

April 2018

# Problematic Pipelines

## TMEP's challenges go beyond B.C. government opposition

On April 8, Kinder Morgan Canada Limited (KML)<sup>1</sup> announced that, in the face of continuing opposition from the B.C. government, it was “suspending all non-essential activities and related spending on the Trans Mountain Expansion Project (TMEP).”<sup>2</sup> The company confirmed that it hoped to reach agreements with stakeholders by May 31 that may allow TMEP to proceed. However, the risks facing TMEP go beyond permitting difficulties in B.C. This briefing outlines the intensifying opposition to TMEP from a diverse range of stakeholders including the B.C. government, the Governor of Washington, First Nations, and Nestlé Waters Canada (Nestlé) which threatens to force the cancellation or delay of TMEP. Institutional financiers may wish to ask Kinder Morgan whether adequate assurances can be obtained on all of these risks or whether the company should instead cancel TMEP.

The Governor of Washington State has indicated an intention to follow B.C.’s lead in examining measures to mitigate the impact of increased oil tanker traffic — which could ultimately render TMEP commercially unviable.

Public opposition to TMEP has intensified attracting more media coverage. In March, as many as 10,000 Indigenous People and their allies marched in Burnaby, B.C., kickstarting more than a week of non-violent

direct action. Reports suggest the Natural Resources Minister was informed prior to granting approval, that “First Nations believed its ‘paternalistic’ approach to consultations was both ‘unrealistic’ and ‘inadequate’”.<sup>3</sup> Court challenges based on the infringement of Indigenous’ rights are expected to be decided in the coming months.

On March 27, Nestlé confirmed its opposition to TMEP’s proposed route because of potential impacts on Nestlé’s bottled water operations. According to Nestlé, Kinder Morgan has failed to initiate, let alone make any serious attempt at, meaningful discussion regarding Nestlé’s concerns.

### Key risks facing TMEP

- British Columbia’s proposal for restricting the transport of diluted bitumen
- Possibility of restrictions on increased tanker traffic in Washington state
- Nestlé’s opposition to the proposed pipeline route
- Growing First Nations’ opposition and non-violent direct action, which is attracting mainstream media coverage
- Pending litigation

## Approval process state of play

On April 8, KML announced that “under current circumstances, specifically including the continued actions in opposition to the Project by the Province of British Columbia, it will not commit additional shareholder resources to the Project.” It confirmed an intention to consult with stakeholders until May 31 focusing on “clarity on the path forward, particularly with respect to the ability to construct through BC; and, adequate protection of KML shareholders.” The company stated that if agreement is not reached by that date, “it is difficult to conceive of any scenario in which we would proceed with the Project.”<sup>4</sup>

The original planned in-service date for TMEP was December 2019. In a March 2018 investor presentation, Kinder Morgan acknowledged that owing to a slower than anticipated permitting process, this could be pushed back by up to 12 months.<sup>5</sup> Admitting that “construction delays entail increased costs due to a variety of factors”, Kinder Morgan stated that “as the extent of the delay is currently unknown, we are not updating cost estimate at this time.” However, in court documents submitted a week later, Kinder Morgan, “...claimed \$89 million in lost revenue for every month the project is delayed, as well as hundreds of thousands more for weekly security, staff, and equipment costs.”<sup>6</sup>

In December 2017, the National Energy Board (NEB) declared certain of Burnaby’s municipal bylaws which would have required Kinder Morgan to obtain certain permits, constitutionally inapplicable to TMEP.<sup>7</sup> The NEB found that there was no evidence of political interference or deliberate obstruction, but held that the time for permitting was an “unreasonable delay”.<sup>8</sup>

In February, the NEB issued three decisions that collectively enabled Kinder Morgan to begin pre-construction tree-clearing and grading work at the entrance of the Burnaby Mountain tunnel (or portal) on its Westridge Marine Terminal property until March 25.<sup>9</sup>

Construction is not yet authorised along the rest of the pipeline route and can only begin once the necessary conditions have been satisfied, and the applicable portions of the route are approved. To date, nearly 66 per cent of the route has been approved by the NEB.

The NEB also established a process for dealing with similar matters relating to provincial or municipal requirements setting a decision time limit of 3–5 weeks, rather than the 18 days requested by Kinder Morgan.<sup>10</sup>

Burnaby and the B.C. government appealed these decisions to the Federal Court of Appeal, which ruled in favour of Kinder Morgan on March 23. Burnaby has confirmed it will appeal to the Supreme Court of Canada.<sup>11</sup>

On April 13, the BC government provided an update on Trans Mountain expansion project permitting process. In total, 1,187 provincial permits are required for the Trans Mountain expansion project, with many involving First Nations consultation. To date, Trans Mountain has only submitted 587 of these permit applications and of those, 201 have been approved and permits issued.<sup>12</sup>

### Questions for Kinder Morgan

- What reassurances does the company require by May 31 regarding “the ability to construct through BC” including reassurances about possible restrictions in B.C. on increased transportation of diluted bitumen?
- What would the company consider “adequate protection of KML shareholders”?
- The company has suggested prolonged litigation may prove an insurmountable obstacle to TMEP.<sup>13</sup> Judgements on First Nations’ legal challenges to TMEP are unlikely to be delivered by May 31. Will the company suspend activities and spending until such time as those cases are finally determined?

## Possible regulations in British Columbia and Washington State threaten TMEP

### British Columbia

Kinder Morgan's suspension announcement acknowledged the impact of the B.C. government's opposition stating: "Those actions have created even greater, and growing, uncertainty with respect to the regulatory landscape facing the Project." The company stated that "BC's intention in that regard [to stop TMEP] has been neither validated nor quashed, and the Province has continued to threaten unspecified additional actions to prevent Project success.<sup>14</sup> We set out below details of actions taken by the B.C. government which threaten TMEP.

The expanded capacity of TMEP could lead to as many as 590,000 more barrels of oil per day arriving at the pipeline terminal in British Columbia. The added oil would be loaded onto an additional 348 tanker ships per year, on top of existing tanker traffic through the Salish Sea. The tankers could head to refineries in Washington, California, or across the Pacific to supply markets in Asia.<sup>15</sup>

On January 30, the B.C. government announced<sup>16</sup> that it was opening consultations around five safeguards against a bitumen spill: spill response time, geographic response plans, compensation for loss of public and cultural use of land, the application of regulations to a marine spill, and restrictions on increased diluted bitumen transportation until spill mitigation was better understood.

Following a retaliatory, temporary boycott of B.C. wines by the Alberta government, the B.C. government

announced on February 22<sup>17</sup> that it was moving forward with the consultation on four bitumen spill safeguards while asking the courts to confirm B.C.'s constitutional right to place "restrictions on the increase of diluted bitumen ("dilbit") transportation until the behaviour of spilled bitumen can be better understood and there is certainty regarding the ability to adequately mitigate spills."<sup>18</sup>

On March 12, B.C. confirmed the appointment of a high-profile external counsel.<sup>19</sup> The B.C. government is expected to soon publish an "intentions paper" providing an overview of the proposed regulations which will likely set out the question to be put to the court. Owing to a lack of precedents, it is unclear how long the case will take.

If ultimately B.C. enacts regulations restricting increases in the transportation of dilbit in the province (either via pipeline or tanker), and they are held to be constitutional, then TMEP would likely only be allowed to transport synthetic crude oil (i.e. bitumen that has been upgraded). This would require new upgrading facilities in Alberta, which are not currently economic to build.<sup>20</sup> Accordingly, such restrictions would likely render TMEP a 'stranded asset'.



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## Washington State

On March 16, the Governor of Washington State said that his state was “‘allied’ with British Columbia in questioning whether TMEP should be built.”<sup>21</sup> Governor Jay Inslee said that his state was looking at marine safety laws to mitigate the impact of a tanker spill,<sup>22</sup> reportedly stating that the “Salish Sea is no place for 5-7x increase in oil tanker in orca-stressed waters.”<sup>23</sup> This announcement came just days after the Governor signed an executive order outlining a strategy to protect southern resident orcas and Chinook Salmon – species potentially impacted by the proposed TMEP.<sup>24</sup> The executive order establishes a task force which will study and propose solutions, including funding and potential legislation, to help orcas. The task force will also examine problems related to “toxic contaminants and vessel traffic and noise.”<sup>25</sup>

Governor Inslee also signed the “Oil Spill Prevention Act” on March 23.<sup>26</sup> The act will, among other things, strengthen the state’s ability to prevent and prepare for oil spills by hiring new inspectors for oil transfers and vessels and identifying additional safety measures.<sup>27</sup> It also directs Washington State’s Department of Ecology to address the “risks of oils submerging and sinking and more extensively coordinate with our Canadian partners in order to protect our state’s economy and its shared resources.”<sup>28</sup>

The Executive Order and the Oil Spill Prevention Act coupled with Gov Inslee’s recent statements supporting

the B.C. government indicate that his administration is taking the issue of potential impacts from oil projects and pipelines very seriously. It would be prudent to anticipate further actions from Washington State that could add additional obstacles, delays, and costs to TMEP.

## Questions for Kinder Morgan

- What reassurances will the company require by May 31 about the B.C. case seeking constitutional approval for restrictions on transportation of diluted bitumen?
- What is the company’s assessment of the likelihood and impact on TMEP of any regulations being introduced in Washington which would limit the impact of tanker traffic or protect endangered orcas and other wildlife?



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## Nestlé formally opposes the Proposed Route for TMEP

On June 2, 2017, Nestlé Waters Canada (Nestlé) filed a Statement of Opposition<sup>29</sup> to the proposed detailed route for TMEP across Nestlé's property in B.C.; the route would run in close proximity to the Hope Spring and Nestlé's water bottling facility. On January 23, 2018 the NEB granted Nestlé an individual detailed route hearing. On March 27, 2018 Nestlé submitted written evidence to the "Trans Mountain Detailed Route Hearing – Segment 5."<sup>30</sup>

According to Nestlé, Kinder Morgan<sup>31</sup> has failed to initiate, let alone make any serious attempt at, meaningful discussion regarding Nestlé's concerns. These remain: (i) satisfactory resolution of routing issues across the Nestlé property; (ii) concerns about construction practices, construction timing, and ongoing operations that may put the Hope Spring and aquifer at risk; and (iii) logistical impacts arising from TMEP construction upon Nestlé's operations.

Nestlé felt it was necessary to obtain its own independent experts to assess the potential impacts of the construction of TMEP along the Proposed Route on the Hope Spring, aquifer, and Nestlé's operations. Nestlé proposes an alternative route still within the approved corridor.

Nestlé states that Kinder Morgan's Groundwater Management Plan does not identify the existence of the aquifer, Hope Spring, or Nestlé's bottling operation and "Thus, it is not known if KM has adequately considered these elements in its construction and operations planning and monitoring of TMEP."<sup>32</sup>

### Questions for Kinder Morgan

- What is the company's response to the various claims made by Nestlé with regard to inadequate engagement and a failure to consider the potential impacts of TMEP on the Hope Spring, aquifer and Nestlé's operations?
- Has the company undertaken an assessment of the financial impact of a worst-case-scenario spill impacting the Hope Spring, aquifer and/or Nestlé's operations?
- What would be the impact on the estimated in-operation date and construction costs if TMEP was to follow Nestlé's alternative route as opposed to the current Proposed Route?



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## Indigenous and public opposition is escalating

On March 10, as many as 10,000 people marched in Burnaby, British Columbia, to protest TMEP and “also erected a physical ‘watchhouse’ that will serve as a beacon for ongoing opposition to the pipeline company’s efforts.”<sup>33</sup> This was followed by more than a week of peaceful direct actions<sup>34</sup> which resulted in the arrest of more than 170 people for acts of civil disobedience against TMEP<sup>35</sup> and mainstream press coverage across North America.<sup>36</sup>

In its 2017 Annual Report,<sup>37</sup> KML discloses that the climate movement presents a potentially insurmountable threat to both the construction TMEP and to its future economic viability. The company acknowledges that it faces near-term political risks arising from opposition to TMEP over its contribution to global warming. KML also acknowledges that it is facing fierce resistance from Indigenous groups, as well as adverse public opinion, which could result in serious delays or even the inability to build TMEP.

“The development of TMEP, [...] will at times be subject to public opposition which could expose us to the risk of higher costs, delays or even project cancellations (including TMEP) due to increasing pressure on governments and regulators by special interest groups including Aboriginal groups, landowners, environmental interest groups (including those opposed to oil sands and other oil and gas production operations) and other non-governmental organizations, blockades, legal or regulatory actions or challenges, increased regulatory oversight, [...]. There is no guarantee that we will be able to satisfy the concerns of the special interest groups and non-governmental organizations and attempting to address such concerns may require us to incur significant and unanticipated capital and operating expenditures.”<sup>38</sup>

The concern over blockades (and other forms of peaceful civil disobedience) is well-placed. As of February, more than 23,000 people had signed the Coast Protectors pledge that states: “With our voice, in the courts or the streets, on the water or the land. Whatever it takes, we will stop the Kinder Morgan pipeline expansion.”<sup>39</sup> A February survey, conducted on behalf of Kennedy Stewart (the federal Member of Parliament for Burnaby South, where the Kinder Morgan terminal is located) found that 44 per cent of British Columbians oppose the pipeline. More significantly, it found that nearly a quarter (23%) of those opposed would consider engaging in civil disobedience to stop it.<sup>40</sup>

## Free Prior and Informed Consent (FPIC) and pending litigation

In its March investor presentation, Kinder Morgan reassured investors that the Federal government and Trans Mountain have “extensively consulted with Aboriginal communities regarding TMEP”. However, TMEP is currently the subject of a number of legal challenges from First Nations alleging infringements of their rights. The traditional territories of the First Nations who are party to the Federal Court of Appeals cases cover approximately 50% of the Proposed Route. Kinder Morgan suggested on its April 9 investor call that prolonged litigation leading to additional conditions being imposed which are in turn appealed may be “just too much to bear...”.<sup>41</sup>

In January, the National Observer revealed that “The Trudeau government approved TMEP after being told in a series of memos that First Nations believed its ‘paternalistic’ approach to consultations was both ‘unrealistic’ and ‘inadequate.’”<sup>42</sup> The report continues that First Nations’ feedback on the process was “that the government was rushing consultations, without giving affected First Nations enough time or resources to assess how the Trans Mountain expansion would affect them.”<sup>43</sup>

In February, Prime Minister Trudeau admitted in an interview that the Federal government approval of TMEP “was always a trade-off” for “action from Alberta Premier Rachel Notley’s government that pledged to put a price on pollution and cap emissions from the oilsands.”<sup>44</sup> However, that “trade-off” deal was made in 2015 before Indigenous consultation was completed. First Nations’ claims of inadequate consultation are at the heart of a Federal Court of Appeal hearing challenging the federal government’s approval of TMEP.<sup>45</sup>

Given these claims and the experience with the Dakota Access Pipeline,

institutional financiers should consider, whether TMEP has met international best practices on consultation with Indigenous Peoples and respect of FPIC. Investors in banks currently part of the syndicate financing TMEP may also wish to engage with those banks on these issues.

### Questions for Kinder Morgan

- Is Kinder Morgan conducting a thorough and independent human rights impact assessment of TMEP in line with the UN Guiding Principles on Business and Human Rights Reporting Framework?
- How does the company plan to address the risks arising from the intensifying Indigenous opposition to TMEP?
- In light of the Dakota Access Pipeline controversy, what public reporting will the company do on FPIC from affected First Nations?

## Economic viability of TMEP

KML first addressed climate-related risks in the the prospectus underlying its 2017 share offering, which raised \$1.75 billion to help finance TMEP. These risks, which were not addressed in the company's preliminary prospectus, were added after Greenpeace wrote to the Alberta Securities Commission to argue that the company could potentially be misleading potential investors if it didn't acknowledge climate-related risks.<sup>46</sup>

The business model for a pipeline is fairly straightforward. Shippers, usually producers, refiners or traders, sign long-term contracts — known as “take-or-pay” or firm transportation agreements — to reserve pipeline capacity ahead of project construction. The contracts are typically for a period of 10–20 years. The success of this model is dependent on the shippers fulfilling those contracts. KML acknowledges that, in a world that is making serious progress towards the goals of the Paris agreement, the companies that ship on TMEP might not be able to honour existing contracts or sign new ones.<sup>47</sup>

Kinder Morgan has pitched TMEP as a way to reach the rapidly growing Chinese market. The Canadian Association of Petroleum Producers' (CAPP) 2016 forecast,<sup>48</sup> makes the case for rising demand in India and China, citing the International Energy Agency's (IEA) New Policies Scenario. However, the China National Petroleum Corporation Economics & Technology Research Institute's 2016 Current Policies Scenario,<sup>49</sup> has a much lower forecast for increased oil demand than in the CAPP / IEA forecast.

KML's 2017 Annual Report discloses that policy and technology changes consistent with the Paris Agreement's decarbonisation objective could result in a lower demand for oil, but the report doesn't provide an assessment of how the company might adjust its business strategy in light of such a possible future.

### Questions for Kinder Morgan

- Has KML assessed the impact on its business of reduced global oil demand due to factors including the rapid adoption of new technologies such as electric vehicles?
- What would be the impact on TMEP if shippers sought to renegotiate contracts in the event of an oversupply of pipeline capacity?
- Will KML prepare a well below 2 degree Celsius scenario assessment in order to show how the company might adapt its business strategy and capital investment plans to be consistent with a low-carbon future?



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## Conclusion

Kinder Morgan has now acknowledged that TMEP may be cancelled because of stakeholder objections. But as the company attempts to overcome the opposition of the B.C government, resistance from other stakeholders has intensified.

First Nations-led protests have increased in number and scale, leading to multiple arrests and increased media attention bringing with it an increased risk of negative public opinion and reputation damage. Washington Governor Jay Inslee's desire to limit the impact of increased tanker traffic have created significant regulatory uncertainty outside British Columbia.

We suggest institutional financiers engage with Kinder Morgan to understand the factors being weighed by Kinder Morgan as it decides whether to proceed with TMEP. Investors in banks which have agreed to finance the construction of TMEP may also wish to engage with those banks on these same issues.

### Questions for Kinder Morgan

- What reassurances does the company require by May 31 regarding "the ability to construct through BC" including about possible restrictions in B.C. on increased transportation of diluted bitumen?
- What would the company consider "adequate protection of KML shareholders"?
- The company has suggested prolonged litigation may prove an insurmountable obstacle to TMEP. Judgements on First Nations legal challenges to TMEP are unlikely to be delivered by May 31. Will the company suspend activities and spending until such time as those cases are finally determined?
- Does the company plan to delay construction of TMEP until such time as the British Columbia Reference Case is decided, given the potential impacts on TMEP of the suggested restrictions on transportation of diluted bitumen?
- What reassurances will the company require by May 31 about the B.C. case seeking constitutional approval for restrictions on transportation of diluted bitumen?
- What is the company's assessment of the likelihood and impact on TMEP of any regulations being introduced in Washington which would limit the impact of tanker traffic or protect endangered orcas and other wildlife?
- What is the company's response to the various claims made by Nestlé with regard to inadequate engagement by Trans Mountain and a failure to consider the potential impacts of TMEP on the Hope Spring, aquifer and Nestlé's operations?

- Has the company undertaken an assessment of the financial impact on it, in the event of a worst case scenario spill impacting the Hope Spring, aquifer and/or Nestlé's operations?
- What would be the impact on the estimated in-operation date and construction costs if TMEP was to follow Nestlé's alternative route as opposed to the current Proposed Route?
- Is Kinder Morgan conducting a thorough and independent human rights impact assessment of the project in line with the UN Guiding Principles on Business and Human Rights Reporting Framework?
- How does the company plan to address the risks arising from the intensifying Indigenous opposition to TMEP?
- In light of the Dakota Access Pipeline controversy, what public reporting will the company do on securing FPIC from affected First Nations?
- Has KML assessed the impact on its business of reduced global oil demand due to factors including the rapid adoption of new technologies such as EVs?
- What would be the impact on TMEP if shippers sought to renegotiate contracts in the event of an oversupply of pipeline capacity?
- Will KML prepare a below 2 degree Celsius scenario assessment in order to provide a more comprehensive assessment of how the individual risks addressed in the annual report interact and how KML might adapt its business strategy and capital investment plans to be consistent with a low-carbon future?

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## Endnotes

- 1 KML was established as a separate company on April 7, 2017. It owns and operates Kinder Morgan pipelines and oil terminals in Canada, but is itself majority-owned by the U.S.-based parent company (Kinder Morgan Incorporated). In this briefing 'Kinder Morgan' is used to refer to Kinder Morgan Inc. and to its relevant subsidiaries including Kinder Morgan Canada Limited and Trans Mountain Pipeline ULC.
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