ANALYSIS OF JONES ACT LEGISLATIVE WAIVERS AND THEIR RELEVANCE TO LNG TANKERS USED TO TRANSPORT NORTH SLOPE GAS TO CALIFORNIA

PREPARED FOR:

DEPARTMENT OF REVENUE
STATE OF ALASKA
550 WEST SEVENTH AVENUE
ANCHORAGE, ALASKA 99501

PREPARED BY:

WILSON GILLETTE & CO.
PETROLEUM AND LOGISTICS SPECIALISTS

HOUSTON • WASHINGTON

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REPORT SUMMARY

Sempra Energy's recent effort to secure a legislative wavier to the Jones Act for LNG tankers that would be used to transport North Slope gas to California raised questions about this process and prospects for its success. Our report addresses these issues and responds to questions asked by the Alaska Department of Revenue.

Section 27 of the Merchant Marine Act of 1920 (the Jones Act) reserves cabotage rights of the United States to vessels built in the U.S., registered in the U.S. and manned with citizen crews. For vessels not meeting requirements needed to participate in the U.S. coastwise and protected noncontiguous trades, a waiver to the Jones Act must be obtained. There are two types of waivers which are administrative and legislative.

Administrative waivers are issued by the Treasury Department on grounds of national security. These are for short periods and often cover a single voyage. Few administrative waivers have been granted for commercial purposes and most were done to accommodate government shipping activities.

Legislative Jones Act waivers fall into two categories. First, there are legislative waivers which allow foreign built fishing boats and small coastwise craft to become trade qualified vessels. These waiver requests occur frequently and many are enacted into law. The second group involve legislative waivers for large oceangoing vessels that are the focus of this assignment. During the last 25 years, over 80 bills were introduced to waive the Jones Act or to significantly reduce its scope. Twenty of these bills were enacted into law and the remainder either died in committee or were defeated in debate. Bills enacted into law were carefully scrutinized by Congress before passage to ascertain a compelling need or unusual circumstance that would justify legislative inroads being made into the Jones Act.

Four common elements were present in successful Jones Act legislative waiver initiatives with large oceangoing vessels. First, the trade in which the vessel is to be employed has sound economic fundamentals and the waiver is supported by shippers who would use the vessel. Second, all of the major maritime unions (whose members would be employed on the vessel) endorsed the waiver. Third, proactive backing is given by members of Congress whose constituents benefit from the waiver. Fourth, the domestic shipbuilding industry must support or not be actively opposed to the waiver.

Sempra Energy's effort (March-April-May 2005) to secure legislative waivers for LNG tankers was well funded and employed prominent lobbying firms. However, their initiative was poorly planned, ineptly executed and unable to get support from Alaska's Congressional delegation.

Due to the lack of backing from Alaska's Congressional delegation the most important marine labor organizations (Seafarers International Union and the American Maritime Officers Association) decided not to support the process. Moreover, the Marine Engineers Beneficial Association's early support for Sempra's wavier caused concern among SIU and AMO leaders who felt their decision was premature and unnecessary. MEBA is one of the smaller and less influential marine unions whose policy positions often conflict with those taken by SIU and AMO.

The shipbuilding industry's support for Sempra's waiver was conditional on LNG replacement vessels being built in the United States. The American Shipbuilding Association (ASA) proposed that older U.S. built LNG ships (operating under foreign registry) be reflagged and allowed to enter the Alaska gas trade on a temporary basis provided newbuilding contracts for replacement ships built in domestic yards are stipulated in the waiver legislation. ASA's requirement complicates Sempra's waiver initiative and would increase marine transportation expense associated with Alaska gas deliveries to California.

The federal-Alaska state governments and North Slope producers are fully committed to building a pipeline that will deliver gas directly to the Middle West. Due to their singular focus no support will be forthcoming from producers and governments for projects that propose to transport North Slope gas by LNG tankships from Alaska's ice free ports.

Conclusion. Over the next few years there will be no meaningful support available to advance legislative Jones Act waivers for LNG ships used in the Alaska trade. This is due to all of the key players in the process being opposed to any initiative which detracts from their primary goal of constructing a natural gas trunkline from Alaska to the Middle West. The only scenario in which North Slope LNG transportation becomes possible is one where the producing companies fail to build a gas line from Alaska to the Middle West. Since this eventuality is unlikely to happen there is no reason to believe waterborne transportation and LNG ships will have a role in marketing North Slope gas in the foreseeable future.

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CHAPTER I

THE MERCHANT MARITIME ACT OF 1920 AND JONES ACT WAIVERS

Section 27 of the Merchant Marine Act of 1920 (the Jones Act) reserves cabotage rights of the United States and its possessions (e.g. Puerto Rico) to vessels built in the U.S., registered in the U.S. and manned with citizen crews. For vessels not meeting requirements needed to participate in the U.S. coastwise and protected noncontiguous trades, a waiver to the Jones Act must be obtained. There are two types of waivers whose particulars are discussed below.

A. ADMINISTRATIVE WAIVERS.

Due to accelerated shipping requirements that arose during the Korean War, Congress enacted a statute (1950) which gave the Secretary of Defense authority to grant administrative waivers to the Jones Act in the interest of national defense. Under this statute the Secretary of the Treasury is required to waive Jones Act restrictions on foreign vessels when requested to do so by the Secretary of Defense.

Moreover, the Treasury Department is also authorized to grant waivers on its own initiative or upon the written recommendation of other government agencies when the request is deemed by the Treasury to be in the interest of national defense. Within the Treasury, the U.S. Customs Service (Vessel Entry Procedures and Carriers Branch) is responsible for interpreting and enforcing cabotage laws. Since 1951, the Customs Service has approved approximately 160

Jones Act vessel waivers requested by the Departments of Defense-Commerce-Energy-Interior, the Military Sealift Command and the Coast Guard. Administrative waivers were usually granted for short periods and often for a single voyage. Few waivers have been granted for commercial shipping and most were done to accommodate government activities.

Pursuant to oil transportation (crude oil-petroleum products-liquefied gases) requests for administrative waivers are firstly handled by the Secretary of Energy who submits them to the Treasury Department. The Maritime Administration is then contracted to see if trade qualified vessels are available to cover the required transportation. In most cases, Jones Act tankships have been identified and the waiver requests withdrawn. The availability of Jones Act shipping (and not its higher expense) has been the criterion used to approve or deny waiver requests. In special cases foreign ships have been granted waivers to: (1) transport Strategic Petroleum Reserve oil during supply drawdowns; (2) move propane from the Gulf Coast to the Northeast during the winter; and (3) to cover the emergency needs of the Miltiary Sealift Command.

B. LEGISLATIVE WAIVERS.

Legislative waivers fall into two categories. First, there are legislative waivers which allow foreign built fishing boats and small coastwise craft to become trade qualified vessels. These requests occur frequently and many are enacted into law.

The second group (which is the focus of this report) involve legislative waivers for large oceangoing vessels. Since 1980, over 80 bills have been introduced to waive the Jones Act or to signfiicantly reduce its scope. Approximately 20 of these bills were enacted into law. Most of the proposed bills either died in Committee or were defeated in debate. Bills enacted into law were carefully scrutinized by Congress before passage to ascertain a compelling need or unusual circumstance that would justify legislative inroads being made into the Jones Act. Particulars of the more significant Jones Act legislative initiatives are discussed in Chapter II of this report.

CHAPTER II

JONES ACT LEGISLATIVE WAIVERS INVOLVING LARGE OCEANGOING COMMERCIAL SHIPS.

This section describes eleven initiatives made after 1980 to secure employment for large oceangoing foreign vessels in coastwise commercial service. These disparate actions tightened Jones Act provisions, allowed some foreign ships to enter the domestic trade under U.S. registry and permitted several U.S. built ships employed in foreign flag service to return to Jones Act service. However, most of the legislation introduced to allow foreign ships to operate in the coastwise trade was unsuccessful. Our analysis addresses initiatives that involved large blue water commercial vessels and excludes legislative waivers granted to fishing boats, small barges and ferries that are not pertinent to this assignment.

A. PROPOSAL (1981) TO AMEND THE JONES ACT (H.R. 3577) AND PERMIT FOREIGN SHIPS TO TRANSPORT FOREST PRODUCTS FROM THE PACIFIC NORTHWEST TO THE GULF COAST, EAST COAST AND PUERTO RICO FOR TWO YEARS.

In response to declining Northwest timber sales in the eastern U.S., lumber companies in Washington and Oregon introduced legislation (1981) that proposed to exempt their coastwise transportation from Jones Act shipping requirements for two years. Historically, these timber companies maintained proprietary U.S. fleets that shipped cargos to the Gulf and East Coast with railroad transportation considered to be uneconomic. Due to growing vessel obsolescence, high U.S. newbuilding costs and rising marine operating expense lumber company fleets were retired during the 1970s and shippers became dependent on independent Jones Act companies for

transportation to eastern markets.

The timber companies argued that high U.S. marine transportation expense imposed a burden on their Gulf and East Coast sales and these markets could only be recaptured if they had access to lower cost foreign shipping. Opponents of this waiver initiative argued that other economic factors were responsible for declining Pacific Northwest timber sales in eastern markets. Rising forest products production in the South Atlantic region (more tributary to eastern markets) and increased imports from Canada (facilitated by favorable Crown and Provincial government policies) were cited as principal reasons for declining Pacific Northwest timber sales in the eastern U.S. Moreover, opponents provided information on Jones Act marine transportation expense which they maintained was competitive with other alternatives open to timber companies intending to ship products from the Pacific Northwest to the East and Gulf Coast.

Proponents of this waiver request were timber companies operating in the Pacific Northwest. Groups opposed to this initiative were Jones Act shipping companies, U.S. shipyards and maritime unions. This initiative failed to gain support in the House of Representatives and it did not progress beyond hearings held by the Merchant Marine Committee.

B. LEGISLATION (1982) WHICH ALLOWED THE OCEANIC CONSTITUTION TO OPERATE IN THE WEST COAST TO HAWAII PASSENGER TRADE.

This initiative proposed that the Constitution be allowed to operate in the noncontiguous Jones

Act passenger trade between the California and Hawaii. The Constitution was a large passenger liner built in U.S. during the early 1950s. The Constitution and Independence (sister ships) both operated in U.S. flag trans-Atlantic passenger service until the late 1960s when declining traffic and the elimination of federal operating subsidies forced them into retirement. These liners were sold to new owners who placed them under foreign registry and operated the ships in international passenger service during the 1970s.

Growing obsolescence of the Independence and Constitution during the late 1970s made them less attractive in foreign flag service as new passenger ships entered the international cruise trade. Concurrently, increased opportunities in the California to Hawaii cruise ship business and the high cost of U.S. liner construction created incentives to return the Constitution and Independence to Jones Act service.

However, federal maritime law precludes the return of U.S. built ships to Jones Act service after they have operated in foreign flag service. Groups who advocated the return of these liners to domestic service were the Maritime Unions, Hawaii's Congressional Delegation and the U.S. Maritime Administration.

Due to the large number of seagoing jobs involved in passenger ship operations, U.S. Maritime Unions were proactive in supporting legislation that would allow the Constitution and

Independence to return to Jones Act service. The only group opposed to this initiative was the shipbuilding lobby who was unable to block this initiative that was enacted into law as P.L. 97-13 during 1982.

C. ELIMINATION OF THE JONES ACT THIRD PROVISO FROM THE ALASKA STATEHOOD STATUTE1983-1984.

The Jones Act Third Proviso is a special exception that permits the use of foreign vessels and crews for the movement of "Lower 48" commerce through Canadian ports to U.S. ports provided the goods are transported over Canadian rail lines subject to joint tariffs filed with the Interstate Commerce Commission. When enacted (in 1920) its purpose was to facilitate the continuation of rail-ferry service in the Great Lakes region through Canada to the upper Middle West, New England and the Northeast. This provision of the Jones Act was not intended to apply to Alaska but it was incorporated in 1958 statehood legislation.

In 1983, the Burlington Northern Railroad, Alaska Railroad and Alaska Navigation proposed to charter two German built-Norwegian flag containerships and put them in service between Vancouver, British Columbia and Seward, Alaska. This action was permissible under the existing statute and it presented a serious threat to Tote's new roll on-roll off service between Seattle and Anchorage.

At the same time the Alaska Statehood Commission formally raised objections to the Jones Act due to the high cost of U.S. shipping and the burdens it imposed on the State. The Statehood Commission issued reports that: (a) measured the additional cost of employing Jones Act Shipping in North Slope crude oil transportation and its negative impact on State oil revenues; and (b) identified the higher cost of cargos delivered to Alaska from the West Coast.

Preliminary efforts to change this provision in Alaska Statehood legislation were made by domestic shipyards, Jones Act shipping companies and the maritime unions. Their arguments centered on U.S. vessel investments already made to support Alaska, Alaska employment resulting from these investments and the fact that foreign shipping costs would not be materially below those already charged by Jones Act operators. These arguments proved to be effective and the entire Alaska Congressional Delegation (Stevens-Murkowski-Young) supported a legislative change which excluded Alaska from being able to use the Third Proviso to the Jones Act.

D. COAL LIGHTERING SERVICE IN HAMPTON ROADS, VIRGINIA 1983.

Due to shallow drafts at docks in Hampton Roads, Virginia coal exports on foreign flag vessels were hampered by the use of smaller bulk carriers in the international trade where the employment of large ships is preferred. To overcome this constraint, the Norfolk Southern Railroad (owner of the Hampton Roads marine terminal and coal export business) proposed that foreign lighters be employed to add cargo to large foreign flag coal carriers. Their plan was to

firstly partially load large foreign carriers at the Hampton Roads Terminal and then move them to deeper water in Chesapeake Bay where they would receive additional cargos from foreign lightering vessels also loaded at the Hampton Roads Terminal.

Supporters of this project were the Norfolk Southern Railroad, Coastal Barge Company and Canadian Steamship lines. The initial effort was to secure an Administrative Waiver based on the rationale that increased coal exports would enhance U.S. energy security. In addition, proponents argued that since foreign lighters would be used in international commerce their employment would not violate Jones Act provisions. Their request for an Administrative Waiver was denied.

Supporters of the Hampton Roads coal lightering project then approached the House Merchant Marine Committee with proposed legislation. Hearings were held and opposition was expressed by shipbuilders, maritime unions, and the U.S. Maritime Administration who maintained that such lightering activities were subject to the Jones Act. This proposal failed to go beyond public hearings held by the House Merchant Marine Committee.

E. NORDIC LOUISIANA 1991-TEMPORARY USE OF FOREIGN BUILT SULFUR CARRIER IN CROSS-GULF SERVICE TO FLORIDA.

Sulfur Carriers, Inc. was a U.S. affiliate of Waterman Steamship Company who is a Jones Act operator. One of their vessels (Louisiana Brimstone) was employed transporting sulfur for

Freeport McMoran between offshore Louisiana and Florida. During its employment, the Louisiana Brimstone was damaged beyond repair and Sulfur Carriers experienced an immediate need for replacement tonnage that was not available in the domestic fleet due to the specialized nature of vessels used to transport sulfur.

To cover their loss Freeport McMoran Resource Partners (the shipper) requested an Administrative Jones Act Waiver that was granted for six months. The Nordic Louisiana (British built) was allowed to operate temporarily in Louisiana to Florida service with the stipulation that the ship be put under American registry, operate with a U.S. crew and all repairs be done in domestic shipyards.

Needing a longer term transportation arrangement, Freeport McMoran then had legislation introduced that would allow them to operate the Nordic Louisiana in Jones Act service for up to four years. This legislation (P.L. 102-100) was approved with the condition that Freeport McMoran enter into a contract to build a replacement vessel in the U.S. nine months after enactment of this statute. Pursuant to this requirement the Sulfur Enterprise (21,649 DWT) was constructed at the McDermott Shipyard in Louisiana and put into operation in 1994. The Sulfur Enterprise is presently operated by Canal Barge Lines of New Orleans. Due to the specialized nature of this type of vessel and the absence of replacements in the domestic fleet, opposition to this legislative waiver was minimal. Moreover, groups normally opposed to waivers were

satisfied with requirements that: (1) replacement construction occur in the U.S.; (2) all ship repairs be done in domestic yards; (3) U.S. crews be employed on temporary and replacement vessels; and (4) the Nordic Louisiana be withdrawn from the Jones Act fleet when the Sulfur Enterprise entered service.

F. HAWAIIAN CRUISE TRADE (1997) P.L. 105-56.

Due to inefficiencies and considerable expense associated with using forty year old passenger ships (the Constitution and Independence) in the Hawaii cruise trade, American Classic Voyages (vessel owner-operator) was instrumental in getting legislation inserted into the Department of Defense FY 1998 Appropriations Act that allowed the following actions.

- Permanent operation of one foreign built-U.S. flag cruise ship within the Hawaiian Islands.
- Eighteen months after enactment (with the foreign built-U.S. flag cruise ship employed in intra-Hawaii service) American Classic Voyages was required to enter into a binding contract to build two large cruise ships in the United States.
- The first U.S. built cruise ship was to be delivered no later than January 2005 and the second U.S. built cruise ship delivered no later than January 2008.

U.S. marine interests supported this legislation due to shipyard work (at Pascagoula, Mississippi) that would result from it and additional seagoing jobs attendant to the introduction of three modern passenger liners to the Jones Act fleet. The Pascagoula yard was awarded contracts to construct two cruise ships for $1.4 billion and the Maritime Administration provided federal loan guarantees of $1.1 billion that were needed to underwrite vessel construction. American Classic

Voyages was thinly capitalized and unable to make progress payments on these passenger ships while they were under construction, which established the need for federal loan guarantees (Title XI) issued by the Maritime Administration.

G. TEMPORARY USE OF FOREIGN BUILT TANKERS IN JONES ACT SERVICE CAUSED BY DELAYED VESSEL DELIVERY FROM DOMESTIC SHIPYARDS (2003) SECTION 214 OF P.L. 107-295.

This statute resulted from Exxon Mobil's abortive interest in building replacement crude ships for their Alaska fleet. Due to considerable delays experienced by Conoco Phillips and British Petroleum with deliveries of double hull tankers from Avondale (Millennium Class-COP) and Nassco (Alaska Class-BP) Exxon Mobil wanted to minimize their exposure to tonnage shortfalls that could result from late shipyard deliveries. Being confronted with impending statutory retirements on their single hull tankers, EOM needed assurance that late shipyard deliveries of replacement vessels could be covered by SeaRiver's temporary use of foreign built ships in the Alaska crude oil trade. EOM's concern was based on: (1) Avondale Shipyard being three years behind schedule in delivering five Millennium Class tankers to Conoco Phillips; and (2) National Steel and Shipbuilding being two years behind schedule in delivering four Alaska Class tankers to British Petroleum.

Edison Chouest was attempting to secure Exxon Mobil's newbuilding orders for the Alaska crude oil trade. This company is a major constructor of oil production platforms and service

boats used in the offshore Gulf of Mexico. Edison Chouest is a privately held company sited in Louisiana that has considerable political influence at the state and federal level. In anticipation of getting the EOM business (and to demonstrate their capabilities) Edison Chouest had legislation introduced and enacted which authorized the Secretary of Transportation to grant Jones Act Waivers for the employment of foreign tankers when newbuilds are delayed due to unforeseen developments in domestic shipyards building the replacement vessels. Provisions of this statute are summarized below.

General - the Transportation Secretary may issue documentation certificates with appropriate endorsement for the employment in coastwise service of a self-propelled tankship not built in the United States under conditions listed below.

Waiver Requirements.

- The person requesting the waiver is party to a binding legal contract (executed 24 months after enactment of this statute) with a American shipyard involving domestic construction of a petroleum product or crude oil tanker.
- The Secretary determines both parties are making a serious effort to construct the tankship in a timely manner.
- The tankship under construction is not available for use on the stipulated delivery date due to unforeseen developments and alternate trade qualified vessels are not available in the Jones Act fleet for hire.
- The Secretary concludes (through public hearings) that no suitable trade qualified Jones Act vessels are available to the company requesting the waiver.

Waiver Conditions.

- The waiver must be granted for a vessel with capacity similar to the tankship under construction.
- Waivers must be for no more than 48 months.
- The Secretary may grant waivers for no more than three foreign built tankships.
- Waivers will terminate 60 days after the newbuildings are completed and delivered to the shipping company.

H. FOREIGN BUILT LAUNCH VESSELS USED TO TRANSPORT OFFSHORE OIL PRODUCTION PLATFORM JACKETS FROM TEXAS-LOUISIANA PORTS TO OCS GULF OF MEXICO DRILL SITES (2003) P.L. 107-295.

Transportation between U.S. ports and oil drilling rigs sited in the Outer Continental Shefl is subject to the Jones Act and vessels employed in this business must be trade qualified. British Petroleum was developing deep-water fields in the Gulf of Mexico (Atlantis-Thunderhorse-Holstein-Mad Dog-Murphy-Medusa-Dominion-Devil's Tower) and confronted with shortages in vessels needed to transport production platform components to drill sties. To resolve this limitation BP was allowed to (through a legislative waiver) employ five large foreign built supply boats in the construction of these deep-water production platforms. However, foreign vessels could only be used if Jones Act qualified vessels were unavailable.

I. PASSENGER VESSEL SERVICES ACT (2005) P.L. 108-7.

The Passenger Vessel Services Act was an outgrowth of the failed American Classic Voyages-Pascagoula Shipyard project discussed in Section F above. Major cost overruns were

experienced while building the two ACV passenger liners and construction delays escalated without any assurance these vessels would or could be completed. Moreover, these vessels were being built under a fixed price contact and total shipyard losses could not be determined. At the same time, Litton Industries (owner of the Pascagoula Shipyard) was acquired by Northrup Grumman who was unfamiliar with the extent of growing shipbuilding losses. The upshot was that the Pascagoula Shipyard halted work on the two ACV passenger liners in order to stop mounting financial losses being incurred on this project.

During this period, American Classic Voyages was forced into bankruptcy and ownership of the unfinished passenger ships (by default) was transferred to the Maritime Administration who had issued federal loan guarantees that were necessary to underwrite their construction. ACV argued their bankruptcy was caused by an unforeseen decline in cruise ship business that occurred after the 11 September 2001 World Trade Center disaster. Shortly thereafter the Maritime Administration declared the ACV-Pascagoula passenger project a total loss and absorbed a $1 billion write-off in Title 11 loan defaults.

From the wreckage of the ACV-Pascagoula project the Hawaiian cruise ship program was reborn new with participants. Under the Passenger Vessel Services Act (PVSA) Norwegian Cruise Lines was brought into the program with the following provisions.

- Three ships would be employed in the inter-island Hawaiian cruise market.

- One of these ships would be foreign built (Germany) and operate under the U.S. flag with an American crew.
- Two of the ships would be American built. The American built ships were those partially constructed at Pascagoula that were purchased by Norwegian Cruise Lines. NCL paid $29 million for the two hulls that were towed to Europe and completed at a German shipyard.
- The U.S.-German built passenger vessels operate under U.S. registry with American crews.

Support for PVSA came from the Maritime Unions, Hawaii's Congressional Delegation and most especially from Senator Inouye who played a decisive role in its enactment. Opposition from the shipbuilders was ineffective due to the poor performance by the Pascagoula Shipyard on this project. The postmortem was that U.S. yards were incapable of building large oceangoing passenger liners due to the lack of a skilled labor force and the absence of allied domestic industry infrastructure needed to construct such vessels.

J. PACRIM COAL-CHUITNA PROJECT 2002-2005.

For several years, Petro-Hunt has lobbied Congressman Don Young (Chairman of the House Committee on Transportation and Infrastructure) to introduce a legislative Jones Act waiver for foreign built colliers that would be employed under U.S. registry to transport coal from Alaska to markets in the lower 48 states. Petro-Hunt proposes to develop the Chuitna Coal reserves in Cook Inlet and to sell this low sulfur fuel to electric power plants located on the West Coast, Gulf Coast and East Coast. Due to lengthy voyages associated with these shipments marine

transportation is a major expense item which has a decisive impact on program economics and project feasibility.

As planned the Chuitna project would produce 3-5 million tons of low sulfur coal each year and employ up to eight U.S. flag Panamax (75,000 DWT) Class colliers. There are no suitable oceangoing coal carriers in the Jones Act fleet and colliers would have to be built in domestic shipyards to cover this requirement at an approximate cost of $900 million. However, there are numerous modern bulk carriers in the foreign fleet that could be acquired for a third of the U.S. newbuilding cost.

Citing benefits from the Chuitna project that would accrue to U.S. maritime employment and the State of Alaska, Petro-Hunt requested Congressman Young to: (1) introduce legislation that would permit foreign built colliers to operate in the coastwise coal trade from Alaska under U.S. registry; and (2) hold hearings on their proposal in the House Committee on Transportation and Infrastructure. Thus far, the maritime unions (American Maritime Officers and Seafarers International) have been party to these discussions and presumably would be expected to support this initiative when it becomes part of Young's legislative agenda. The Petro-Hunt project has been under discussion for more than four years and its economics are marginal which explains why this initiative has not surfaced as a formal legislative proposal.

K. GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) AND WORLD TRADE ORGANIZATION (WTO) REQUIREMENTS 1996-1998.

International trade agreements entered into by the United States and approved by Congress also influence what can be done with Jones Act vessel waivers involving foreign built ships. In December 1994, the U.S. Trade Representative notified the GATT Secretary General that existing U.S. maritime legislation grandfathered under the agreement would include:

- The Jones Act.
- Passenger Vessel Act.
- Dredging.
- Towing.
- Fishery endorsements for Vessels.

Under this Grandfather Agreement, U.S. build requirements for the coastwise and protected trades cannot be made more restrictive. Liberalizing amendments to U.S. cabotage laws are permitted but more restrictive amendments are prohibited. Furthermore, U.S. cabotage laws grandfathered under this GATT/WTO agreement would lose their status if they were changed in a way that decreases their conformity with GATT principles.

Pursuant to this GATT/WTO stipulation is the status of temporary waivers (e.g. Nordic Louisiana-Section E) granted to foreign built ships that allows them to operate in the Jones Act coastwise trade under U.S. registry until replacement tonnage is built in domestic shipyards. The

GATT/WTO agreement considers this type of legislation more restrictive and it is not permitted. Therefore, foreign built ships allowed into the Jones Act trade and operated in the domestic fleet could not be removed. We believe the GATT/WTO agreement makes the enactment of Jones Act waivers more difficult to accomplish because it precludes compromise actions with domestic shipyards whose cooperation (based on the construction of replacement tonnage in U.S. yards) is needed to get such legislation approved.

L. CONCLUSIONS.

Over the last 25 years, four elements have been present in successful Jones Act legislative waiver initiatives. First, the trade in which the vessel is to be employed had sound economic fundamentals and the support of shippers who would use the vessel. Second, all of the major maritime unions endorsed the waiver. Third, proactive political backing is necessary from members of Congress whose constituents benefit from the waiver being proposed. Fourth, the domestic shipbuilding industry must support or not be actively opposed to the waiver. Shipbuilding support is based on the construction of replacement tonnage when temporary waivers are granted.

CHAPTER III

USE OF FOREIGN BUILT LIQUEFIED NATURAL GAS (LNG) TANKERS TO TRANSPORT ALASKA NORTH SLOPE GAS TO BAJA, CALIFORNIA.

Information on Sempra Energy's effort (held during March-April-May 2005) to secure Jones Act waivers for LNG tankers came from participants engaged in the process with whom we have business relationships. First, is National Steel and Shipbuilding (Nassco) who wants to build LNG tankers for the Alaska trade. Nassco recently built two roll on-roll off ships for Saltchuk and their yard is owned by General Dynamics who built ten LNG tankers in the United States during 1977-1980. Second, is the Seafarers International Union (SIU) which is the most influential maritime union in the country. SIU attended Sempra Energy's meetings during their initial effort to secure Jones Act waivers. Third, is the American Shipbuilding Association (ASA) who represents the largest private yards. In addition to supporting large Navy shipbuilding budgets ASA is charged with preserving the U.S. build provision in the Jones Act. Particulars of groups involved in the LNG waiver initiative are discussed below.

A. GROUPS INVOLVED IN THE WAIVER INITIATIVE.

The motivation of some parties involved in the LNG waiver process was influenced by global considerations which transcended the parochial issues at issue. Groups involved in the process were: (1) shipbuilders; (2) North Slope producers; (3) maritime unions; (4) Sempra Energy; and (5) the federal government and State of Alaska.

1. U.S. Shipbuilding Industry. Due to rising warship costs and constraints imposed on Navy shipbuilding budgets fewer warships and auxiliary vessels will be built in the future. This development caused large shipbuilders to become more reliant on commercial newbuilding orders that are needed to maintain yard employment and keep overhead expenses affordable for all customers including the Navy. The industry's increased reliance on commercial construction is supported by Congress and the Department of Defense as a way to maintain shipbuilding capacity which is needed to support national security programs. All of the major shipyards are owned by defense companies (General Dynamics and Northrup Grumman) who have influence in Washington. Based on these circumstances, the shipbuilding and defense industries will oppose efforts made to secure legislative Jones Act waivers for foreign built LNG tankers.

2. North Slope Producing Companies. The principal North Slope producers are also major participants in liquefied natural projects being developed in the Middle East-Africa-Asia. These companies (BP-COP-Exxon) plan to market their foreign LNG cargos in all of the industrialized countries including the United States. Presently, BP and Shell have contracts to supply Sempra's Baja LNG terminal with half of its requirements with their cargos coming from Indonesia and Sakhalin Island. Offshore gas development-liquefaction programs are well underway, LNG tankers ordered, receiving terminals built and sales contracts negotiated with end-users.

North Slope gas development is based on overland transportation and sales in the Middle West. This is the focus of BP-COP-Exxon Mobil and federal-state governments who support the Alaska gas project. Due to divergent international and domestic gas strategies it is unlikely ANS producers would support any initiative which proposes to market North Slope LNG in the Pacific Rim. Moreover, BP and Conoco Phillips invested heavily in replacing their Alaska crude oil ships in U.S. yards and they would object to Jones Act waivers being granted to a competitor whose program would undermine their North Slope gas project.

3. The Maritime Unions. Four maritime unions have a Washington presence and they maintain individual lobbying programs having different degrees of effectiveness. The most influential maritime unions are the Seafarers International Union (SIU) and the American Maritime Officers Association (AMO) whose power is based on large memberships, substantial political contributions and longstanding ties with the Bush Administration. The Marine Engineers Beneficial Association (MEBA) and Masters, Mates & Pilots (MM&P) are smaller-ineffectual unions whose position on policy issues is often at odds with the SIU and AMO. MEBA's early support for Jones Act waivers on Sempra's LNG project caused concern among SIU and AMO who felt their decision was premature and unnecessary. SIU believes Jones Act waivers for LNG ships could become an issue in the long run if North Slope gas development and pipeline transportation issues are not resolved.

In Chapter II (Section C) of this report we observed that maritime union support was involved in all of the legislative Jones Act waivers enacted during the last 25 years. Presently, the principal maritime unions (SIU and AMO) are disinclined to get involved in LNG waivers because this project may not come to fruition. These major maritime unions will not get involved in costly and protracted legislative battles (such as Alaska oil exports) which fail to produce additional seagoing jobs.

4. Sempra Energy-Alaska Gasline Port Authority. The first effort to gauge interest in securing legislative waivers for LNG tankers (March-April-May 2005) was underwritten by Sempra Energy. This initiative was well funded and employed many prominent lobbyists. However, their effort was poorly planned, badly executed and unable to get support from Alaska's Congressional delegation. As noted in Chapter II, all of the successful Jones Act wavier initiatives received proactive support from Congressional delegations whose constituents expected to benefit from changes in legislation.

5. Governments. Pursuant to developing North Slope gas reserves, the federal government and the State of Alaska concentrated on a pipeline delivery system and ways to reduce transportation expense to the Middle West. Due to this focus, no attention was given to using LNG tankers and those involved in the pipeline solution consider the marine alternative counterproductive.

B. ALTERNATE SOLUTION PROPOSED BY U.S. MARINE INTERESTS.

National Steel and Shipbuilding presented Sempra Energy with an alternative to their Jones Act waiver proposal. Three elements are involved in this initiative.

First, these ships would be operated under U.S. registry with American crews which is a precondition for Maritime union support that is needed to secure a legislative waiver.

Second, a concern with building LNG tankers in the United States is the long lead time that would be involved in their construction. To overcome this constraint, Nassco is willing to support a waiver that allows U.S. built LNG tankers to return to Jones Act service if Sempra Energy entered into a contract to build replacement vessels in the U.S. The LNG ships that would be reflagged and put into ANS service are now operating under Marshall Islands registry and employed between Indonesia and Japan. For most of their lives these ships operated in the foreign trade under the U.S. flag with American crews. These ships would be replaced in Indonesia-Japan service with foreign newbuildings that are more efficient than the older tankers due to being larger and consuming less fuel.

Because the U.S. constructed LNG tankers are 25 years old and heavily depreciated their capital hire charges would be materially lower than those incurred with domestic newbuildings. Precisely how long these older ships would be employed in Alaska LNG service before being

replaced is unclear. However, from a technical perspective they have operating lives of 35 to 40 years and 10 to 15 years of employment life remaining. Approximately 6 to 8 LNG ships would be needed in the Alaska to Baja trade and a list of U.S. built LNG ships now operating in foreign gas service are identified below.

LNG SHIPS BUILT IN THE UNITED STATES AND EMPLOYED IN GAS SERVICE BETWEEN INDONESIA AND JAPAN

VESSEL	YEAR BUILT	CUBIC METERS	BUILDER	OPERATOR
AQUARIUS	1977	126,300	GENERAL DYNAMICS	PRONAV
ARIES	1977	126,300	GENERAL DYNAMICS	PRONAV
CAPRICORN	1978	126,300	GENERAL DYNAMICS	PRONAV
GEMINI	1978	126,300	GENERAL DYNAMICS	PRONAV
LEO	1978	126,300	GENERAL DYNAMICS	PRONAV
LIBRA	1979	126,400	GENERAL DYNAMICS	PRONAV
TAURUS	1979	126,400	GENERAL DYNAMICS	PRONAV
VIRGO	1979	126,400	GENERAL DYNAMICS	PRONAV

Third, Nassco's replacement vessel (which is an integral part of their waiver proposal) is a 165,000 cubic meter spherical tankship. The estimated U.S. newbuilding price for this LNG carrier is $380 million per vessel and it is considerably higher than the $190 million newbuilding price quoted by South Korean yards for the same ship. Based on six ship LNG fleet operating between Alaska and California, the difference in vessel construction costs between those built in San Diego ($2.4 billion) and South Korea ($1.2 billion) is estimated to be $1.2 billion.

CHAPTER IV

LIKELY OUTCOME OF FUTURE INITIATIVES MADE TO SECURE LEGISLATIVE JONES ACT WAIVERS FOR LNG SHIPS USED IN THE TRANSPORTATION OF NORTH SLOPE GAS TO CALIFORNIA

Our analysis of statutory waiver initiatives conducted during the last 25 years and Sempra Energy's failed effort in 2005 established a framework in which to evaluate the likely outcome of future proposals. Five groups will influence the outcome of legislation which proposes to employ foreign built LNG tankers in the Alaska gas trade to California.

First and most important is active backing from Alaska's Congressional delegation. Sempra Energy was unable to get support from Senators Stevens-Murkowski and Congressman Young this year and we believe their position will remain unchanged while particulars of North Slope gas development and the overland pipeline system are being finalized. Once terms of the Alaska gas-pipeline system are agreed upon and the project is underway there will be no reason to promote a North Slope LNG project.

Second, shipper (North Slope producer) support for a LNG transportation system from Alaska to California is necessary to make such a project credible. However, the North Slope producers are firmly committed to the overland gas pipeline which undermines the credibility of alternative marine transportation proposals.

Third, the principal marine labor unions will not support legislative Jones Act waivers for LNG tankships unless: (a) they are encouraged to do so by Alaska's Congressional delegation; and (b) believe this initiative will produce additional seagoing jobs. Based on current circumstances neither of these conditions are likely to be met and as a result meaningful marine labor support for LNG tankship waivers is unlikely to occur.

Fourth, the American Shipbuilding industry (and their advocates in Congress) will insist that any legislative waiver granted to LNG tankers used in Alaska gas transportation be temporary and require that replacement vessels be built in the United States. Their proactive opposition to employing foreign built LNG ships in the domestic trade will make the enactment of a legislative waiver both time consuming and difficult to accomplish.

Fifth, federal-Alaska State government departments and North Slope producers are committed to building a pipeline that will deliver gas directly to the Middle West. With this program being their singular objective no government support will be given to projects that propose to transport North Slope gas to market on LNG tankers.

Conclusion. In the near term there will be no political support available to advance legislative Jones Act waivers for LNG ships. Key players in the process (e.g. principal maritime unions) are unwilling to get involved unless encouraged to do so by Alaska's Congressional delegation who

has shown no interest in North Slope LNG tanker projects. Moreover, American shipbuilders will insist that U.S. built LNG tankers replace vessels granted Jones Act waivers. This requirement will complicate any waiver initiative and increase the waterborne transportation expense associated with Alaska gas delivered to California.

The only scenario in which North Slope LNG transportation becomes possible is one where the producing companies and pipelines fail to build a gas line from Alaska to the Middle West. Since this eventuality is unlikely to result there is no reason to believe that waterborne transportation and LNG ships will play a role in marketing North Slope gas in the foreseeable future.