TransCanada Keystone XL Pipeline Faces Political Peril: Ian Doig

The TransCanada Pipeline project could be one of the most important oil infrastructure developments in a generation. For an analysis of what is holding the project up and what investors should be watching in the industry, The Energy Report, asked Ian M. Doig, editor of Doig’s Digest.

Source: The Energy Report Editors

The Energy Report: After months of debate, the U.S. State Department recently announced that it would take another year to study alternative routes for TransCanada Corp.’s (TRP:TSX) proposed $7 billion (B), 2,700 kilometer Keystone XL Pipeline system. Why the departure from previous federal statements that the project, which filed its application in 2008, was on track for approval to begin pumping in 2013?

Ian Doig: Since the State Department issued its positive report in August, TransCanada’s system faced many roadblocks that it couldn’t jump over. The Inspector General ordered a special review on the work that Cardno ENTRIX of Houston had conducted on Keystone XL’s economic impact study. The firm had previously done work for TransCanada and identified the company as one of its major clients. But the biggest roadblock was erected by the State of Nebraska, where concern was high about the pipeline making its way through its delicate Sand Hill region that overlays the Ogallala region, the state’s primary source of drinking and irrigation water. As the halt was called in Washington, Nebraska’s legislative natural resources committee was holding a hearing with the intent to forcing TransCanada to reroute the pipeline.

TER: So, is this an environmental or political problem?

ID: When I heard the announcement, my thoughts returned to May of 1956 and the original TransCanada Pipelines Limited’s (TCPL) system to Central Canada through Northern Ontario, which was debated in the Canadian House of Commons. The controversy eventually led to the defeat of the Liberal government in the Canadian general election the next year and the Progressive Conservatives, led by John Diefenbaker, taking power. Fifty-five years later, the president of the United States found himself walking in the same shadow facing his own political end. In the end, the national interest test that the pipeline had to pass revolved around the re-election of the president on Nov. 2, 2012, and not about the jobs it would create or the energy it would provide.

The president arrived in Washington three years ago saying that he was going to do things differently. For those looking for a tangible reason as to why Canada ought to diversify its export markets for crude oil and natural gas, the answer was there last month. The United States, under its current President, can no longer be counted upon as a reliable energy market.
The Canadian government, which self-proclaimed itself an energy superpower back in 2006, has left much to be desired. The federal government, including the new minister of Natural Resources who is struggling with his portfolio, was left on the sidelines by events leading up to Nov. 10. The end result will have Ottawa having to make harder decisions in the aftermath of the National Energy Board’s (NEB) forthcoming regulatory decision on the Northern Gateway Pipeline project to Kitimat that is expected in early 2013. Canada’s prime minister, facing his own re-election issues, is playing survival politics.

TER: Was it the politicians, the companies, industry or all of the above who failed to get this project moved forward?

ID: Unfortunately, the Canadian oil industry never really publicly rallied around this project with needed support. The companies wanted governments to do their spadework for them. In late October and early November, the presidents of Canadian Natural Resources Limited and Suncor Energy Inc., via conference calls from the comforts of their offices, tried to rally support for the pipeline, but by then it was too little and way too late. Environmental activists had all but closed that door. Although the U.S. Chamber of Commerce and the American Petroleum Institute are backing the pipeline, many more are against it and they were publicly making their views known. At this point, the company and industry are using high-priced lobbyists, including a former U.S. ambassador to Canada, to help to get U.S. approval. Unfortunately, they all misread the signals. In fact, those in the U.S. on the buying side did a much better job advancing the Keystone XL pipeline than those in Canada on the selling side.

The TransCanada board also has to be held accountable. One board member has been in place 19 years, another 10 years and the chairman has been in place nine years. In total, the group of nine Canadians and three U.S. members have collectively served 87 years—7.25 per member. New blood is badly needed. It will be interesting to see what this board, which received $2.5 million (M) in retainers and fees in 2010, pays the company’s senior management team for their performances this year. In 2010, the top six executives (including the retired chief executive officer) received total compensation of $24.2M, of which $3.8M (15.7%) came from salaries. The remaining $20.4M (84.3%) came from other goodies—share-based awards, option-based awards, annual incentive plans, long-term incentive plans, pension value and other compensations.

The Industry as a whole didn’t help the cause. ExxonMobil Corporation’s spill into the Yellowstone River in Montana and the infamous Deepwater Horizon blowout in the Gulf of Mexico last year also damaged the project’s safety argument.

TER: How will this delay impact the movement of the 830,000 barrels per day (bbl/d) of oil scheduled to ship to Cushing, Oklahoma from from the Bakken oil shales in North Dakota?

ID: As much as 25% of the output of the Bakken was to have been transported through this route. By 2013, the project was scheduled to be halfway through its next regulatory hurdle, rather than languishing at the starting point on this phase. What makes this delay even more disastrous is the fact that supplies from Mexico and Venezuela now going to refiners in the Gulf Coast, are in decline. For the U.S. economy, time is of the essence.
For TransCanada, shipper agreements for 445,000 bbl/d that form the backbone of the XL pipeline are at risk. Canadian oil sands producers are firming up capital spending budgets for 2012 now and without approvals, they could get left out of the equation.

The status of TransCanada's Houston Lateral and Cushing Marketlink Open Seasons are also very much in doubt. They call for additional capacity of up to 300,000 bbl/d of new pipeline capacity south of Cushing. The company is mulling the idea of splitting up the building of the XL into two parts: starting in the south by building the leg from Cushing to Mulling to Houston and the refining centers in Port Arthur, Texas, next year; then building the northern section from Hardisty to Cushing when approval is received. It would be a gutsy move considering how things have gone so far with XL.

TER: What are the next steps?

ID: Four days after the Washington announcement, the State of Nebraska introduced its Oil Pipeline Certification Act, which established an application process for oil pipeline routings in the state. That Act won state approval on Nov. 22 and the authority of pipeline certifications will now rest with the governor. So Nebraska will conduct its own study into the route that the XL system will take and will pay for this hearing process that will take six to nine months to complete. But at this time, there are no guarantees that a new acceptable route can be found through Nebraska, and there will be no change to Washington's time schedule calling for its next decision in the spring of 2013.

The company willingly approved this change of events when only weeks earlier it said it would never consider a change in the route. Make no mistake, this rerouting wasn't voluntary; it was forced. But beware, for the green movement, changing the route isn't the prize; no pipeline period is the goal.

TER: So, is this a delay or death for Keystone XL?

ID: Unfortunately at this point in time nobody knows what the U.S. political and regulatory playing fields will look like in 15 months and whether TransCanada can find the right pieces to put into place for Keystone XL-2. But, if a new president gets voted in next fall, then TransCanada is looking at a whole new playing field, which is likely to be more friendly.

As serious as the delay or cancellation of the XL system is, it is just a forerunner of the major test facing TransCanada in 2012: the fallout from the Business and Servicing Restructuring and Mainline 2012-2013 Tolls Application filed by TransCanada Pipelines Ltd., NOVA Gas Transmission Limited and Foothills Pipe Lines Limited. This will inflict damages more serious and long lasting.

The company entered 2011 trading at $37.99 per share after undergoing a 2010 high-low of $39.28-$30.01 per share. The stock started last month trading at $42.49 per share and by the end of the month was at $42.88.

TER: Are any other Canadian natural gas companies worth watching?

ID: AltaGas Ltd. (ALA:TSX), a Calgary-based energy company that commenced operations in 1994 and concentrates on natural gas, power and regulated utilities, will be more than doubling its regulated rate base by increasing its customer base
from 75,000 to 110,000.

It is in the process of purchasing all the issued and outstanding common shares of Pacific Northern Gas Ltd. (PNG:TSX) for $36.75 per share. This purchase will cost approximately $233.8M. The equity component of this purchase is $145.5M; long-term debt, $83.3M; and $5M of preferred shares. AltaGas will continue to operate the new purchase under the Pacific Northern Gas name and with the same Pacific Northern Gas management team.

The British Columbia Utilities Commission approved this purchase Nov. 24. However, the price could be lightened by $20 to $21M through ongoing arrangement that Pacific Northern Gas has outstanding with third parties, which will close after this sale is completed.

AltaGas will be holding pipeline capacity along the Summit Lake to Kitimat/Prince Rupert corridor in northern British Columbia, and will be a major player in both the fast-moving unconventional natural gas plays in northeastern British Columbia and in the transportation of natural gas to liquefied natural gas (LNG) export terminals on the coast.

For the shareholders of Pacific Northern Gas, it is happy days. The AltaGas offer represents a 20% premium over its price of $30.50 per share on Oct. 28 and a 28% premium based on the volume weighted average price for the 20 prior trading days. The company entered 2011 trading at $19.40 per share after a 2010 high-low of $18.75 to $5.21.

TER: Any others?

ID: Spectra Energy Partners, L.P. (SEP:NYSE) has announced that it will be spending $2B to $4B in the next few years to expand its natural gas transmission system in British Columbia.

Also, last month, Enbridge Inc. (ENB:NYSE) entered into an agreement to purchase ConocoPhillips' (COP:NYSE) 50% interest in the Seaway Crude Oil Pipeline system for (US) $1.15B. On the closing of this sale in early 2012, Enbridge will be a joint owner of the system with Enterprise Products Partners L.P. (EPD:NYSE). Enterprise Products will continue to operate the south-to-north pipeline, which has a capacity of 350,000 bbl/d, and storage facilities.

The 1,078-kilometre Seaway Pipeline, which commenced operations in 1976, includes the 805-kilometer, 30-inch diameter Freeport, Texas, to Cushing system plus the Texas City Terminal and Distribution System, which serves refineries in the Houston and Texas City areas. The Seaway Pipeline also includes 6.8M bbls of crude oil tankage on the Texas Gulf Coast and four import docks at two locations. Enbridge/Enterprise plan to build a 72-kilometre pipeline that will join Seaway directly to Enterprise's ECHP crude oil storage terminal southeast of Houston.

By purchasing the 50% interest in the Seaway Pipeline and reversing its direction, at an estimated cost of $1.5B, Enbridge and its partner Enterprise have effectively taken the Wrangler Pipeline proposal off the table for now. Plans had called for it to be shipping 800,000 bbl/d from Cushing to the Gulf Coast by mid-2013.

Considering that it came at the same time that TransCanada Corporation was explaining to the financial community why it really didn't matter that the building of its Keystone XL line had been delayed for at least 15 months, many wonder
whether the timing of Enbridge's Seaway purchase was hitting below the belt or just more of the competitive battle now going on between the two companies.

**TER:** Any final thoughts for our readers?

**ID:** North American crude oil producers are finally getting some good news. Moves are in play that will narrow the price spreads between North Sea (Brent) oil and West Texas Intermediate, which was as wide as US$40.74/bbl on Sept. 16, but was down to US$11.01/bbl on Nov. 28.

However, happiness for producers is gloom for refiners. This price-spread problem started last year with the completions of TransCanada Corporation's Keystone and Enbridge Inc.'s Alberta Clipper systems that moved too much crude oil into Cushing, Oklahoma, without the needed takeaway capacity to move it further south to refiners on the Gulf Coast.

**TER:** We will have to watch that. Thank you for your time.

*Ian M. Doig* is an energy writer who has been involved in the Canadian oil industry since 1960 and has published his own newsletter, *Doig’s Digest*, since 1983.

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