POLITICAL RISK AND THE TRANS MOUNTAIN PIPELINE EXPANSION

by Robert Lyman @2018

POLITICAL RISK AND THE TRANS MOUNTAIN PIPELINE EXPANSION

PERCEPTIONS AND FACTS

Summary

The U.S.-based Institute for Energy Economics and Financial Analysis (IEEFA) recently issued a statement that was picked up and repeated in various media in Canada, including the Canadian Broadcasting Corporation. The statement warned that the U.S. Administration must approve the sale to the government of Canada of the U.S. assets of the Trans Mountain Pipeline system now owned by the Kinder Morgan Corporation and that approval was "not a foregone conclusion".

What was not reported is that the IEEFA is, in fact, an environmental organization funded largely by foundations such as the Rockefellers Brothers Foundation and the William and Flora Hewlitt Foundation. Through her extensive research of U.S. tax records, Vivian Krause has shown these foundations to be major funders of the "Tar Sands Campaign". The goals of this campaign since the 1990's have been to stop expansion of the Canadian oil industry, to reduce demand for oil sands crude oil in the U.S. and to stop or stall pipeline and port construction. The apparent objective of the IEEFA statement was to increase the political risk associated with the Trans Mountain Pipeline Expansion project – to undermine investor and public confidence that the Canadian government's purchase will proceed and that the project will be built.

In fact, there are two approvals that may apply to the U.S. portion of the Trans Mountain System – the Puget Sound pipeline that transports crude oil from the Canada-U.S. border to the refineries in the state of Washington. The U.S. Committee on Foreign Investment in the

United States (CFIUS) must approve the sale based on a review of its effects on U.S. national security. A Presidential permit of the same kind that is usually required for the construction of a new cross-border pipeline may also be required.

The CFIUS is an inter-agency review process led by the U.S. Department of the Treasury that serves the President in overseeing the national security implications of foreign investment, and especially the acquisition of foreign control of companies in the U.S. economy. The processes of review, investigation and decision are subject to statutory time limits of up to 90 days in total. CFIUS operates under defined terms of what constitutes "national security" and its procedures entail many internal checks along the way to ensure that it adheres to these terms. In fact, since CFIUS was established in 1975, U.S. Presidents have disallowed only four foreign acquisitions. The requirement to undergo this review is not a likely threat to the Canadian acquisition.

Presidential permits are required for the construction of major new cross-border oil pipelines. There are administered by the Department of State which, like the President, has significant discretion in terms of how it assesses projects according to the United States "national interest". An Interpretive Guidance document issued by the Department of State in 2007 stated that a "change in ownership of a border crossing that is not encompassed within or provided for under an applicable Presidential permit" requires formal "notification" but left it unclear as to whether it would require issuance of a Presidential permit. This appears to be up to the discretion of the State Department and the U.S. President.

If, in fact, a presidential permit was required based on a review of the national interests involved, it would be made clear that the existing Trans Mountain pipeline system now transports crude oil that is used by refineries not just in British Columbia but also by those in Washington State to meet the needs of consumers in the Pacific Northwest. Crude oil delivered by the pipeline to the Westridge Terminal is also loaded on to tankers and shipped to export markets, now mainly in California. Much of the additional exports from Canada's west coast ports will go to California or other parts of PADD 5 rather than Asia. As PADD 5's existing crude oil supply from Alaska is steadily declining, the additional crude oil from Canada would both increase the region's security of supply and increase competition in refined product markets, thus benefiting American consumers. For the United States, these are genuine, not speculative, national interest considerations.

POLITICAL RISK AND THE TRANS MOUNTAIN PIPELINE EXPANSION

PERCEPTIONS AND FACTS

On August 4, 2018 the U.S.-based Institute for Energy Economics and Financial Analysis (IEEFA) issued a statement warning that the U.S. Administration must approve the sale to the government of Canada of the U.S. assets of the Trans Mountain Pipeline system now owned by the Kinder Morgan Corporation. The Institute's statement was immediately picked up by various media, including the Canadian Broadcasting Corporation, and re-broadcast to a wide audience, along with the claim that these approval requirements were "not a foregone conclusion." Unknown to most people who read it, the objective of the Institute's statement was to increase the political risk associated with the Trans Mountain Pipeline Expansion project – to undermine investor and public confidence that the Canadian government's purchase will proceed and that the project will be built.

In fact, there are two approvals that may apply to the U.S. portion of the Trans Mountain System – the Puget Sound pipeline that transports crude oil from the Canada-U.S. border to the refineries in the state of Washington. The U.S. Committee on Foreign Investment in the United States (CFIUS) must approve the sale based on a review of its effects on U.S. national security. It also is possible that a Presidential permit of the same kind that is usually required for the construction of a new cross-border pipeline will be required.

What is the Institute for Energy Economics and Financial Analysis? According to its website, its mission is to "*accelerate the transition to a diverse, sustainable and*

profitable energy economy". In other words, it is an environmental organization that produces reports on energy issues. To really understand its objectives, however, one must examine its sources of funding. These are listed as the Rockefeller Family Fund, the Rockefeller Brothers Fund, Energy Foundation, Mertz-Gilmore Foundation, Moxie Foundation, William and Flora Hewlett Foundation, Growald Family Fund, Flora Family Fund, Wallace Global Fund, and V. Kann Rasmussen Foundation.

Vivian Krause is a researcher who, over the last five years, has gone through 100,000 pages of U.S. tax returns and traced more than 2,000 grants from U.S foundations to environmental and aboriginal groups in Canada. She has extensively documented the participants in the Tar Sands Campaign, a heavily funded political initiative launched by the Rockefellers Brothers Fund and the Tides Foundation in 2008. The Tar Sands Campaign is co-funded today by the Rockefeller Brothers Fund, the William and Flora Hewlett Foundation, the Oak Foundation, the Tides Foundation, the Sea Change Foundation, and the Marisla Foundation. According to Krause's research, the Rockefeller Brothers Foundation alone has granted at least U.S. $10 million since the 1990's to groups in Canada that oppose oil sands development. To quote her, *"The explicit goals of the Tar Sands Campaign are to stop expansion of the Canadian oil industry, to reduce demand for oil sands crude in the U.S. and to stop or stall pipeline and port construction."* The fact that both the Rockefeller Brothers Foundation and the William and Flora Hewlett Foundation are among the key funders of the Institute for Energy Economics and Financial Analysis suggests that it shares the goals of the Tar Sands Campaign. In other words, it is not an organization that promotes economic development or expert information for investors, but rather a front for organizations opposed to Canadian oil development.

That IEEFA is opposed to Canadian oil development does not in itself disprove its reports concerning the impact of the reviews that may occur in the United States on the Canadian government's acquisition of the Kinder Morgan assets. The fact that governments undertake reviews, however, does not mean that they will block or delay a transaction. It is important to distinguish between the purpose and nature of the reviews that will occur and the claims of IEEFA and other pipeline opponents that this will threaten the construction of the Trans Mountain Expansion Project.

Let us examine the facts.

The Committee on Foreign Investment in the United States

The Congressional Research Service has published a number of useful reports describing the history and operations of the CFIUS. The most recent and comprehensive report was published in July 2018 and can be read here:

https://fas.org/sgp/crs/natsec/RL33388.pdf

CFIUS was established by Executive Order in 1975. It is not an agency of government like Canada's Foreign Investment Review Agency, but rather an interagency committee that serves the President in overseeing the national security implications of foreign investment, and especially the acquisition of foreign control of companies in the U.S. economy. There have been several changes to the composition of the Committee and its procedures over the period since 1975. Some of this has resulted from an increased desire by members of the U.S. Congress for more transparency in the way the Committee operates and for more Congressional oversight. The most recent changes were made pursuant to the *Foreign Investment Risk Review Modernization Act of 2018*.

CFIUS is required to review all "covered" foreign investment transactions to determine whether a transaction threatens to impair U.S. national security, or a foreign government controls the foreign entity, or it would result in control of any "critical infrastructure that could impair the national security". A covered foreign transaction is defined as any merger, acquisition or takeover that results in "Foreign control of any person engaged in interstate commerce in the United States". According to Treasury Department regulations, investment transactions that are not considered to be covered, and therefore not subject to CFIUS review, are those that are undertaken "solely for the purpose of investment" or an investment in which the

foreign investor has “no intention of determining or directing the basic business decisions of the issuer”.

The parties to a foreign acquisition of ownership and control of a U.S. firm must give notice to the Treasury Department of the proposed transaction. The President (i.e. the Administration) can initiate a review of the transaction. After it receives a formal notification of the acquisition, the CFIUS has 45 days to review the transaction to decide whether to investigate the case as a result of its determination that the investment “threatens to impair the national security of the United States”.

The use of “national security” as a key consideration has different implications under different U.S. laws. In the case of trade, for example, “national security” can be used as grounds for issuing Executive Orders that are not subject to Congressional review (and delay or opposition). In the case of CFIUS, the “national security” review must be based on twelve factors. The list includes the following elements:

“ (1) domestic production needed for projected national defence requirements;

(2) the capability and capacity of domestic industries to meet national defence requirements, including the availability of human resources, products, technology, materials, and other supplies and services;

(3) the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the U.S. to meet the requirements of national security;

(4) the potential effects of the transactions on the sales of military goods, equipment, or technology to a country that supports terrorism or proliferates missile technology or chemical and biological weapons; and transactions identified by the Secretary of Defence as ‘posing a military threat’ to the United States;

(5) the potential effects of the transaction on U.S. technological leadership in areas affecting U.S. national security;

(6) whether the transaction has a security-related impact on critical infrastructure in the United States;

(7) the potential effects on United States critical infrastructure, including major energy assets;

(8) the potential effects on United States critical technologies;

(9) whether the transaction is a foreign government-controlled transaction;

(10) in those cases involving a government-controlled transaction, a review of (A) the adherence of the foreign country to nonproliferation control regimes, (B) the foreign country's record on cooperating in counter-terrorism efforts, (C) the potential for transshipment or diversion of technologies with military applications;

(11) the long-term projection of United States requirements for sources of energy and other critical resources and materials; and

(12) such other factors as the President or the Committee determine to be appropriate."

This list indicates that, from the perspective of Congress, a review of "national security considerations" is not a hunting expedition. There are a number of specific potential concerns, relating largely to national defence, technology, strategic resources, nuclear non-proliferation, terrorism, espionage and the potentially hostile actions of government-owned companies unrelated to commercial interests.

To be sure, the President and Committee may consider "such other factors" as they may determine to be appropriate. They, however, would certainly invite a great deal of controversy if they started to use the foreign acquisition review process as, for example, a way to punish another country's trade policies. In its guidance to businesses that are parties to transactions involving acquisitions, published as a regulation in 2008, the Treasury Department stated specifically that, "*CFIUS focuses solely on any genuine national security concerns raised by a covered transaction, not on other national interests.*"

In some cases, following a review, CFIUS may initiate an investigation. It must complete the investigation within 45 days, although this deadline may be extended for another 15 days in "extraordinary circumstances". CFIUS initiates an investigation only when:

"(1) CFIUS or a member of CFIUS believes that the transaction threatens to impair the national security of the United States and that the threat has not been mitigated;

(2) an agency designated by the Department of the Treasury as a lead agency recommends, and CFIUS concurs, that an investigation be undertaken;

(3) the transaction is a foreign government-controlled transaction; or

(4) the transaction would result in foreign control of any critical infrastructure of or within the United States, if CFIUS has determined that the transaction could impair national security and that the risk has not been mitigated."

CFIUS assesses whether a foreign person has the capability or intention to exploit or cause harm (i.e. whether there is a threat) and whether the nature of the U.S. business, or its relationship to a weakness or shortcoming in a system, entity or structure makes national security more susceptible to being impaired (i.e. whether there is a vulnerability).

If CFIUS or any member of CFIUS recommends suspension or prohibition of the transaction, or if CFIUS otherwise seeks a Presidential decision on the transaction, it will refer the matter to him. In order to exercise the authority to suspend or prohibit a covered transaction, the President is required by law (the *International Emergency Economic Powers Act*) to make two findings: (1) That there is credible evidence that leads the President to believe that the foreign interest exercising control might take action that threatens to impair the national security; and (2) that provisions of law, other than the *International Emergency Economic Powers Act*, do not provide adequate and appropriate authority for the President to protect national security. Suspension or prohibition of a transaction, in other words, is a last resort when all other options are not available.

What has been the actual experience with respect to the considerations of the CFIUS and the decisions of U.S. Presidents over the past decade? The following table summarizes the data over the period 2008 to 2016, the most recent available:

CFIUS Covered Transactions, Investigations and Presidential Decisions

Year	Notices	Investigations	Presidential Decisions	Notices Rejected
2008	155	23	0	0
2009	65	25	0	0
2010	93	35	0	0
2011	111	40	0	0
2012	114	45	1	1
2013	97	48	0	0
2014	147	51	0	0
2015	143	66	0	0
2016	172	79	1	1

Source: CFIUS

Note that in the recent past the number of investigations as a percentage of notices has increased. Note, too, the very small number of cases in which the President has actually disallowed a transaction. While the full data for 2017 is not available, on September 13, 2017 President Trump disallowed the proposed $1.3 billion acquisition of Lattice Semiconductor by the Chinese Investment Company, Canyon Bridge Capital Partners. This was only the fourth investment transaction blocked under the CFIUS statute since 1975. President Obama also blocked a transaction in 2016. This makes clear that, while proposed foreign acquisitions are increasingly subject to review and investigation, it is extremely rare for them to be blocked, and those that have been blocked have had clear national security concerns, as traditionally defined by CFIUS, associated with them. Viewed in this context, the statement by the Institute for Energy Economics and Financial Analysis simply promoted poorly-founded speculation.

Presidential Permits for Border-Crossing Oil Pipelines

In what follows, I will again refer to the excellent analyses published by the Congressional Research Service, specifically its brief entitled, "*Presidential Permits for Border Crossing Energy Facilities*" published in April 2017. It can be found here:

https://fas.org/sgp/crs/misc/R43261.pdf

The United States has different approval regimes applying to crude oil and refined oil products pipelines, natural gas transmission lines, and electricity transmission lines that cross international borders. In all three cases, it is the executive branch that holds and exercises permitting authority; Congress has not passed legislation in this area. A series of Executive Orders, starting with one issued in 1968, have determined the procedures that must be followed.

In the case of crude oil and refined oil products pipelines, the U.S. Secretary of State is empowered to receive all applications for permits for the construction,

connection, operation or maintenance of the pipelines at the border of the United States and to determine whether the issuance of a permit would "serve the national interest". The text of the relevant Executive Orders provides no guidance as to what is considered the national interest, but Department of State documents have indicated that the relevant considerations include many factors, such as: energy security; environmental, cultural, and economic impacts; foreign policy; and compliance with relevant federal legislation.

It is notable that the Presidential permit process even for projects that appear very similar are evaluated on a case-by-case basis and may receive different permitting outcomes. Thus, for example, the national interest determination for Enbridge Energy's Alberta Clipper crude oil pipeline that transports oil from the oil sands to U.S. markets was positive and resulted in the issuance of a Presidential permit in August 2009, while the national interest determination for the Keystone XL pipeline was held up for several years by the Obama Administration due to entirely different judgments as to how the issue of greenhouse gas emissions should be dealt with. Both the State Department and the President have considerable discretion in determining where the "national interest" lies.

It is not clear, however, whether a Presidential Permit would be required in this case. As noted in the Congressional Research Service report:

"In February 2007, the State Department's Bureau of Western Hemisphere Affairs – Office of Canadian Affairs published Interpretive Guidance on Non-Pipeline Elements of E.O. 13337, Amending E.O. 11423. As the title indicates, the document is not binding with respect to pipeline facilities, although dialogue with State Department staff indicated that the guidance found in the document would be applied in a similar manner to pipeline facility permitting decisions... According to the Interpretive guidance, any 'substantial modification of existing border crossings" would fall under Executive Order 13337 and thus require a new or amended Presidential Permit."

The Interpretive Guidance includes in the definition of "substantial modifications" a "change in ownership of a border crossing that is not encompassed within or provided for under an applicable Presidential permit".

"The Interpretive Guidance also provides that projects should be placed in one of three categories; Red (both notification to the State Department and a new or amended permit is required), Yellow (notification required and a new permit may be required), and Green (neither notification nor a permit required). The 'Red' category is described in language similar to that found in the document's definition of a 'substantial modification'. The 'Yellow' category includes capacity changes, temporary changes due to construction projects and changes in responsibility for ownership, operations, or maintenance, among other things. The 'Green' category includes regular maintenance and repair work, exterior changes to a facility within its existing footprint, systems changes (e.g. HVAC, electrical), and changes made at the request or direction of the State Department, among other changes."

The Interpretive Guidance thus appears to leave it up to the discretion of the State department as to whether a change in ownership of the Sumas connection and Puget Sound Pipeline would require a Presidential permit. This might well depend on which Administration is in Office.

The Trans Mountain Expansion Project and the U.S. National Interest

No doubt environmental organizations like the Institute for Energy Economics and Financial Analysis and the anti-oil sands foundations that fund them will try to use their political influence to ensure that a Presidential permit process is required, with all the opportunities that presents for lengthy hearings, administrative delays and court challenges. If, as appears highly likely, a change of ownership notification is made under the current Trump Administration, the chances of such delay and obstruction tactics succeeding seem poor.

The opponents of the Trans Mountain Pipeline insinuate that, in a review of the U.S. national interest in its acquisition by Canada, President Trump and his advisors would place primary importance on continuing the present situation in which the shortage of export pipeline capacity forces Canadian heavy oil producers to accept large discounts of their sales to U.S. refineries. In effect, they confuse the Trump Administration's determination to eliminate trade disadvantages it perceives for American firms with an alleged desire to create unfair disadvantages for Canadian oil suppliers. There is, of course, no evidence in the statements of U.S. Administration official to support such claims. They represent yet more speculation.

An objective review of the U.S. national interest in this matter would bring to light a completely different reality. The existing Trans Mountain pipeline system now serves many different requirements. It transports crude oil that is used by refineries not just in B.C. but also by those in Washington State to meet the needs of consumers in the Pacific Northwest. Less well known is that crude oil delivered by the pipeline to the Westridge Terminal is also loaded on to tankers and shipped to export markets, now mainly in California.

Within the United States, most of the west coast is included in the region defined by the U.S. government as the Petroleum Administration for Defence (PADD) 5. PADD 5 is geographically isolated from other U.S. refining centres, notably the Gulf Coast, where 52% of U.S. refining capacity is located, and from global refining centres that can efficiently supply products by tanker to other regions. There are no pipelines that cross the Rocky Mountains in the United States to move products to central and northern PADD 5 from the Midwest, and only limited pipelines that deliver from the Gulf Coast to California. The U.S. west coast is 10 days travel by tanker from the U.S. Gulf Coast, three weeks from Asia, and more than four weeks from Europe. Pipeline and marine infrastructure (i.e. ports and tanker loading and unloading facilities) to move products into and out of the area are also limited. According to a U.S. Energy Information Administration report on west coast transportation fuels markets in 2015, refinery production within PADD 5 is sufficient to meet about 91% of in-region gasoline demand, 96% of jet fuel demand, and 113 % of distillate demand. See the EIA report here:

https://www.eia.gov/analysis/transportationfuels/padd5/

Because of heavy reliance on in-region refinery production, any disruptions tend to quickly limit short-term supplies and cause prices to increase and remain higher for a longer period than would be typical in other North American markets. As in B.C., consumers end up paying more.

Much of the crude oil needs of PADD 5 have been met since the 1980s by Alaskan production, but that has declined from about two million barrels per day (b/d) at its peak to about 550,000 b/d today. As a result, PADD 5 imports of crude oil rose from about 300,000 b/d in the 1980's to about 1.3 million b/d today. In 2016, 226,000 b/d was supplied by Canada.

The proposed expansion project would add a second "twinned" pipeline alongside the existing pipeline and increase the capacity of both the pipeline and the Westridge Terminal near Vancouver. There is a persistent myth that the additional facilities would only move crude oil and then only to Asian markets. In fact, as explained in the Trans Mountain application to the National Energy Board, once the expansion was finished, the proposed Line 2 would transport heavy crude and bitumen to Vancouver for export, but "export" includes the oil that will be supplying the Puget Sound pipeline via the Sumas delivery point to serve the four refineries in Washington State. This will reduce the amount of crude oil that has to travel to the Puget Sound by rail or by tanker.

Much of the additional exports from Canada's west coast ports will go to California or other parts of PADD 5 rather than Asia. The lower shipping costs to U.S. markets would, in fact, make that more appealing to Canadian producers. This would both increase the security of PADD 5's supply and increase competition in refined product markets, thus benefiting American consumers.

For the United States, these are genuine, not speculative, national interest considerations.

~~~~

Robert Lyman is an Ottawa energy policy consultant who was a public servant for 27 years and a diplomat for 10 years prior to that.
~~~~