

Opportunities For The Oil Industry In NAFTA Renegotiations

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As he promised during the presidential campaign, President Trump moved quickly after entering office to renegotiate and modernize the North American Free Trade Agreement. Following the fifth round of negotiations, which concluded on Nov. 21, 2017, in Mexico City, U.S. Trade Representative Robert Lighthizer, the U.S. government's chief trade policy negotiator, signaled concern for the future of the negotiations. Ambassador Lighthizer stated that, while some progress has been made to modernize NAFTA, "I remain concerned about the lack of headway. Our teams will be meeting again next month in Washington. I hope our partners will come to the table in a serious way so we can see meaningful progress before the end of the year."^[1] His words indicate a lack of progress, possibly paving the way for a NAFTA withdrawal that President Trump has threatened repeatedly.



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According to experts, a NAFTA withdrawal or renegotiation has the potential to harm many U.S. industries by increasing tariffs on most goods and disrupting the supply chains that companies have spent decades building across Canada, the United States and Mexico since NAFTA came into effect in 1994.^[2]



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One such industry, the oil industry, voiced its concerns over the negotiations in a joint statement issued by the American Petroleum Institute, the Asociacion Mexicana de Empresas de Hidrocarburos and Canada's Oil & Natural Gas Producers,^[3] which asserts that NAFTA already is a success story that will allow North America to achieve energy self-sufficiency as early as 2020. The North American oil industry fears that renegotiating NAFTA may disrupt energy trade, potentially putting at risk tens of millions of jobs that are sustained by interdependent energy markets.

Potential Changes to the Rules of Origin

Not all revisions of NAFTA are viewed negatively, however. Concerns over renegotiations have been offset somewhat by the possibility of changes to NAFTA rules of origin that oil industry players are eager to see. One in particular — the rule of origin affecting the commingling of crude oil and the use of diluents and condensate — has long plagued the industry and may be ripe for revision during these renegotiations.

Commingled Crude Oil

Commingling and pooling of crude oil to optimize pipeline system capacity is a common oil industry practice. Using this technique, a pipeline can commingle certain types of crude oil into common pools upon injection into the pipeline system for ultimate delivery under a different commodity name. This approach, however, creates problems for the companies that claim duty-free, preferential treatment under NAFTA. The documentation evidencing the “origination” of the imported crude oil is a hurdle for many importing companies since it is not always easy for the customs authority in each NAFTA member country to verify the origin of the commingled oil product. For example, a recent U.S. Customs and Border Protection ruling[4] states that if a company “purchases MKH (MacKay River Heavy) crude oil from a Canadian supplier, and receives a NAFTA certificate of origin,” the company “does not take the title to the MKH until the supplier delivers it to a ‘feeder’ facility,” the oil is “commingled with MKH belonging to other parties,” and the oil is withdrawn from the feeder facility pipeline at the pipeline operator’s own discretion, the certificate of origin provided by the Canadian supplier is not deemed sufficient for NAFTA eligibility. This finding also applies to a company that “purchases crude oil from a Canadian supplier, which is already in the EPL pipeline,” and where the company “receives a NAFTA certificate of origin from the supplier indicating that this crude oil originates in Canada.”[5] In each of these cases, the companies were required to provide additional documentation to trace the crude oil to be eligible for NAFTA preferential treatment.

These examples illustrate problems the oil industry is encountering with the current NAFTA origin rules addressed in the joint statement: “The rules of origin developed under NAFTA are difficult to apply in the context of a highly liquid commodity market place with electronic bulletin board trading, multiple trades, and commingling of goods in pipeline transport.” The industry advises “[a] new approach ... for qualification and verification that offers equal protection to producers in all three countries through greater incentives for issuing certificates of origin.”[6] The joint statement recommends two solutions to address this problem: “First, the three associations support better requirements and incentives within NAFTA for a producer and other sellers of crude oil or natural gas in Mexico, the US or Canada to provide a NAFTA certificate of origin attesting that the oil or gas has been wholly obtained or produced in the territory of Mexico, the US or Canada. Second, all three associations advocate that NAFTA require customs officials in Mexico, the US and Canada, when verifying NAFTA origin for hydrocarbons at the border, to rely on and accept general information and representations that crude oil or natural gas is originating from Mexico, the US and Canada and, therefore, qualifies for NAFTA preferential tariff treatment.”[7]

Diluents and Condensates

Another problem with the rules of origin involves the diluents and condensates used to lighten or lower the viscosity so the heavy crude oil is able to flow through the pipeline. When the diluents/condensates are added to the crude oil, it is often difficult for the blended crude oil to receive preferential treatment under NAFTA. In fact, 65 percent of Canadian crude oil exports were rejected as NAFTA in origin and assigned U.S. customs duties because the diluent did not originate in a NAFTA member country.[8] The joint statement also addresses this issue: “API, AMEXHI and CAPP support new language for diluent rules of origin that allow for up to 40% by volume.”[9]

TPP as a Baseline?

The oil industry expects the Trump administration to address these problems during the NAFTA renegotiation process. As stated in its NAFTA objectives, the administration aims to “preserve and

strengthen investment, market access, and state-owned enterprise disciplines benefitting energy production and transmission and support North American energy security and independence, while promoting continuing energy market-opening reforms.” Regarding the rules of origin, the administration aims to “update and strengthen the rules of origin,” “ensure that the rules of origin incentivize production,” “ensure origin procedures that streamline the certification and verification of rules of origin,” and “promote cooperation with NAFTA countries to prevent duty evasion, combat custom offenses, and ensure that goods that meet the rules of origin receive NAFTA benefits.”[10]

These objectives, however, do not clarify the administration’s position on the particular rules of origin issues affecting the commingling of crude oil and diluents/condensates. There are published reports that the administration is willing to incorporate provisions from the Trans-Pacific Partnership, which involved all three NAFTA member countries in its negotiations, into a revamped NAFTA.[11] If the administration relies on the TPP to address these problems, a satisfactory fix may be available. The TPP language regarding diluents aligns with the joint statement. Heading note 3 of TPP Chapter 27 under Annex 3-D provides that a diluent used to facilitate the transportation between parties of crude petroleum oils and crude oils will be disregarded, provided that the diluent constitutes no more than 40 percent by volume of the good.[12] Further, the TPP provides an increased “non-originating material” threshold of 25 percent for goods under heading 27.10 that have undergone a “direct blending.”[13]

Conclusion

Although the NAFTA renegotiations carry inherent risks such as possible termination, they also could create opportunities for the oil industry if the TPP is used as a baseline for a revamped NAFTA. Changes in areas such as the rules of origin for crude oil would prove advantageous for the industry.

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[1] <https://www.nytimes.com/2017/11/21/us/politics/nafta-talks.html> .

[2] <https://www.nytimes.com/2017/10/12/business/economy/what-would-happen-if-the-us-withdrew-from-nafta.html?register=google> .

[3] <http://www.api.org/~media/Files/News/Letters-Comments/2017/APIAMEXHICAPPJointPositionPaperonNAFTAV1002Aug2017.pdf> .

[4] See CBP HQ H270579 (August 27, 2017).

[5] Id.

[6] See note 3.

[7] Id.

[8] <http://policyoptions.irpp.org/magazines/august-2017/understanding-the-nafta-rules-of-origin-negotiations/>.

[9] See note 3.

[10] Summary of the Objectives for the NAFTA Renegotiation published by Office of the United States Trade Representative on November 2017. See <https://ustr.gov/sites/default/files/files/Press/Releases/Nov%20Objectives%20Update.pdf> .

[11] See <https://www.ictsd.org/bridges-news/bridges/news/us-canada-weigh-next-steps-in-softwood-lumber-trade-spat>; <https://www.ictsd.org/bridges-news/bridges/news/us-trade-rep-notifies-congress-of-nafta-negotiation-plans> .

[12] See <https://ustr.gov/sites/default/files/TPP-Final-Text-Annex-3-A-Product-Specific-Rules.pdf> .

[13] Id.