INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

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By Electronic Submission

BIS Regulatory Docket
Regulatory Policy Division
Bureau of Industry and Security
U.S. Department of Commerce
Room 2099B
14th Street and Pennsylvania Avenue NW
Washington, DC 20230

Requirements for Submissions Requesting Exclusions From the Remedies Instituted in Presidential Proclamations Adjusting Imports of Steel Into the United States and Adjusting Imports of Aluminum Into the United States; and the Filing of Objections to Submitted Exclusion Requests for Steel and Aluminum
Docket: BIS–2018–0006
RIN 0694–AH55

These comments are filed on behalf of the Independent Petroleum Association of America (IPAA). IPAA represents the thousands of independent oil and natural gas explorers and producers, as well as the service and supply industries that support their efforts, that will be the most significantly affected by the actions resulting from this regulatory proposal. Independent producers drill about 90 percent of American oil and gas wells, produce 54 percent of American oil and produce 85 percent of American natural gas.

The Bureau of Industry and Security solicited comments on the implications of actions taken by the Trump Administration with regard to tariffs and limitations on steel imports. In March, the Trump Administration initiated new imported steel and aluminum tariffs under the authority of Section 232 of the Trade Expansion Act of 1962. The scope of these tariffs impacts American oil and natural gas producers. The implications are numerous. They include:

1. Higher prices for Oil Country Tubular Goods (OCTG) and Line Pipe (LP) due to both tariffs and increased domestic steel prices;
2. An excessively complicated and invasive product exclusion process for imported products that particularly burdens small businesses; and,
3. The creation of alternative trade agreements potentially leading to import quotas that could cripple expansion of American oil and natural gas production because of supply restrictions.

Background

Section 232 of the Trade Expansion Act of 1962 provides the President authority to impose trade restrictions – tariff and/or quotas – on imported products if necessary to protect national security.

The Department of Commerce completed a Section 232 analysis concluding that the current level of steel and aluminum imports posed a threat to national security and recommended actions to increase production of domestic steel to 80 percent of its capacity. The President announced steel tariffs (25 percent) and aluminum tariffs (10 percent) that became effective on March 19, 2018.

American independent producers utilize OCTG and LP steel products to develop and produce oil and natural gas resources. These steel products include OCTG such as carbon steel casing and alloyed steel tubing that reinforce and stabilize the wellbore and LP that are both carbon steel and alloyed steel used to move oil and natural gas on the surface of the well site and for transport off the well site to pipelines or storage. These products typically range from 10 to 20 percent of well development costs.

Over the past few years, domestic steel products have captured more than 50 percent of the OCTG and LP market. However, historically, imports have provided from 35 to 55 percent of OCTG, and many of the alloyed steel products are not produced in the United States and must be imported.

Issues

Recent development of unconventional American oil and natural gas production changed the fundamentals of American energy. After decades of severe dependency on foreign oil and facing a future of imported liquefied natural gas, the United States now is realizing new production, generating not only new unconventional supplies to address critical national needs but the capability to export record volumes as well as a comprehensive product range of oil and natural gas. Increased American energy production creates both domestic security and the capacity to influence international affairs. However, for the past couple of years, low commodity prices have threatened the structure of the industry, particularly its small business component. Consequently, the impact of added costs and – more critically – limited products by quotas can seriously inhibit the economic recovery of American oil and natural gas producers.

Price Implications

When the Section 232 review process was initiated, independent oil and natural gas producers began to see domestic steel product prices increase, ranging from $50/ton to $130/ton depending on the product. With the initiation of the 25-percent steel tariffs, these prices will continue to increase. For example, in March, U.S. prices for OCTG soared by 14-28 percent and LP prices jumped 7-23 percent. At the same time, oil and natural gas commodity prices have not allowed for any pass through of added costs to develop new wells.

The Process

The current process to alleviate the impact of steel and aluminum tariffs involves two key components.

<u>Country Exemptions</u>

The first is country exemptions. These are granted by the Administration. Initially, country exemptions were granted for Canada, Mexico, the European Union, Australia, Argentina, Brazil, and South Korea. On April 30, country exemptions were limited to Canada, Mexico and the European Union until June 1, 2018, unless they are extended by the Administration or subject to separate negotiations resulting in agreements, such as a bilateral trade agreement. At the same time, in addition to the previously announced bilateral agreement with South Korea, the countries of Australia, Argentina and Brazil were announced as committed to bilateral agreements. Significantly, South Korea has been the largest exporter of OCTG products to the United States. Other key OCTG producing countries such as Japan – which is the only source of many of the alloyed steel products – have not been granted exemptions. This process creates enormous uncertainty. The Administration needs to grant country exemptions for meaningful periods of time to allow for better planning and to prevent chaos in the supply chain for OCTG and LP products.

<u>Product Exclusions</u>

The second key component is the product exclusion process. It applies to countries not granted an exemption. However, the product exclusion process is complex. Each user of the product must file for an exclusion. Each product must be addressed; for example, each diameter of tubular goods would appear to require a separate exclusion. The Bureau of Industry and Security (BIS) makes initial decisions on an exclusion but then posts the decision for 30 days when objections can be raised. Detailed information on projected product use is required, but Confidential Business Information (CBI) protections are limited because some of the required public information can be used to predict a company's planned drilling actions. The complexity of the process raises significant potential challenges for small businesses.

For example, in the Federal Register notice, BIS states:

> Only individuals or organizations using steel articles identified in Proclamation 9705 in business activities (*e.g.,* construction, manufacturing, or supplying steel to users) in the United States may submit exclusion requests with respect to that Proclamation. This limitation recognizes the close relation of the economic welfare of the Nation to our national security by affording those who contribute to that economic welfare through business activities in the United States the opportunity to submit exclusion requests based on particular economic and national security considerations. Allowing individuals or organizations not engaged in business activities in the United States to seek exclusion requests could undermine the adjustment of imports that the President determined was necessary to address the threat to national security posed by the current import of steel articles. Any individual or organization in the United States may file objections to steel exclusion requests, but the Commerce Department will only consider information directly related to the submitted exclusion request that is the subject of the objection.
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> Approved exclusions will be made on a product basis and will be limited to the individual or organization that submitted the specific exclusion request, unless Commerce approves a broader application of the product based exclusion request to apply to additional importers.
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> Other individuals or organizations that wish to submit an exclusion request for a steel or aluminum product already approved for exclusion may submit an exclusion request under the two new supplements. Such follow-on requesters of exclusion requests are not required to reference a previously approved exclusion,

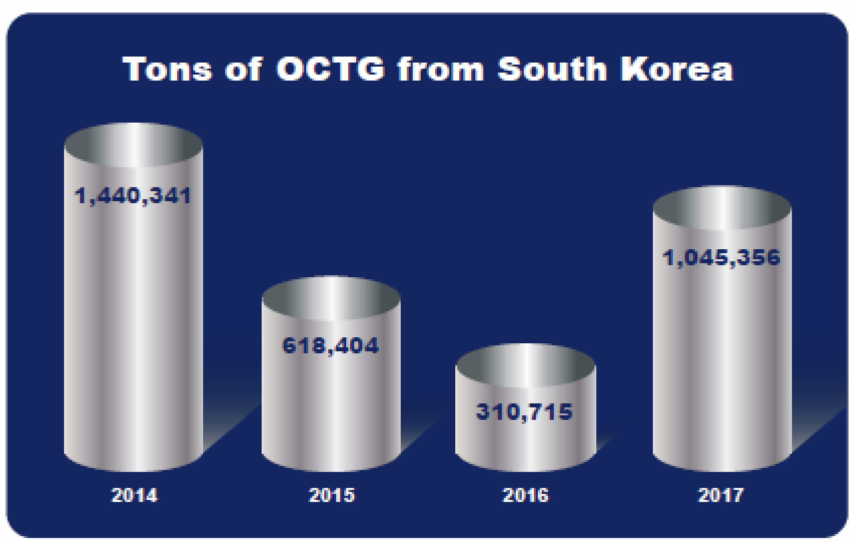
but Commerce may take that into account when reviewing a subsequent exclusion request.

While the rationale that exclusion requests need to be made by participants in the use of steel, creating a process that requires duplicative submissions for the same product serves neither the users of steel nor the staff of BIS that must replicate its process repeatedly for no reason. Having a structure that creates a path that only works when "Commerce approves a broader application of the product based exclusion request to apply to additional importers" places the burden on a further regulatory action. It would seem appropriate that, once BIS approves and sustains a determination that a specific product should be granted an exclusion, the exclusion should be available for all users without each needing to apply. However, neither BIS nor the Department of Commerce has indicated it would adopt this approach. Similarly, while the Department of Commerce has indicated that rebates would be made for products where the tariff is paid and an exclusion is subsequently granted, this position has not been codified.

The Trade Agreement Alternative

The Presidential Proclamation that established the specific country exemptions also presented the option of negotiating agreements to address the import concerns. Most likely, these would be bilateral trade agreements. This approach is more threatening to American oil and natural gas production and the Administration's Energy Dominance agenda than the imposition of tariffs. It creates the potential for severe shortages of OCTG and LP if quotas are poorly designed since both products are required in large amounts to manage growing American production and American exports.

The first action is an announced framework with South Korea. In this instance, it includes a voluntary limitation by South Korea on its exports of steel products to the United States. Specifically, it would cap each steel product at 70 percent of its average tonnage based on the 2015-2017 period. For OCTG and LP, this time period produces a lower effective cap because of the lower import volumes in 2015 and 2016 when commodity price weakness limited American drilling activity. South Korea has been the largest exporter of OCTG and LP to the United States. This quota can create potential shortages of these products depending on both domestic capacity for specific products and the capacity of other exporting countries. If the same percentage limitations are included in future bilateral agreements, such as those with Australia, Argentina and Brazil, the total steel supply for OCTG and LP for the United States could be significantly limited.



In fact, using the information in the preceding graph, South Korean OCTG imports would be limited to approximately 460,700 tons (70 percent of an average of 658,000 tons). However, this amount is 44 percent of 2017 imports and 32 percent of 2014 imports – the last year with robust oil and natural gas production. While some of this lost volume can be replaced with domestic carbon steel OCTG products, domestic production of high alloyed specialty steel products is much more limited. But the limitations on imports does not appear to address this significant reality.

Anecdotal reports indicate that much of the quota has already been imported – since the quota's effective date was January 2018. Not only are costs increasing, but the loss of steel products that cannot be produced domestically or cannot be produced domestically in sufficient quantities are forcing independent producers to seek products elsewhere. However, other countries are already at capacity and cannot supply America's needs for many months.

Additionally, among the issues that must be considered in the quota approach to bilateral trade agreements is the ability of domestic steel producers to increase their output. The Section 232 analysis recommended actions to move domestic steel production from 74 percent of its listed capacity to 80 percent based on tonnage of output. However, "working" steel capacity can differ from listed capacity. For example, in the OCTG area, a significant part of the listed capacity is based on production of offshore products. These are generally of larger diameter and heavier steel than onshore tubular goods. Since the primary growth in American oil and natural gas production is in onshore unconventional development, domestic steel production will need to increase correspondingly for these products. Because onshore OCTG are of smaller diameter and lighter steel, a mill producing the same linear footage of onshore tubular goods as it did for offshore tubular goods would produce fewer tons of product. Consequently, using listed capacity as a basis for determining success of the Section 232 initiative for oil and natural gas production steel demand would be inaccurate. Correspondingly, building a steel tariff/quota system that does not recognize these realities could result in adverse, unintended consequences to American oil and natural gas production and American energy dominance.

Conclusions

Revival of American oil and natural gas production created a strong national economic force, a new capacity for American exports into the world marketplace, and a major factor in international energy policies – the inherent framework of the Trump Administration's Energy Dominance initiatives. Steel and aluminum tariffs and – more potentially critical and harmful – quotas could undermine these successes and the national security benefits that they provide.

As the Administration's steel and aluminum production policies continue to evolve, the Administration needs to understand and address unintended consequences. Among these are:

1. Understanding the magnitude of cost increases for oil and natural gas production development and the implications for continued strong American production;
2. Creating a country exemption structure that is clear and sustained;
3. Structuring a product exclusion process that is straightforward, that allows for easy submission and protects CBI, and that includes blanket exclusions for everyone once a product qualifies; and,

4. Assuring that negotiated trade agreements recognize the limits of current domestic steel production capacity and do not create a quota structure that limits the availability of OCTG and LP steel products.

If we can supply additional information or if there are questions, please contact Lee Fuller by email at lfuller@ipaa.org or by telephone at 202-857-4722.

Sincerely,

Lee O. Fuller

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