demonstrated by the low number of U.S. flag vessels operating outside the United States in the oil and gas industries, the market has already clearly demonstrated that those vessels cannot provide the efficiencies of foreign flagged vessels that make them competitive in the international marketplace.
- Re-flagging could present security concerns in certain areas of the globe where the U.S. flag could present a target for terrorists.
- Re-flagging legislation may conflict with U.S. international trade commitments.
- **USCG Inspection oversight required to support Certificates of Inspection would be problematic.** To operate under U.S. registry, a vessel must maintain a USCG Certificate of Inspection, which requires periodic inspections by USCG. Historically, USCG has not authorized its inspectors to travel to areas with security concerns and inspectors who are active duty military may have limited travel authorization under Status of Forces agreements. Consequently, vessel owners cannot predictably obtain USCG inspection services necessary to maintain a USCG Certificate of Inspection in many foreign countries – particularly those that are active in offshore E&P. USCG would need to allow third party “recognized organizations” to inspect U.S. flagged vessels in other countries to overcome this difficulty of inspecting numerous vessels, but doing so would not remove the other identified re-flagging problems.
- **Re-flagging would increase the burden of U.S. agencies that would have to administer such a policy change.** Re-flagging would require the vessels to undergo detailed USCG inspection for certification to U.S. regulations. USCG policy<sup>6</sup> since 1981 restricts many vessels from re-flagging under the U.S. flag, because it narrowly applies to vessels between two and ten years old. This policy would need to be extensively revised to accommodate the foreign flagged vessels currently providing services on the OCS. Under the proposed legislation, USCG would need to develop a practicable policy for the near-simultaneous re-flagging of hundreds of vessels. The costs are unpredictable, but could be considerable, depending upon the revised policy.

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<sup>6</sup> Navigation and Vessel Inspection Circular No. 10-81 (Oct. 1981)

- **Crewing:** There is currently an insufficient U.S. mariner force trained, experienced and capable of crewing these highly complex, specialized vessels.

**REQUIRING 75% U.S. OWNERSHIP WOULD CAUSE ECONOMIC HARDSHIPS AND JEOPARDIZE VIABILITY OF COMPANIES THAT EMPLOY SIGNIFICANT NUMBERS OF U.S. WORKERS.**

- **The ownership mandate would require refinancing of vessel construction loans.** Implementation of a 75% ownership requirement would present significant loan restructuring and investment hurdles in obtaining sufficient capital; for many this will not be possible. This may undermine financial needs in other economic sectors and further restrict credit availability where it is needed.
- **U.S. tax policies** on foreign earnings are not aligned with those of other nations and would also present a serious hardship for U.S. flagged vessels attempting to compete internationally to meet market demand.

**SHOULD MORE OFFSHORE FACILITIES BE BUILT IN AMERICA?**

**The U.S. does not presently have the infrastructure in place to fabricate the massive hulls required for deepwater facilities, drillships, and semi-submersible MODUs.**

- U.S. shipyards would need several years to upgrade their operations and expertise to build these much larger OCS facilities.
- However, U.S. shipyards already competitively build smaller OCS facilities, such as self-elevating MODUs (jack-ups) for both U.S. registry and foreign registries, and the majority of the topside sections of major offshore facilities destined for the U.S. OCS.
- A large percentage of OCS facilities’ final assembly already takes place in the U.S.

**WOULD “AMERICANIZATION” OF OFFSHORE OPERATIONS CREATE JOBS FOR U.S. CITIZENS?**

**No, this is a job loser and would jeopardize a significant number of existing U.S. jobs associated with the operation of the foreign flagged fleet currently operating in the Gulf of Mexico.**

- Under existing provisions of the Outer Continental Shelf Lands Act, workers on an OCS facility, rig, platform or vessel that is engaged in OCS activities must be U.S. citizens or resident aliens if they are part of the “regular complement.” Certain limited exemptions may be obtained from the USCG.
- If all foreign flagged vessels and MODUs now employing U.S. citizens or resident aliens are required to leave U.S. waters, those workers, as well as existing U.S. workers at shore-based facilities that support the current offshore fleet, would very likely lose their jobs. It is uncertain when, if at all, vessels under U.S. registry would fill the void.
- If the Gulf of Mexico region loses access to these specialty vessels, new energy production from the OCS would be brought to a halt, with disastrous impacts to American jobs and the U.S. economy.

**COULD US SHIPYARDS AND FABRICATION FACILITIES BE EXPANDED AND UPGRADED TO CONSTRUCT THESE VESSELS?**

**Yes, but the cost to do so would be prohibitive, the investment highly speculative, and it would take years to develop – in the meantime offshore production would be replaced by increased imports.**

- Shipyards in Singapore and Korea produce these units and vessels in three years or less in existing facilities that are largely fully capitalized. They have demonstrated the capability to shift production to other types of vessels for the worldwide market (e.g., tankers) to maintain production capacity.
- Enacting an American-build requirement may violate international trade agreements with the World Trade Organization.