**Crude Oil Swaps with Mexico: Is the Export Ban on its Last Legs?**

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On August 14, 2015, the Obama Administration announced that it would approve a number of crude oil “swaps” with Mexico. Pursuant to this approval, Mexico’s state-owned oil company, Petróleos Mexicanos (Pemex), will be able to exchange its heavy Maya crude for lighter U.S. crude and condensate, a move previously prohibited under the forty-year-old U.S. crude oil export ban. Although this is not the first oil swap to be approved with Mexico, this most recent approval comes as calls to repeal the crude oil export ban have grown increasingly louder in the past year, with steady pressure coming from both Congress and outside entities. When the Department of Commerce’s Bureau of Industry and Security (BIS) approved certain exports of lease condensate last year, some saw this as an indication that the Obama Administration tacitly agreed that the crude oil export ban had outlived its usefulness. However, those hopes were dashed earlier this year after Energy Secretary Ernest Moniz commented that the oil industry had not yet made “an overly compelling argument” on the economics of overturning the ban.

This most recent approval for export to Mexico raises the question of whether the industry finally has convinced the Obama Administration that repealing the export ban makes sound economic sense. In all likelihood, the answer is no. However, the approved swaps will benefit both the U.S. and Mexico, and likely will provide further encouragement and data to those seeking to overturn the statutory ban.

# Background

In the wake of the October 1973 Organization of the Petroleum Exporting Countries (OPEC) oil embargo on the United States, Congress in 1975 passed the Energy Policy and Conservation Act (EPCA). Among other things, Section 103 of EPCA required that the President “promulgate a rule prohibiting the export of crude” and vested with the President discretion to provide exemptions to the general prohibition. President Gerald Ford delegated his authority to the U.S. Department of Commerce. Today, the BIS oversees the regulation of crude oil exports and processes license applications from parties seeking to export crude oil abroad.

Pursuant to the BIS’s regulations, crude oil faces a general prohibition on export, consistent with EPCA. Over the years, the President has approved several limited exceptions to this general prohibition, such as the export to Canada for consumption therein, the export of certain crude oil through the Trans-Alaska Pipeline System, and the export of a certain number of barrels of California heavy crude. More recently, in late 2014, the BIS published a list of “Frequently Asked Questions” in which it determined that lease condensate “that has been processed through a crude oil distillation tower is not crude oil but a petroleum product.” This pronouncement effectively allowed American companies to market abroad ultra-light crude oil produced from formations such as the Bakken and Eagle Ford, provided it was materially processed.

# Swaps with Mexico

In approving the crude oil swaps with Mexico, the BIS will permit companies with an approved export license to export crude oil to Mexico in exchange for an equivalent quantity of Mexican Maya crude. Companies involved in these transactions will need to document that equivalent quantities of crude oil are being traded. The licenses, which will be approved in late August, also will require that all crude oil be refined at its final destination in either Mexico or the U.S. The licenses will be effective for one year, subject to renewal.

# The Significance of Mexican Swaps

The Administration’s move to approve the swaps with Mexico marks the second notable announcement related to crude oil exports in the past two years, following the BIS’s approval of exports of processed lease condensate. Although permitting the swaps requires no change in U.S. law or policy, approval of the swaps with Mexico does open up another, albeit limited, market for American companies saddled with a glut of light crude oil produced from domestic fracking operations, which is not well-suited for processing by U.S. refineries along the Gulf Coast. Accordingly, swapping light crude for heavier Mexican crude will benefit these domestic refineries. The exchanges also will benefit Mexico, which has experienced a significant decline in oil production and diversity during the last thirty years. Mexican refineries do not have “deep conversion coking units,” and, therefore, lack the capacity to increase gasoline yields from heavier crude and to reduce output of lower-value fuel oil. Accordingly, the greater availability of light crude will allow the Mexican petroleum products industry, saddled by aging refineries, to operate more efficiently. That said, these swaps are not likely to have a significant impact on oil economics in either the United States or Mexico, as Pemex is seeking only to import about 100,000 barrels of light U.S. crude per day, less than one percent of U.S. output.

Ultimately, approval of the swaps with Mexico probably does not signal a sea change in the Obama Administration’s stance on repealing the EPCA crude oil export ban. There are several reasons for this. First, swaps with Mexico are contemplated under EPCA. Second, the BIS in the past reportedly has rejected similar applications for export to countries in Europe and Asia. More likely, the Obama Administration’s approval of the swaps with Mexico is intended to serve as a type of relief valve to alleviate the pressure that has been building from the industry to engage in these types of export transactions. By providing the industry with this discrete opportunity for export, the Obama Administration hopes that it can quell the growing pressure from the industry to undertake executive action to relax the ban.

Notwithstanding the Obama Administration’s perspective, this announcement likely is encouraging to those in Congress and the industry who are seeking the outright repeal of the crude oil export ban. Beyond the symbolic value of new crude oil exports, these swaps also will provide information to those advocating for more liberal exports of crude oil, specifically important data points on the ideal price differential between various oil benchmarks (e.g., Brent, West Texas Intermediate) necessary to make export economical.

# For more information

As noted above, companies engaging in crude oil swaps with Mexico will need to secure an export license from the BIS. Van Ness Feldman, LLP can help clients better understand the requirements of the BIS’s export approval process and is available to assist clients wishing to obtain licenses to export crude oil.

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