

STATEMENT BY

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ON BEHALF OF
THE AMERICAN PETROLEUM INSTITUTE
THE INTERNATIONAL ASSOCIATION OF DRILLING
CONTRACTORS

AND THE
NATIONAL OCEAN INDUSTRIES ASSOCIATION

BEFORE THE
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ON THE
LAW OF THE SEA

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Mr. Chairman and members of the Committee:

Thank you for inviting me to testify before you today to express the U.S. oil and natural gas industry's views on the important subject of United States accession to the United Nations Law of the Sea (LOS) Convention.

Taken together, the three associations I am representing here today, the American Petroleum Institute (API), the International Association of Drilling Contractors (IADC) and the National Ocean Industries Association (NOIA), represent the full spectrum of American companies involved in all phases of oil and natural gas exploration and production in the oceans of the world, as well as the marine transportation of petroleum and petroleum products.

The offshore oil and natural gas industry is a multibillion-dollar industry. A recent economic survey of global ocean markets done in the United Kingdom¹ brings home clearly the economic significance of offshore oil and natural gas production. Offshore oil and natural gas is now the world's biggest marine industry where oil production alone can have a value of more than \$300 billion per annum. This compares to global shipping revenues of \$234 billion and expenditures of all the world's navies amounting to \$225 billion. Submarine cables, which provide the "worldwide" part of the worldwide web and enable the very existence of the internet, is the next largest marine business with \$86 billion in revenues; and incidentally, that important industry is on record as supporting United States accession to the LOS Convention. In addition to activities in areas under United States jurisdiction such as Alaska and the Gulf of Mexico, our nation has substantial interests in offshore oil and natural gas development activities globally, given our significant reliance upon imported oil. U.S. oil and natural gas production companies, as well as oilfield drilling, equipment and service companies, are important players in the competition to locate and develop offshore natural gas and oil resources. The pace of technological advancement, which drove the need to define the outer limits of the continental margin, has not abated. Advances in technology and increased efficiencies are taking us to greater and greater water depths and rekindling interest in areas that once were considered out of reach or uneconomic.

Recognizing the importance of the LOS Convention to the energy sector, the National Petroleum Council, an advisory body to the United States Secretary of Energy, in 1973 published an assessment of industry needs in an effort to influence the negotiations. Entitled "Law of the Sea: Particular Aspects Affecting the Petroleum Industry," it contained conclusions and recommendations in five key areas including freedom of navigation, stable investment conditions, protection of the marine environment, accommodation of multiple uses, and dispute settlement. The views reflected in this study had a substantial impact on the negotiations, and most of its recommendations found their way into the Convention in one form or another.

Among the provisions that were influenced by the study are the following:

¹ John Westwood, Barney Parsons and Will Rowley, Douglas Westwood Associates, Canterbury, United Kingdom, *Oceanography*, vol. 14, no. 3/2001.

- ◆ confirmation of coastal state control of the continental shelf and its resources to a distance of 200 nautical miles and beyond to the outer edge of the continental margin, defined on the basis of geological criteria;
- ◆ establishment of a Continental Shelf Commission to advise states in delimiting their continental shelves in order to promote certainty and uniformity;
- ◆ specific provisions on the settlement of disputes related to the delimitation of continental shelves among states with opposite or adjacent coasts;
- ◆ revenue sharing applicable to development of resources beyond 200 nautical miles based on a modest royalty beginning in the sixth year of production;
- ◆ recognition of the role of the International Maritime Organization in setting international safety and select environmental standards;
- ◆ allocation of enforcement responsibility for safety and environmental standards among states of registry, port states, and coastal states;
- ◆ requirements for the prompt release of detained vessels and crews upon the posting of bond; and
- ◆ a comprehensive system of dispute settlement allowing a choice among the International Court of Justice, a specialized Law of the Sea Tribunal, and arbitration.

Having been satisfied with changes made to the Convention, the U.S. oil and natural gas industry's major trade associations, including API, IADC and NOIA, support ratification of the Convention by the United States Senate. Also, the Outer Continental Shelf Policy Committee, an advisory body to the United States Secretary of the Interior on matters relating to our offshore oil and natural gas leasing program, in 2001 adopted resolutions supporting the United States acceding to the Convention.

Offshore Oil and Natural Gas Resources

The Convention is important to our efforts to develop domestic offshore oil and natural gas resources. The Convention secures each coastal nation's exclusive rights to the living and non-living resources of the 200-mile exclusive economic zone (EEZ). In the case of the United States this brings an additional 4.1 million square miles of ocean under U.S. jurisdiction. This is an area larger than the U.S. land area. The Convention also broadens the definition of the continental shelf in a way that favors the U.S. as one of the few nations with broad continental margins, particularly in the North Atlantic, Gulf of Mexico, the Bering Sea and the Arctic Ocean.

Considering the remarkable advances in offshore exploration technology that have taken us farther and farther offshore into deeper and deeper water, the assessment of the National Petroleum Council in 1973 seems remarkably prescient in retrospect; and that assessment rings more true today than ever.

With what may be the largest and most productive continental shelf in the world, the U.S. obtains about 28 percent of its natural gas and almost as much of its oil production from the outer continental shelf (OCS); this share of U.S. production is increasing thanks to new world class oil discoveries in the deep waters of the Gulf of Mexico.

Exploration Moving Farther from Shore into Deeper Waters

Offshore petroleum production is a major technological triumph. We now have world record complex development projects located in 5,000-6,000 feet of water in the Gulf of Mexico which were thought unimaginable a generation ago. Even more eye-opening, a number of exploration wells have been drilled in the past three years in over 8,000 feet of water and a world record well has been drilled in over 9,000 feet of water. New technologies are taking oil explorers out more than 200 miles offshore for the first time, thus creating a more pressing need for certainty and stability in delineation of the outer shelf boundary. Before the LOS Convention there were no clear, objective means of determining the outer limit of the shelf, leaving a good deal of uncertainty and creating significant potential for conflict. Under the Convention, the continental shelf extends seaward to the outer edge of the continental margin or to the 200-mile limit of the EEZ, whichever is greater, to a maximum of 350 miles. The U.S. understands that such features as the Chukchi Plateau and its component elevations, situated to the north of Alaska, are not subject to the 350-mile limitation. U.S. companies are interested in setting international precedents by being the first to operate in areas beyond 200 miles and to continue demonstrating environmentally sound drilling development and production technologies.

Revenue Sharing

The Convention provides a reasonable compromise between the vast majority of nations whose continental margins are less than 200 miles and those few, including the U.S., whose continental shelf extends beyond 200 miles, with a modest obligation to share revenues from successful minerals development seaward of 200 miles. Payment begins in year six of production at the rate of one percent and is structured to increase at the rate of one percent per year to a maximum of seven percent. Our understanding is that this royalty should not result in any additional cost to industry. Considering the significant resource potential of the broad U.S. continental shelf, as well as U.S. companies' participation in exploration on the continental shelves of other countries, on balance the package contained in the Convention, including the modest revenue sharing provision, clearly serves U.S. interests.

Importance of Delineating the Continental Shelf

The Convention established the Continental Shelf Commission, a body of experts through which nations may establish universally binding outer limits for their continental shelves under Article 76. The objective criteria for delineating the outer limit of the continental shelf, plus the presence of the Continental Shelf Commission, should avoid

potential conflicts and provide a means to ensure the security of tenure crucial to capital-intensive deepwater oil and natural gas development projects.

It is in the best interest of the U.S. to register its claims extending the outer limits of our continental margin beyond 200 miles where appropriate— in so doing the U.S. could expand its areas for mineral exploration and development by more than 291,383 square miles. We need to get on with the mapping work and other analyses and measurements required to substantiate our claims, however. Some of the best technology for accomplishing this resides in the United States. Establishing the continental margin beyond 200 miles is particularly important in the Arctic, where there are a number of countries vying for the same resource area. In fact, Russia has already submitted claims with respect to the outer limit of its continental shelf in the Arctic.

Resolution of Boundary Disputes

As regards maritime boundaries, there presently exist about 200 undemarcated claims in the world with 30 to 40 actively in dispute. There are 24 island disputes. The end of the Cold War and global expansion of free market economies have created new incentives to resolve these disputes, particularly with regard to offshore oil and natural gas exploration. During the last few years hundreds of licenses, leases or other contracts for exploration rights have been granted in a variety of nations outside the U.S. These countries are eager to determine whether or not hydrocarbons are present in their continental shelves, and disputes over maritime boundaries are obstacles to states and business organizations which prefer certainty in such matters. We have had two such cases here in North America where bilateral efforts have been made to resolve the maritime boundaries between the U.S. and Mexico in the Gulf of Mexico and between the U.S. and Canada in the Beaufort Sea. Both of these initiatives have been driven by promising new petroleum discoveries in the regions. The boundary line with Mexico was resolved in 2000 after a multi-year period of bilateral negotiations. Negotiations with Canada, however, seem to be languishing.

While such bilateral resolution is always an option, the Convention provides stability and recognized international authority, standards and procedures for use in areas of potential boundary dispute, as well as a forum for dealing with such disputes and other issues.

The settlement we made with Mexico now makes it possible for leases in the Gulf of Mexico issued by the Department of the Interior's Minerals Management Service (MMS) to be subject to the Article 82 "Revenue Sharing Provision" calling for the payment of royalties on production from oil and natural gas leases beyond the EEZ. According to MMS, seven leases have been awarded to companies in the far offshore Gulf of Mexico which include stipulations that any discoveries made on those leases could be subject to the royalty provisions of Article 82 of the Convention. MMS also reports that one successful well has been drilled about 2.5 miles inside the U.S. EEZ. Details on how the revenue sharing scheme will work remain unclear, and without ratification the U.S. Government's ability to influence decisions on implementation of this provision is limited or non-existent. This creates uncertainty for U.S. industry.

Gas Hydrates

Ratification of the Law of the Sea Convention also has an important bearing on a longer-term potential energy source that has been the subject of much research and investigation at the U.S. Department of Energy for several years: gas hydrates.

Gas hydrates are ice-like crystalline structures of water that form “cages” that trap low molecular weight gas molecules, especially methane, and have recently attracted international attention from government and scientific communities. World hydrate deposits are estimated to total more than twice the world reserves of all oil, natural gas and coal deposits combined.

Methane hydrates have been located in vast quantities around the world in continental slope deposits and permafrost. They are believed to exist beyond the EEZ. If the hydrates could be economically recovered, they represent an enormous potential energy resource. In the U.S. offshore, hydrates have been identified in Alaska, all along the West Coast, in the Gulf of Mexico, and in some areas along the East Coast. The technology does not now exist to extract methane hydrates on a commercial scale. A joint industry group of scientists has been at work in the Gulf of Mexico since May of this year examining the hydrate potential in several deepwater canyons. This work is intended to help companies find and analyze hydrates seismically and to complete an area-wide profile of hydrate deposits.

In the Methane Hydrate Research and Development Act of 2000 Congress mandated the National Research Council to undertake a review of the Methane Hydrate Research and Development Program at the Department of Energy to provide advice to ensure that significant contributions are made towards understanding methane hydrates as a source of energy and as a potential contributor to climate change. That review is now underway. The U.S. Navy has also done work on gas hydrates, as has the U.S. scientific community, including universities such as Louisiana State University and Texas A&M. Significant research is also being conducted by scientific institutions in Japan. The United States needs to have a seat at the table of the Continental Shelf Commission in order to influence development of any international rules or guidelines that could affect gas hydrate resources beyond our EEZ.

Marine Transportation of Petroleum

Oil is traded in a global market with U.S. companies as leading participants. The LOS Convention’s protection of navigational rights and freedoms advances the interests of energy security in the U.S., particularly in view of the dangerous world conditions we have faced since the tragic events of September 11, 2001. About 44 percent of U.S. maritime commerce consists of petroleum and petroleum products. Trading routes are secured by provisions in the Convention combining customary rules of international law, such as the right of innocent passage through territorial seas, with new rights of passage through straits and archipelagoes. U.S. accession to the Convention would put us in a much better position to invoke such rules and rights.

U.S. Oil Imports at All-Time High

The outlook for United States energy supply in the first 25 years of the new millennium truly brings home the importance of securing the sea routes through which imported oil and natural gas is transported.

According to API's Monthly Statistical Report published on October 15, 2003, imports of crude oil reached a new, all-time high in September. At close to 10.4 million barrels per day, crude imports surpassed the previous high reached in April 2001. When combined with higher volumes for products such as gasoline, diesel fuel and jet fuel, total imports amounted to nearly two thirds of domestic deliveries for the month. This is an extraordinary volume of petroleum liquids being transported to our shores in ships every day.

The Department of Energy's Energy Information Administration (EIA), in its 2003 Annual Energy Outlook, projects that by 2025, net petroleum imports, including both crude oil and refined products on the basis of barrels per day, are expected to account for 68 percent of demand, up from 55 percent in 2001. Looking at the October numbers from API makes one wonder whether 2025 is fast approaching.

Growing Natural Gas Imports

EIA's 2003 Outlook also states that, despite the projected increase in domestic natural gas production, over the next twenty years an increasing share of U.S. gas demand will also be met by imports. A substantial portion of these imports will come in the form of liquefied natural gas (LNG). All four existing LNG import facilities in the U.S. are now open, and three of the four have announced capacity expansion plans. Meanwhile, several additional U.S. LNG terminals are under study by potential investors, and orders for sophisticated new LNG ships are being placed. This means even more ships following transit lanes from the Middle East, West Africa, Latin America, Indonesia, Australia, and possibly Russia, to name the prominent regions seeking to participate in the U.S. natural gas market.

Global Significance of Persian Gulf Exports

Another important factor to consider is that, according to EIA, Persian Gulf exports as a percentage of world oil imports are in the process of growing from 30 percent in 2001 to 38 percent in 2025. The Persian Gulf is a long, semi-enclosed sea. Much of it lies beyond the 12-mile limit of the territorial sea but not beyond the 200-mile limit. Within the Persian Gulf there are seven settled international maritime boundaries and as many as nine possible maritime boundaries that have not been resolved in whole or in part.²

Fortunately, from the standpoint of U.S. and world dependence on Persian Gulf oil imports, the LOS Convention provides authority that in those areas beyond the

² See "Persian Gulf Disputes," comments prepared by Jonathan L. Charney, Professor of Law, Vanderbilt University, for a conference on "Security Flashpoints: Oil, Islands, Sea Access and Military Confrontation," New York City on February 7-8, 1997.

territorial sea the right of high seas navigation applies to all vessels. According to the Convention, within the territorial sea vessels have the right of innocent passage and, for straits used for international navigation, the right of transit passage applies. It goes without saying that the United States would be in a better position to secure these rights in this unstable area if it were a party to the Convention.

Rising World Oil Demand

World oil demand in 2001 was 76.9 million barrels per day. Up to 1985 oil demand in North America was twice as large as Asia. As developing countries improve their economic conditions and transportation infrastructure we could soon see Asian oil demand surpass North American demand. By 2025 world demand is expected to reach nearly 119 million barrels per day. Steady growth in the demand for petroleum throughout the world means increases in crude oil and product shipments in all directions throughout the globe. The Convention can provide protection of navigational rights and freedoms in all these areas through which tankers will be transporting larger volumes of oil and natural gas.

Need for U.S. Involvement in LOS Governance

In conclusion, from an energy perspective we see potential future pressures building in terms of both marine boundary and continental shelf delineations and in marine transportation. We believe the LOS Convention offers the U.S. the chance to exercise needed leadership in addressing these pressures and protecting the many vital U.S. ocean interests. Notwithstanding the United States' view of customary international law, the U.S. petroleum industry is concerned that failure by the United States to become a party to the Convention could adversely affect U.S. companies' operations offshore other countries. In November 1998, the U.S. lost its provisional right of participation in the International Seabed Authority by not being a party to the Convention. At present there is no U.S. participation, even as an observer, in the Continental Shelf Commission—the body that decides claims of OCS areas beyond 200 miles—during its important developmental phase. The U.S. lost an opportunity to elect a U.S. commissioner in 2002, and we will not have another opportunity to elect a Commissioner until 2007.

The United States should also be in a position to exercise leadership and influence on how the International Seabed Authority will implement its role in being the conduit for revenue sharing from broad margin States such as the U.S., yet the U.S. cannot secure membership on key subsidiary bodies of the Seabed Authority until it accedes to the Convention. Clearly United States views would undoubtedly carry much greater weight as a party to the Convention than they do as an outsider. With 143 countries and the European Union having ratified the Convention, the Convention will be implemented with or without our participation and will be sure to affect our interests.

It is for these reasons that the U.S. oil and natural gas industry supports Senate ratification of the Convention at the earliest date possible.

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