CANADIAN GLOBAL AFFAIRS INSTITUTE
INSTITUT CANADIEN DES AFFAIRES MONDIALES

Canada Can't: Our National Infrastructure Challenge

by Kelly J. Ogle

March 2018

POLICY UPDATE

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OUR NATIONAL INFRASTRUCTURE CHALLENGE

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Prepared for the Canadian Global Affairs Institute
1800, 421 – 7th Avenue S.W., Calgary, AB T2P 4K9
www.cgai.ca

ISBN: 978-1-988493-95-4

Most everyone is familiar with the acronym NIMBY (Not In My Back Yard). However, BANANA is a poignant acronym for "Build Absolutely Nothing Anywhere Near Anyone". It seems that in the recent past this has become the norm rather than the exception.

Today, all jurisdictions face extensive, laborious and clock-robbing consultation processes to build *anything*. For example: it takes five to 10 years to build a new highway in Nova Scotia due to consultations and environmental analysis. A natural gas power plant takes a minimum of three years. Moreover, the process isn't limited to the transportation and hydrocarbon sectors. Take, for example, a wind farm. The applicant must hold municipal consultations, provide wind assessment data and subsequent wind farm design, conduct an environmental study, do land acquisition and permitting and conduct more public consultations – all prior to manufacturing, site preparation and construction. These examples are part of a big and growing problem for Canada: all too often governments (municipal, provincial and federal) obstruct or reject all sorts of development projects. It becomes easier to understand why pipelines are not built anymore.

Importantly, it isn't just pipelines. Canada has an overarching infrastructure problem. In a 2017 report, the Canadian Chamber of Commerce said, "Ten thousand years is how much additional time commuters in Toronto, Montreal and Vancouver spend stuck in traffic every single year as a result of road congestion from key bottlenecks in those cities." This severe congestion affects more than the commuters and residents of those cities. It stifles the entire Canadian economy. According to the Business Council of Canada, our country may need to invest $1 trillion to make the economy run with optimal productivity and efficiency. James McKellar, professor and director of the Brookfield Centre in Real Estate and Infrastructure at York University's Schulich School of Business in Toronto, states that "the inability to get people to the right places at the right times and to move goods and services is a tremendous loss." McKellar adds that the profit that's missed is money that might just as well be burned.

In 2016, the *Financial Post* compiled a list of 35 major resource projects in Canada that were in limbo, representing a staggering $129 billion of investment. Thousands of new Canadian jobs would be created in the trades and spinoff effects, as those workers buy homes, go out for dinner and support businesses in other sectors of the Canadian economy. Also consider the massive tax revenues that governments would receive. TransCanada estimated that over its life the Energy East project would contribute $10 billion in tax revenue. Is infrastructure spending the issue? In the resource sector it may not matter, as the capital required to continue development may not be available. Recent changes to Canadian taxation and regulatory hurdles have stalled the flow of capital, especially in the resource sector. Unfortunately, Canadian resource investment is viewed as fraught with an obstacle course of regulatory uncertainty, political duplicity and public apathy.

Investors are afraid that Canada's regulatory and tax environment do not contain enough certainty. Capital is mobile and fungible and obeys the laws of gravity, taking the path of least resistance to where it can make a reasonable return.

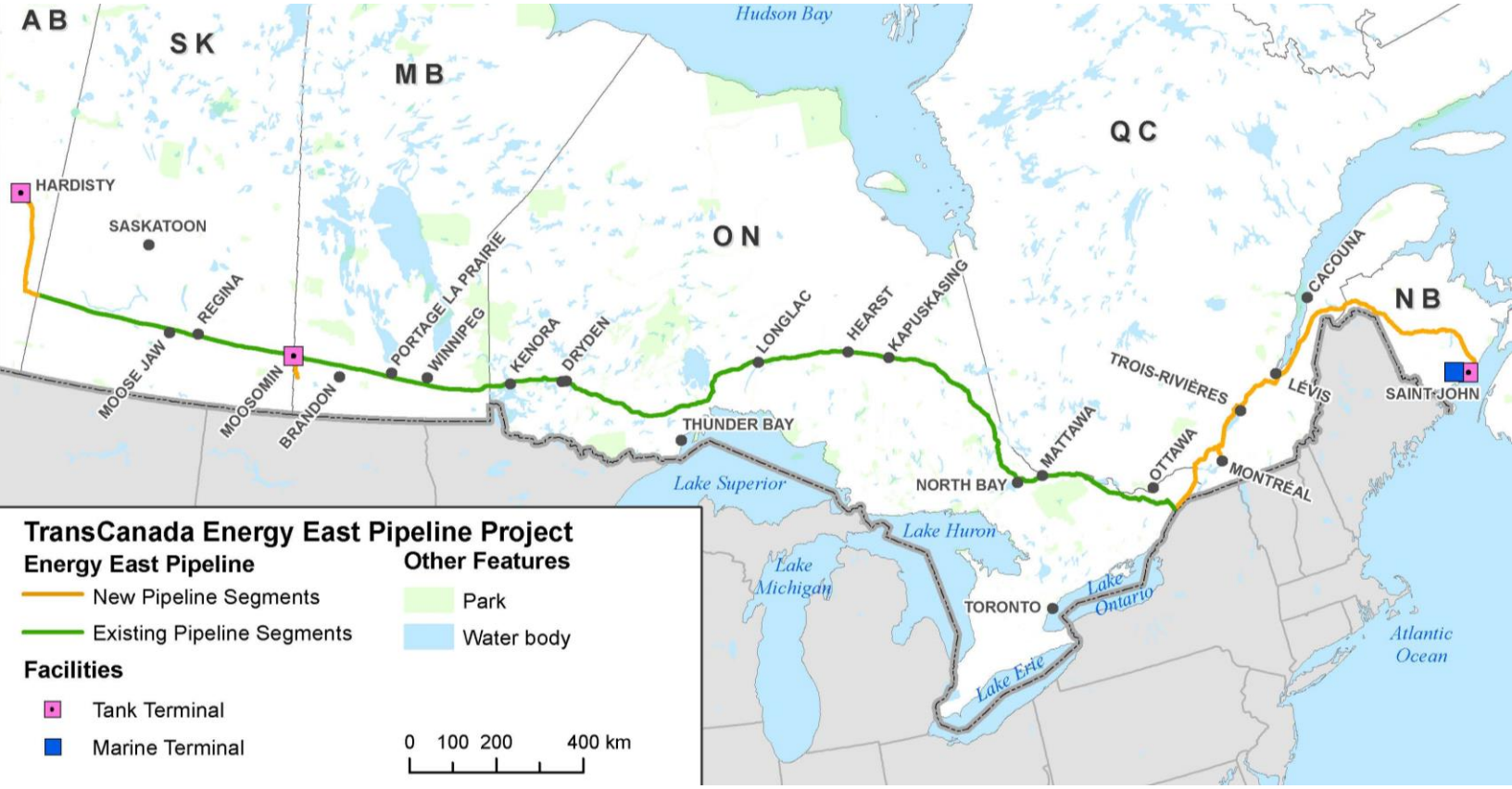

Figure 1: *A map depicting the proposed route of the Energy East project. The graphic illustrates both new and existing pipeline segments. (Source: Canadian Environmental Assessment Agency)*

Last April the repurposing of TransCanada Corporation's gas mainline seemed a "must do" project that would provide additional North American market diversity and access to tidewater for Canada's enormous oil resource bounty. However, on Oct. 5, 2017 TransCanada announced that it would not be proceeding with its repurposed mainline (the Energy East Pipeline) and Eastern Mainline projects. Some 3,000 kilometres of the 4,600-kilometre proposed Energy East pipeline already exist as a natural gas line stretching from Alberta to the Ontario-Quebec provincial boundary. The remainder would be newly constructed pipeline in Quebec and New Brunswick.

When coupled with weak global oil prices, regulatory and environmental challenges caused TransCanada's board of directors to direct management to allocate future capital expenditures to

other projects – such as Keystone XL, existing and future projects in Mexico and other U.S. assets. It is important to note that in its fourth quarter financial statements, TransCanada will take an approximate $1 billion charge against income due to Energy East, the majority being the pursuit of regulatory approval.[1]

From the start the project was plagued by regulatory delay and regional pushback, particularly in Quebec, eventually leading the National Energy Board (NEB) to cancel a scheduled Montreal panel session and hearing to discuss the project's validity. Protesters criticized the NEB's integrity and staged a sit-in at the site of the hearing in August of 2016. After the panel members subsequently resigned,[2] Natural Resources Canada (NRCan) implemented a vigorous modernization of the NEB to "continue to effectively regulate energy in a way that has the confidence of Canadians." The announcement caused then-Saskatchewan premier Brad Wall to call into question his province's role in the federation. He pointed the finger at the federal government, blaming them for regulatory hurdles that frustrated the project's progress. In rebuttal, NRCan's Jim Carr argued that TransCanada made a business decision based on low oil prices.

How did this happen? Was this decision based solely on the project's economic viability? What other factors influenced TransCanada's decision to stop the project? We will never know exactly what was said in the TransCanada board room, but one can surmise that the corporation had had enough. Furthermore, the failure of the Energy East project and the reconstitution of the NEB were the watershed events in a much bigger problem plaguing infrastructure projects in Canada. To be succinct, Canada Can't.

There is no question falling global oil prices undermined TransCanada's business case. However, when the NEB opted to evaluate both the upstream and downstream carbon emissions[3] of the

[1] As a result of its decision not to proceed with the proposed projects, TransCanada is reviewing its approximate $1.3 billion carrying value, including allowance for funds used during construction (AFUDC) capitalized since inception and expects an estimated $1 billion after-tax non-cash charge will be recorded in the company's fourth quarter results. TransCanada stopped capitalizing AFUDC on the project effective Aug. 23, 2017, as disclosed on Sept. 7, 2017. In light of the project's inability to reach a regulatory decision, no recoveries of costs from third parties are expected.

[2] On Aug. 23, 2017, the National Energy Board (NEB) issued its Decision on the List of Issues for the review of TransCanada's proposed Energy East and Eastern Mainline projects. The List of Issues is intended to be an indication of the key items that are relevant to the NEB's review. An important determination in the recent Decision is that the NEB's consideration of the applications will consider all greenhouse gas (GHG) emissions associated with the projects. This includes the direct GHG emissions of the pipelines as well as changes to the amount of oil production resulting from project operations (upstream emissions) and changes to the amount of oil consumption resulting from project operations (downstream emissions). When considering the economic viability of the projects, the NEB will also consider the potential market impacts of GHG reduction targets embedded in laws and policies.

[3] The NEB opted to evaluate both the upstream and downstream carbon emissions of the project — taking into account not only the emissions footprint of the project itself, but the increase in emissions from harvesting and consuming more oil. And that came *after* the NEB had to start the process over because the members of the first NEB panel were conflicted out after having been lobbied by TransCanada.

project, one could contend that TransCanada viewed the path to approval as fraught with added delay, risk and cost. Furthermore, President Donald Trump's revival of the Keystone XL project raised legitimate questions about whether a new east-west pipeline was necessary. A plethora of political, strategic and economic factors were inherent to this debate. First: the ever-fluid and dynamic global oil trade and Canada's place in it, which led to the second: Canada's asymmetric oil relationship with the U.S. and the vagaries and risk of having one client for your product. The safety, economic benefits and relative simplicity of the construction and operation of pipelines and, the export optionality for this largest of Canadian resources are also key factors. In the last year, not a lot has changed regarding any of these issues.

According to the International Energy Agency's (IEA) latest *World Energy Outlook* (released in November 2017), powerful impetus from other sectors will keep oil demand on a rising trajectory to 105 mb/d by 2040. Current global demand is about 95 mb/d. Although much of this increased demand is transportation driven, oil to produce petrochemicals and many other everyday products is the largest source of growth.

Canada supplies four per cent of global liquids to a growing global oil market, and Canadian oil production will continue to grow. This is primarily due to oilsands projects that were sanctioned before the 2014 downturn and are now entering the production phase. For several decades these long-life, low-decline oilsands resources will keep Canada at the forefront of global oil suppliers.[4] Moreover, unconventional liquids production is growing as well. According to the NEB, the Duvernay and Montney formations in Alberta and British Columbia hold marketable resources estimated at 500 trillion cubic feet of natural gas, 20 billion barrels of natural gas liquids and 4.5 billion barrels of oil.[5] For as long as hydrocarbons are in the global energy mix, Canada should be a major player; but will we?

Our asymmetric oil export relationship with the United States has not changed, and it can be argued that it has worsened. A recent leak on the original Keystone pipeline and forecast increases in oilsands production has caused a temporary supply glut in Alberta. Although the world price of crude oil is finding a home in the US$65/barrel (West Texas Intermediate WTI) range, medium and heavy quality crude oil in western Canada (connoted Western Canadian Select or WCS) is nowhere near that. There is a pronounced discount, commonly known as "the differential"

[4] The new Suncor Fort Hills and CNRL Horizon Phase 3 oilsands mining projects are ramping up their production into 2018 and should push Canada's total crude oil production near 4.5 MMB/d by the end of 2018 compared with 4.1 MMB/d in 2017. However, future oilsands growth is expected to slow as no new major projects have been sanctioned since the downturn.

[5] CAPP/Wood Mackenzie. Canada's shale output stands at about 335,000 bpd, according to Wood Mackenzie, which forecasts output should grow to 420,000 bpd in a decade. The pace of output growth could accelerate and the estimated size of the resources could rise as activity picks up and knowledge of the fields improves, according to the Canadian Association of Petroleum Producers. See: www.capp.com and www.woodmac.com

between WCS and WTI. The differential is a function of quality; WCS is heavier and sour relative to WTI. After dropping as low as US$10/barrel in mid-2017, the WCS-WTI differential has widened to ~US$28/bbl.[6] Meanwhile, other North American benchmark heavy oil differentials (U.S. imports from Mexico and Venezuela) have tightened, confirming the differential is largely related to current pipeline bottlenecks.

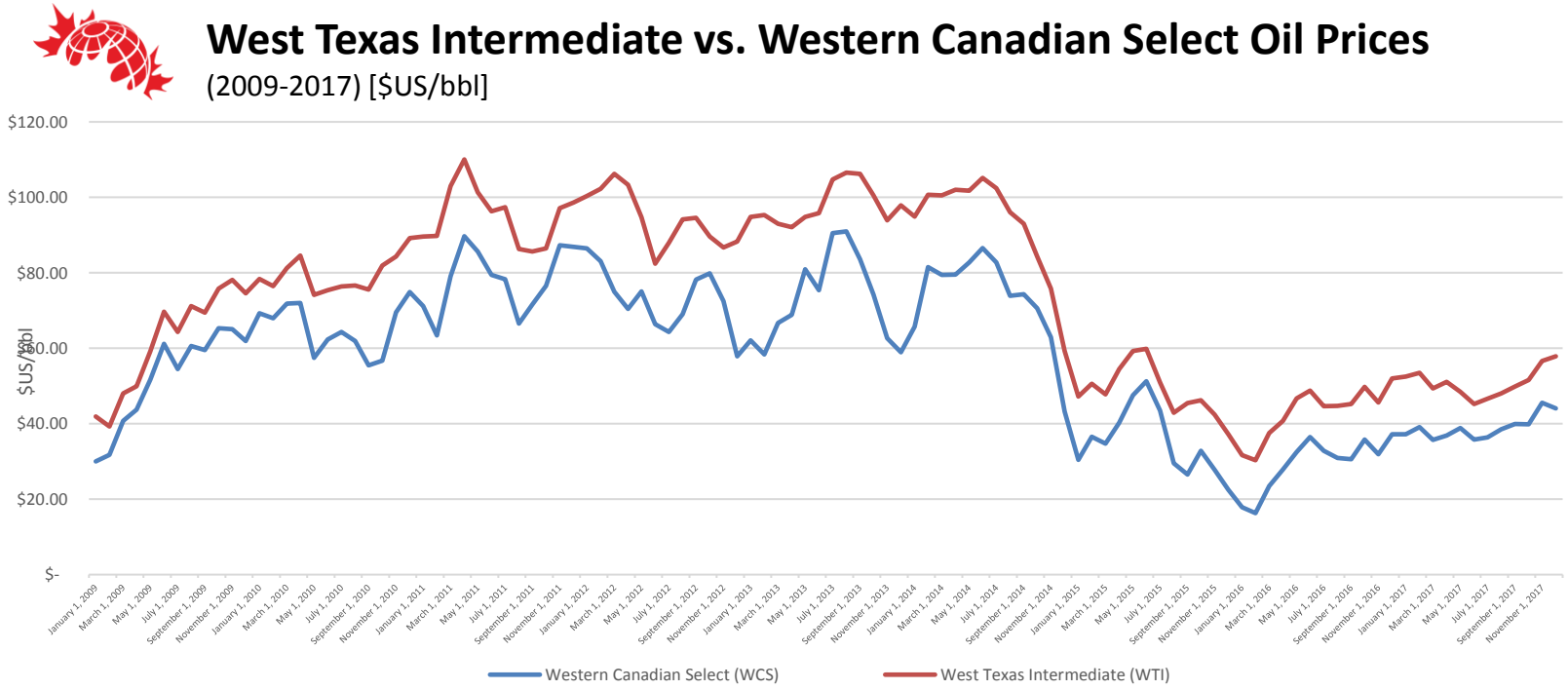

Figure 2: *A graph illustrating the price per barrel of West Texas Intermediate oil & Western Canadian Select oil. (Source: Government of Alberta Economic Dashboard)*

Keystone XL, Enbridge Line 3,[7] and the Kinder Morgan Trans Mountain line are years from completion. Keystone XL continues to face stiff opposition in Nebraska and the operator, TransCanada, has not committed 100 per cent to the project. Furthermore, an interprovincial political storm and possible constitutional crisis is occurring regarding the Trans Mountain pipeline and the movement and potential dangers of spilt diluted bitumen (dilbit). The NDP government of British Columbia has thrown down the gauntlet indicating a desire that the Trans

[6] See: www.genscape.com Genscape assessed WCS on Dec. 11 at $22.50/bbl below the calendar month average of West Texas Intermediate (WTI CMA), the lowest level since Genscape began its assessment in August 2014, and $5.15/bbl below the previous week's assessment. The previous low was WTI CMA minus $19.50/bbl on Aug. 11, 2014. The market continued to tank as the week went on, with WCS heard to trade on Dec. 14 as low as WTI CMA minus $28.50/bbl before parsing the losses at the end of the day. With no end in sight for any of the factors leading to the recent weakness, the Canadian crude markets are expected to remain under pressure in the foreseeable future.

[7] The commissioning of the Line 3 replacement is expected to occur in 2020.

Mountain pipeline never be built, and stating that it plans to let the courts decide. If the political powers that be allow that to happen, Kinder Morgan is likely to walk, pure and simple.

The Notley NDP government of Alberta has responded in kind, breaking off interprovincial electrical generating discussion regarding the proposed Site C dam and banning the import of BC wine. More importantly, Prime Minister Justin Trudeau has entered the fray, albeit tentatively, citing the importance of getting "our oil resources to markets other than the United States for the Alberta economy, for the Canadian economy to continue to grow." However, he also stated that he was not about to opine on an interprovincial trade dispute. The question one must ask is: who is ultimately in charge here?

In certain circumstances government can provide a catalyst for industry. The construction of the original TransCanada mainline was such a time. In the mid-1950s TransCanada was a fledgling corporation with no assets, simply not big enough to complete a project of that magnitude. In June of 1956 the Liberal government of Louis St. Laurent invoked closure in the House of Commons so that construction of the pipeline could begin. This overt action was led by C.D. Howe, the federal minister of trade and commerce, and caused uproar in the House.[8] For construction to begin by summer 1956, this proposed bill needed to move rapidly through Parliament. The Opposition claimed patronage, secrecy, abuse of power and lack of due process. Nonetheless, the Liberals stifled debate at the committee level, rushed the bill through first and second readings, and used closure to force third reading and approval. Many believe that the imposition of closure contributed to the demise of the St. Laurent government in 1957. For our discussion, one could argue that had the St. Laurent Liberals, led by Howe, not done this, the TransCanada mainline may have never been built, which is an interesting topic for another day.

Mark Twain said history doesn't necessarily repeat itself but sometimes it rhymes. The past few days have forced the polity to question government's role in the development of large infrastructure projects. Kinder Morgan, Enbridge and TransCanada certainly don't need the capital required to build these projects, as TransCanada did in 1956. What they do require is the political will at the national level to ramrod this project through if necessary. In November of 2016 when the prime minister approved the Trans Mountain line, he clearly iterated that the project was "in our national interest" and that it would be built, a statement he repeated at town

[8] Construction was to begin in the summer of 1956, two years behind schedule. When financial problems threatened construction, the Ontario and federal governments agreed to form a Crown corporation, Northern Ontario Pipeline, to pay for the portion of the line through the worst part of the Canadian Shield. Unfortunately, TransCanada needed help as well, and the corporation turned to the federal government for financial aid. In May of that year, Howe proposed a bill whereby the Crown corporation would loan TransCanada $80 million, repayable a year later or TransCanada would turn the whole project over to the government.

hall meetings in Edmonton and Nanaimo. We will see in the next few months whether or not politics trumps policy.

About the Author

Kelly J. Ogle *is the President of the Canadian Global Affairs Institute, and a senior executive and scholar with more than 35 years of entrepreneurial experience covering several business sectors including oil and gas, agriculture, trucking, residential development and golf course construction and operations. He has also served as a board member for various corporations, both public and private and has experience in all committee types; health and safety, audit, compensation and corporate governance. Mr. Ogle has also participated in the securing and disbursement of more than $1 billion in debt and equity funding of oil and gas ventures, managed the clearing of numerous prospectuses, Annual Information Forms and Information Circulars. As well, he has orchestrated the merger, acquisition, strategic alternatives processes and/or sale of numerous oil and gas corporations as CEO, President and/or Managing Director.*

Additionally, for the past 25 years, Mr. Ogle has given numerous presentations to various sized groups as both an industry executive and scholar and has had several journal articles published. He is the Chairman of the board of Silvera for Seniors, a not for profit organization in charge of over 1600 residences for low income senior Calgarians, and is the former Chairman of the Board of Student Energy, a global non-profit organization creating a movement of young leaders committed to transitioning the world to a sustainable energy future.

Canadian Global Affairs Institute

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