

Trans Mountain Expansion Project

The National Energy Board Guaranteed Kinder Morgan a Fund To Push Pipeline Expansion Through Regulatory Review

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Executive Summary

On November 29, 2010 Trans Mountain Pipeline ULC applied to the National Energy Board (NEB or Board) under Part IV of the *National Energy Board Act* (Act or NEB Act) for approval of long-term Firm Service Agreements with selected shippers. The purpose of the application was to create guaranteed capacity on a portion of the Trans Mountain pipeline system from Edmonton, Alberta to the Westridge Marine Terminal in Burnaby, British Columbia.

As part of the implementation of the approved Firm Service arrangements, 27,000 barrels per day (bpd) of existing land capacity was allocated to the Westridge dock. Land capacity became 221,000 bpd and Westridge dock capacity became 79,000 bpd. Of the dock capacity, 54,000 bpd was allocated as ten-year long-term firm service agreements with five shippers—China’s largest national oil company PetroChina, Nexen (now owned and controlled by the Chinese National Offshore Oil Corporation—CNOOC, China’s third largest national oil company), Cenovus, Astra and US Oil. The firm service arrangement became known as the “Firm 50”.

In its application Trans Mountain also requested the Board approve Tariff amendments to facilitate implementation of the Firm Service Agreements and the introduction of a “Firm Service Fee”. The Firm Service Fee is a guaranteed amount paid by the Firm Service Shippers over the ten-year life of their long-term take-or-pay contracts. The Firm Service Fee is in addition to the per barrel toll rate these shippers pay for guaranteed access to capacity on Trans Mountain’s pipeline from Edmonton to the Westridge marine terminal in Burnaby. The Board approved Kinder Morgan’s request in December 2011.

The purpose of the Firm Service Fee is to allow Kinder Morgan to accumulate funds as customer contributions towards Trans Mountain’s capacity expansions. The Firm Service Fee is applied on committed Trans Mountain shipments at an average rate of \$1.45 per barrel. The fee totals \$28.6 million per year and the funds are held by Trans Mountain in a Special Deposit Account until required for funding capacity expansion applications and related pre-development work.

Kinder Morgan has confirmed \$136.3 million from the Firm Service Fee account has been allocated to fund its pre-development costs for the Trans Mountain expansion project including the application currently being heard by the NEB under Part III of the Act.

The approval of Kinder Morgan’s Firm Service Fee by the Board was precedent setting. The NEB effectively granted Kinder Morgan a right to guaranteed shipper surcharges in order to build a regulatory approval process “war chest” available to the pipeline company to draw on, when and as needed, to fund capacity expansion applications for its Trans Mountain pipeline system.

1. Background

Trans Mountain Pipeline ULC holds the Certificates of Public Convenience and Necessity (CPCN) granted by the National Energy Board that allows the company to operate and maintain its pipeline system from Edmonton, Alberta to Burnaby, British Columbia. The existing system is approximately 1,147 km of pipeline which transports a range of crude petroleum and refined products to multiple locations in BC including deliveries to the Westridge Marine Terminal in Burnaby for offshore export.

Trans Mountain Pipeline L.P. is the limited partnership entity that holds the pipeline facilities and related assets of the system. Trans Mountain Pipeline ULC is the general partner of Trans Mountain Pipeline L.P. and both are wholly owned subsidiaries of US based Master Limited Partnership, Kinder Morgan Energy Partners, L.P. (KMP).

Kinder Morgan Canada Inc. (KMC), also owned and controlled by KMP from its head office in Houston, Texas, operates the Trans Mountain system pursuant to an operating agreement between KMC and Trans Mountain Pipeline ULC and Trans Mountain Pipeline L.P.

Trans Mountain Pipeline ULC applied to the National Energy Board under Part III, section 52 of the NEB Act in December 2013 for a CPCN and related approvals for the Trans Mountain Expansion Project. The expansion project, if approved, will take the current system capacity from 300,000 barrels per day (bpd) and an average of 5 oil tankers a month calling at the Westridge dock to 890,000 bpd and 34 oil tankers a month.¹

Part III of the NEB Act—Construction and Operation of Pipelines—relates to company applications for approval to construct and operate pipelines. Under certain capacity expansion conditions a CPCN is required and thus the application falls under section 52 of the Act necessitating a public hearing. Under certain conditions an application for construction may also trigger full environmental assessment for designated projects under the *Canadian Environmental Assessment Act* (CEAA). Trans Mountain's expansion project has triggered both the requirement for a public review and an environmental assessment under the CEAA.² Applications for approval to construct and operate oil pipelines are often referred to as Part III Applications.

¹ Trans Mountain Pipeline ULC, Trans Mountain Expansion Project, Volume 1—Summary, page 1-1 - 1-2. https://docs.neb-one.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90552/548311/956726/2392873/2451003/2385938/B1%2D1_%2D_V1_SUMM_%2D_A3S0Q7.pdf?nodeid=2385048&vernum=-2

² National Energy Board Hearing Order OH-001-2014, https://docs.neb-one.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90552/548311/956726/2392873/2449981/2445930/A15%2D3_%2D_Hearing_Order_OH_%2D001%2D2014_%2D_A3V6I2.pdf?nodeid=2445615&vernum=-2

Part IV of the NEB Act—Traffic, Tolls and Tariffs—relates to applications for approval to charge tolls and apply tariffs. Tariff means “a schedule of tolls, terms and conditions, classifications, practices or rules and regulations applicable to the provision of a service by a company and includes rules respecting the calculation of tolls.”³ Companies may only charge tolls specified in a tariff that has been filed with the Board and approved by an order of the Board. Toll and tariff applications are referred to as Part IV Applications. They do not necessarily trigger a public hearing, rather the nature and scope of the hearing is a decision arrived at by the Board.

2. Chronology of Relevant NEB Applications

a) November 29, 2010 Part IV Application for “Firm 50” – NEB Approval December 2011

Trans Mountain applied under Part IV of the NEB Act for approval of:

- i) firm service to Westridge marine terminal;
- ii) amendments to its tariff to implement the Firm Service Agreements (FSAs); and
- iii) the identification of a Firm Service Fee as a customer contribution to future capacity expansion.⁴

b) June 29, 2012 Part IV Application for Trans Mountain Expansion Tolls and Tariffs—NEB Approval May 2013

Trans Mountain applied under Part IV of the NEB Act for approval of the transportation service and toll methodology that would be applied for the expanded Trans Mountain Pipeline System should the Part III expansion application be successful.

c) December 16, 2013 Part III Application for Trans Mountain Expansion—NEB Review Ongoing

Trans Mountain applied under Part III of the NEB Act for approval to construct and operate the expansion of its pipeline system.

³ NEB Act, Section 58.5, <http://laws-lois.justice.gc.ca/eng/acts/N-7/FullText.html>

⁴Application by Trans Mountain Pursuant to Part IV of the NEB Act for Firm Service to Westridge, NEB Application, RH-2-2011, <https://docs.neb-one.gc.ca/ll-eng/llisapi.dll?func=ll&objId=655087&objAction=browse&viewType=1>

3. Discussion

1. On November 29, 2010 Trans Mountain applied under Part IV of the NEB Act for approval of:

- i) firm service to Westridge marine terminal;
- ii) amendments to its tariff to implement the Firm Service Agreements (FSAs); and
- iii) the identification of a “Firm Service Fee” as a customer contribution to future capacity expansion.⁵

*“Under the TSA, Firm Service Shippers would be required to pay the Firm Service Toll for their respective contract volume over a 10-year period. The Firm Service Toll would be the sum of: (i) the applicable uncommitted toll from the effective Tariff; and (ii) the Firm Service Fee established through the Open Season process. **Trans Mountain would use the Firm Service Fee for advancement of capital projects and preliminary activities in support of expansion of the Pipeline.**”⁶[Emphasis added].*

2. **“Firm 50”** is the term referred to for the Application submitted by Trans Mountain to the Board for establishing firm service commitments and the Firm Service Fee. The formal title is, “Application By Trans Mountain pursuant to Part IV of the NEB Act for Firm Service to Westridge”. Firm 50 refers to the fact that shippers agreed to long-term take or pay contracts for 54,000 barrels a day (in total) delivered to the Burnaby marine facility.
3. At the time of the Firm 50 application 248,000 barrels per day (bpd) of Trans Mountain’s 300,000 bpd capacity was allocated to land including destinations throughout British Columbia and Washington State, with 52,000 bpd allocated to Westridge dock on an uncommitted, or spot basis.
4. As part of the implementation of the approved Firm Service arrangements, 27,000 bpd of existing land capacity was allocated to the Westridge dock. Land capacity became 221,000 bpd and Westridge dock capacity became 79,000 bpd. Of the dock capacity, 54,000 bpd was allocated as ten-year long-term firm service agreements with five shippers—China’s largest national oil company PetroChina, Nexen (now owned and controlled by the Chinese National Offshore Oil Corporation—CNOOC, China’s third largest national oil company), Cenovus, Astra and US Oil. The remaining 25,000 bpd allocated to the Westridge dock was made available to uncommitted—or spot—shippers.

⁵NEB Application, RH-2-2011, <https://docs.neb-one.gc.ca/ll-eng/llisapi.dll?func=ll&objId=655087&objAction=browse&viewType=1>

⁶ NEB Reasons For Decision, Chapter 5, page 29, https://docs.neb-one.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/552980/954147/655087/768172/768253/A2J3V8_%2D_Reasons_for_Decision_RH%2D2%2D2011.pdf?nodeid=768090&vernum=-2

5. Not only did the Firm 50 application include an increased surcharge for committed shippers to the Westridge Marine Terminal, Kinder Morgan claimed that because less supply would be available in western Canada, approval of its application would raise the price for all barrels produced. Increased feedstock costs at the refinery gate were not considered by Trans Mountain, but they lead to higher costs and either reduce refinery margins or are passed onto consumers and businesses in the form of higher prices, or a combination of both.⁷
6. The Board approved Kinder Morgan's Firm 50 Application despite being advised by a number of uncommitted shippers on Trans Mountain's system that the precedent setting approach would inappropriately enable the company to finance a portion of its potential future expansion through toll charges rather than through owner's equity —at risk—capital. Firm Service Fees are a customer contribution. When such fees are expensed by Canadian based shippers they reduce taxes payable. Firm Service Fees received by Kinder Morgan are not treated as revenues and thus accumulate on a non-taxable basis. Thus, in the first instance, it is Canadians that are helping finance Kinder Morgan's expansion plans through foregone tax revenue, not Kinder Morgan's shareholders which is the normal course of business practice for capital expansion projects.
7. For example, during oral cross-examination at the Firm 50 hearing, NEB counsel asked Chevron's expert witness a range of questions regarding the company's concern over the establishment of a Firm Service Fee.

Paragraph 4395. DR. GASKE: From my perspective...essentially you have a monopoly pipeline charging monopoly level charges to certain customers and then using that as financing. If they need financing, then they should go to the market for financing or bring in partners.

4396. So I think it's an extraordinary precedent for a regulator to set to have shippers and customers provide the financing, and provide financing based on paying as a group more than a just and a reasonable rate, a total revenue requirement that's greater than the company's total revenue requirement.⁸

8. In its Reasons for Decision the Board explained that "Trans Mountain indicated that the average Firm Service Fee would be \$1.45 per barrel with none of the Firm

⁷ Application, Page 1-6, paragraph 20, https://docs.neb-one.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/552980/954147/655087/678170/654331/B1%2D2_%2D_NEB_Application%2D_Trans_Mountain_Pipeline_ULC_%2D_A1W3Y0.pdf?nodeid=654426&vernum=-2

⁸ Firm 50 Application, Oral Cross-Examination, Transcripts Volume 3, August 24, 2011, paragraph 4395 - 4396, https://docs.neb-one.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/552980/954147/655087/709333/710059/A2C4H8_%2D_Vol%2E3%2DWedAug24.11.pdf?nodeid=710060&vernum=-2

Service Fees being lower than \$0.25 per barrel. The annual amount of Firm Service Fees collected would be constant at \$28.6 million over the 10-year period.”⁹

9. In its Reason for Decision the Board endorsed Trans Mountain’s position with respect to the use of the funds generated, “Trans Mountain confirmed that Firm Service Fees would be used to support projects after they had passed the speculative stage and had moved to the project development stage. Before finalizing the list of capital projects to be funded with Firm Service Fees, Trans Mountain submitted that input from all shippers would be solicited and investments would be adjusted accordingly, to the extent possible. Trans Mountain was of the view that the proposed investment of Firm Service Fees would benefit all shippers by reducing the cost and scope of future expansions.”¹⁰
10. The Board’s acceptance of Kinder Morgan’s application was precedent setting. Prior to granting Kinder Morgan the Firm Service Fee surcharge there had not been a ruling by the Board whereby funds could be accumulated for yet to be specified capital expansion projects.¹¹ This unusual practice had been rejected outright by the US Federal Energy Regulatory Commission (FERC) when Enbridge floated the approach. “I’ve seen a proposal like this in the past, and it was pretty handily rejected out of hand by the regulator...It was an example in the States where Enbridge's Lakehead pipeline was asking for a surcharge on existing customers so they could raise the capital to do an expansion, and FERC said that's out of the question; it rejected it.”¹²
11. On June 29, 2012 Trans Mountain applied under Part IV of the NEB Act for approval of its tolls and toll methodology it intends to rely on if the expansion of the pipeline’s capacity from 300,000 bpd to 890,000 bpd, and the expansion of the Westridge marine terminal to three new berths, proceeds. The company received approval of its toll application in the Board’s Reasons for Decision released May 16, 2013.¹³
12. During the more recent Part IV toll hearing the role and purpose of the Firm Service Fee was discussed. Kinder Morgan explained that \$136.3 million was available from

⁹ Reason for Decision, RH-2-2011, page 29, <https://docs.neb-one.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/552980/954147/655087/768172/768253/A2J3V8 %2D Reasons for Decision RH %2D2%2D2011.pdf?nodeid=768090&vernum=-2>

¹⁰ Ibid, page 31.

¹¹ Ibid, page 29 - 34.

¹² Firm 50 Application, Oral Cross-Examination Transcripts, Op. Cit., paragraph 4369, Chevron expert witness Dr. Gaske.

¹³ RH-001-2012, Part IV Application to the NEB, <https://docs.neb-one.gc.ca/LL-ENG/llisapi.dll?func=ll&objId=828580&objAction=browse>

the Firm Service Fee to fund the Trans Mountain Expansion Project process.¹⁴ The funding amount was included in the Part IV Toll Application as part of the expansion project's Initial Cost Estimate as a credit to the capital cost estimate.¹⁵ Effectively the Firm Service Fee collected from shippers has been relied on as equity financing for Kinder Morgan's Trans Mountain expansion plans reducing the risk and increasing the returns to Kinder Morgan's US based shareholders.¹⁶

13. During oral cross-examination at the Trans Mountain Expansion Project Part IV hearing, Kinder Morgan Canada President, Ian Anderson, was questioned by Suncor legal counsel. Suncor legal counsel relied on a transcript of comments Mr. Anderson made at Kinder Morgan's annual analysts' conference in Houston Texas on January 30, 2013 whereby Mr. Anderson stressed that the Firm Service Fee arrangements granted to Kinder Morgan through the NEB approved tariff ensured that Kinder Morgan and its shareholders would not bear the risk, or the costs, of advancing Trans Mountain's expansion project.

Paragraph 1041 MR. ROTH: Okay. And I believe you in the transcript of the investor conference call which we've talked about earlier, you indicate that: "There's \$29 million a year coming in for Firm 50 fees that is being used to offset all of the development costs for us in the project. So if at some point along the line either ourselves or our shippers exercise some of their very limited outs and the project doesn't succeed or we don't get the permits, all of the development costs are being covered by the Firm service fees that we are collecting so there is no risk there to us." (As read)

That's what you've indicated in your investor conference call, correct?

MR. ANDERSON: I thought it sounded better when I said it at the analysts' conference than you reading it. But that's accurate; that is the deal that we have both with our shippers and through the Board's order in Firm 50. And we believe it to be a very prudent and responsible way to help mitigate the risk of both ourselves and our shippers, as development costs are incurred and the project

¹⁴ January 10, 2013 Response to CAPP, Question 4, pages 6 - 7, <https://docs.neb-one.gc.ca/LL-ENG/llisapi.dll/fetch/2000/90465/92835/552980/954292/828580/865601/902040/B16%2D6%2D Revised Jan 10 2013 CAPP IR Response %2D A3E7F4.pdf?nodeid=902044&vernum=-2>

¹⁵ Appendix 9, Initial Cost Estimate, Firm Service Fee Credit \$136.3 million. <https://docs.neb-one.gc.ca/LL-ENG/llisapi.dll/fetch/2000/90465/92835/552980/954292/828580/865601/828070/B1%2D24%2D Appendix 9 Final form of the FSA %2D TSA Schedules %2D A2U4U6.pdf?nodeid=828168&vernum=-2>

¹⁶ Kinder Morgan Energy Partners L.P. (KMP) is a US based Master Limited Partnership (MLP) listed on the New York Stock Exchange whose structure is established to generate distributable cash flow on a quarterly basis to its unit holders. Master Limited Partnerships are unique entities primarily relied on in the energy sector in the US. Through sophisticated corporate structures MLPs are able to defer and avoid taxes payable. According to Bloomberg, over 90% of KMP units are held by US investors, with less than 2% held by Canadian investors.

is proceeding up to points in time where approvals may not be granted or outs may be exercised.

MR. ROTH: And Trans Mountain's forecast using \$136 million in firm service fees to offset project development costs and, in this case, I realize that's just a forecast, right, but that's what you gave in response to CAPP 1.3? (sic CAPP 1.4)

MR. ANDERSON: If the projects proceed as planned, the permits are received as planned, and the costs incurred are as forecast, that will be the amount of development funds from Firm 50 that we will have to offset development costs at the point of construction commencing.

In the event that the project is not approved, either at CPCN time or sometime prior, then the development cost will be offset at whatever they are incurred at that point in time with future firm service fees that will extend beyond 2015 or 2016.

MR. ROTH: So it could be greater than or less than the \$136 million just depending on when the project is no longer proceeding?

MR. ANDERSON: And what the costs are that have been incurred.¹⁷

14. For clarification, the limited “outs” referred to by Mr. Roth is the situation whereby if the capital cost of the Expansion Project at CPCN approval time exceeds \$1.4 billion of the agreed to capital cost during the Part IV Toll Application, the shippers have an option whereby they can back out of the long-term take or pay contracts they have entered into for purposes of the expansion. Thirteen shippers have entered into primarily 20 year contracts, although a few shippers have committed to 15 year contracts. Trans Mountain was unwilling to disclose to the Panel during the Part IV Expansion Project Toll Hearing which shippers had committed to 20 versus 15 year contracts.
15. There does not appear to be an explanation of the Firm Service Fee in the more than 15,000 page Application now before the Board for the Part III, Section 52 public interest and environmental assessment review. There are two references made in

¹⁷ NEB Part IV Application for Trans Mountain’s Expansion, Transcripts from Oral Cross, Volume 1, paragraph 1041 - 1049. http://docs.neb-one.gc.ca/LL-ENG/llisapi.dll/fetch/2000/90465/92835/552980/954292/828580/917792/917686/A3F3Y2_%2D_13%2D02%2D12_%2D_Volume_1.pdf?nodeid=917789&vernum=-2 Mr. Roth was counsel for Suncor, and Mr. Anderson was and is President of Kinder Morgan Canada (KMC). KMC is the operator of Trans Mountain, but has no ownership rights in the assets. Both KMC and Trans Mountain are owned and controlled by Kinder Morgan Energy Partners L.P., a US based Master Limited Partnership. Capacity expansion decisions are made by the US parent. CPCN refers to the Certificate of Public Convenience and Necessity Kinder Morgan requires to expand its pipeline system.

18. The NEB decision to grant Kinder Morgan the ability to generate deep pockets to fund its controversial project through Canadian based shipper surcharges means the ultimate pre-development costs of the expansion project, whether the project proceeds or not, are a cost borne by the Canadian economy and Canadians.
19. For the Trans Mountain Expansion Project, the NEB's unprecedented ruling has allowed Kinder Morgan to avoid development and regulatory approval risk. Trans Mountain is collecting, and will continue to collect, significant pre-development funds to advance its Application. This funding mechanism effectively enables a financially unconstrained advancement of Kinder Morgan's interests. It is Canadian businesses and consumers that ultimately fund the security for Kinder Morgan's investors, but an equivalent mechanism, in scope or magnitude, is not available to people whose homes, schools and businesses are at risk from the proposed expansion.
20. Trans Mountain is able to accumulate these funds not only with the knowledge of the Board, but with explicit approval by the Board of the funding mechanism and amount.
21. The capacity funding available to Trans Mountain to advance its interests is in direct contrast to the funding process, and funding amounts, available to Intervenor for purposes of presenting their interests and evidence to the Board at the Part III hearing. Kinder Morgan relied on a Part IV hearing process that excluded public interest, First Nations, and environmental intervenors in order to establish its deep pockets and now wants to avoid any scrutiny of its, and the Board's actions, in establishing an unfair advantage in order to force this project on an unwilling public.