Honourable Bill Morneau P.C., MP
Minister of Finance
Ottawa Ontario
K1A 0G5

February 14, 2020

Dear Finance Minister Morneau,

When Prime Minister Trudeau announced the approval of Trans Mountain's expansion on June 19, 2019 he stated, "We've decided every dollar the federal government earns from this project will be invested in Canada's clean energy transition. Additional corporate tax revenue alone could be over $500 million per year, once the project is up and running. We will invest this money, as well as any profits from the sale of the pipeline, in clean energy projects that will power our homes, business and communities for generations to come."[1]

These claims were included as part of the Liberal Party platform in the October election, and re-iterated by you after forming government.

For many months I have been trying to alert you through your staff that the $500 million a year claim is false.[2] I have also tried to alert you to the more than $10 billion in toll and other subsidies arising from Trans Mountain's purchase, and that under the shipper contract terms unnecessarily agreed to by Trans Mountain's Board, there will be no 'profits' from the sale of pipeline.

Natural Resources Canada (NRCan) has confirmed to me that numerous departments within your government, including the Department of Finance, have confirmed why the $500 million a year in additional corporate tax revenue claim is unsubstantiated.[3]

On February 10, 2019 you once again relied on the false tax revenue claim in the speech you gave to the Economic Club of Calgary. You said, "Canada will be using the revenues we get from this project, **from additional taxes estimated at about 500 million dollars a year**, and from the sale, to fund Canada's transition to a cleaner economy."[4]

There will not be additional corporate tax revenue because of Trans Mountain

You should stop misinforming Canadians. Here are the facts.

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1 Justin Trudeau, Prime Minister of Canada, Trans Mountain Expansion will fund Canada's future clean economy June 18, 2019 Ottawa, Ontario.
2 Canadian Press, Feds won't explain claim pipeline expansion will raise $500M in tax revenue, Mia Rabson, November 25, 2019.
3 Email correspondence dated December 30, 2018. I had written explaining that the Scotiabank report predicting $40 million a day and Premier Rachel Notley predicting $80 million a day were based on a false understanding of how the market works. I was advised that a multi-departmental task force looked into and found the claims exaggerated and a list of all the departments involved, including Finance, was provided to me.
4 Bill Morneau addresses Economic Club of Canada in Calgary, February 10, 2020, Minute 34:30

Fact #1: A report prepared by Kinder Morgan's consultant Neil Earnest of Muse Stancil in 2015 is the source for the increase in oil producer profits/revenues of $73.5 billion, which the Conference Board relied on to estimate $500 million a year in additional federal corporate tax revenue.

On December 20, 2019 you confirmed that you are aware of the study upon which the $500 million in additional corporate tax revenue is derived. You wrote, "The Finance Canada estimate is based on a study referenced by the Conference Board of Canada which estimated the Project will raise oil producer profits revenues by $73 billion over 20 years."[5]

When we go to that Conference Board report prepared in 2015, we find that the study "referenced by the Conference Board of Canada" was prepared by Kinder Morgan's Texas-based consultant Neil Earnest of Muse Stancil.

Confirming that the Earnest Report is the original source for the $500 million in additional corporate tax revenue, it becomes necessary to evaluate the veracity of Mr. Earnest's estimate. Simply put, if Mr. Earnest's producer revenue figure is without merit, it follows that any federal tax estimate that relies on his estimate is also without merit. Therefore, this letter addresses Mr. Earnest's fundamentally flawed analysis and explains why his producer profits/revenues figure is effectively fabricated.

The Conference Board report states that, "The Muse Stancil study finds that **oil company revenues** rise by $73.5 billion (CAD$ 2012) over the first 20 years of the pipeline's operations as a result of **higher netbacks attributed to the market access provided by the TMEP**. This generates total fiscal benefits of $23.7 billion. The federal corporate income tax effects account for $10.2 billion of these effects."[6] (emphasis added)

The $10.2 billion estimate prepared by the Conference Board equates to $500 million a year over twenty years. That is, it is the same as the "additional taxes estimated at about $500 million" figure you have been relying upon.

Fact #2: $500 million a year in additional corporate tax revenue requires a massive increase oil producers' profits to pay this tax. It has nothing to do with tax revenue from Trans Mountain's operations.

The $500 million in additional corporate tax revenue that you rely on to convince Canadians that Trans Mountain's expansion will fund a transition to a clean economy is based on a prediction prepared by Kinder Morgan's Texas-based consultant in 2015. That stale-dated report suggests that building the Trans Mountain expansion will cause the price of **all oil supplied** from Western Canada to increase—not just the price on the barrels shipped down the pipeline.

[5] Letter from Honourable Bill Morneau to Marc Eliesen, December 20, 2019.
[6] Conference Board of Canada, TMEP Understanding the Economic Benefits for Canada and its Regions, September 25, 2015, Page 8

This should give pause to even the most ardent supporter of Trans Mountain's expansion. The notion that the price for every barrel of oil supplied will rise every year for twenty years because Trans Mountain is built is, quite frankly, silly.

Even if Mr. Earnest employed Netback Analysis appropriately by applying spot market pricing to the barrels exposed to it, the report is egregiously outdated. I am sure you are aware of how the market and pricing environment for crude oil has changed since 2015. As well, Mr. Earnest relied on toll rates to shippers based on a $5.4 billion project cost, not on a project cost of $13.2 billion.

I appreciate that the recent announcement was that Trans Mountain's cost had increased to $12.6 billion, but contingency is a usual part of a project budget and there is a $600 million contingency reserve which you confirmed in your speech in Calgary is part of Trans Mountain's expected cost.[7] Since it is more accurate to use $13.2 billion for the capital cost of the project I do so in this letter.

To more fully appreciate why accurate toll rates are a crucial part of Netback Analysis remember that higher oil producer revenues—higher netbacks—are calculated based on the price received by producers l**ess the transportation cost of delivering the crude oil to market.** Mr. Earnest explains this in his report.[8] That is, producer revenues—netbacks—erode as pipeline tolls increase.

The most recent capital cost estimate of $13.2 billion triggers much higher shipper tolls than those relied on by Mr. Earnest. In fact higher tolls have likely turned potential producer revenues into producer losses according to Mr. Earnest's model.

Recognizing how the market for Canadian crude functions, how oil prices for Western Canadian crude are determined, and how major oil companies legally avoid paying their fair share of cash taxes, predicted federal taxes will not materialize. The federal tax revenue from tar sands producers that you rely on are illusory and the promise of a clean energy transition because of them a pipe dream.

As Minister of Finance you know—or should know—how ridiculous the trickle-down theory upon which the $500 million a year figure is based. I can only assume you have not been made aware of how the figure was derived so let me put it into more specific terms that I hope will be readily grasped.

In order for an average of $500 million a year in additional federal cash taxes to arise from tar sands producers, Trans Mountain must ship an additional 540,000 barrels a day of heavy oil and this must increase the price for all oil supplied from Western Canada every year for twenty years.[9] When oil producers receive increased revenues for every barrel they supply, that revenue flows directly to their bottom lines as pure profit, and these companies do not use any of their

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[7] Bill Morneau addresses Economic Club of Canada in Calgary, February 10, 2020.
[8] Neil Earnest, Muse, Market Prospects and Benefits Analysis for TMEP, October 28, 2015, page 32.
[9] Neil Earnest, Muse, Market Prospects and Benefits Analysis for TMEP, October 28, 2015, Table A-1 and A-17 of Muse.

deferred tax assets or other numerous accounting measures available to them to avoid these taxes, but instead, pay the federal corporate tax rate on every dollar received from increased oil prices as cash taxes to the federal treasury.

Mr. Earnest's study postulates a price increase in 2019 (the first full year Trans Mountain was expected to be operational when the study was undertaken) on all 4.8 million barrels forecasted to be supplied in Western Canada for that year—all 4.8 million barrels regardless of which refinery they are delivered into in Canada, the US, or Asia (although markets in Asia are proving to be as illusory as well). This postulated price increase on all barrels, according to Mr. Earnest's 2015 analysis, leads to producer revenues increasing by $4.3 billion.

Just consider this notion. Oil producer revenues for companies like Suncor, Cenovus, Imperial, Husky and Canadian Natural Resources are postulated to rise by $4.3 billion in the first full year of Trans Mountain's operation over what they would be without the expansion. This revenue is assumed to flow directly to these companies bottom lines as profit where a federal corporate tax rate is applied. The federal corporate tax portion then flows directly to the federal treasury as cash tax revenue—this is how your promised $500 million in fiscal revenue is derived.

Only 20-25 percent of Western Canadian crude oil barrels supplied are exposed to spot market differential pricing and therefore, Mr. Earnest's analysis significantly overstates potential revenue by about 75 percent. His analysis is fundamentally flawed from the get go. By extension, so is the predicted tax revenue based on Mr. Earnest's revenue claim.

In late 2018 and early 2019 I forwarded to NRCan my research regarding this issue. You may recall that at that time former Alberta Premier Rachel Notley was claiming $80 million a day in producer revenue was being lost because Alberta's oil was underpriced. I knew the Netback Analysis Ms. Notley relied on was drawn from an erroneous Scotiabank assessment.[10] Scotiabank made the same error Mr. Earnest made by applying potential price lifts from additional pipeline capacity to all barrels supplied when relatively few barrels are exposed to such pricing.[11]

My research concluded that only about 20 percent of the barrels supplied are exposed to spot market pricing. NRCan came to a similar conclusion based on analysis undertaken by the Bank of Canada and IHS Markit. NRCan advised that "only about 30% of Western Canadian crude (exported) is exposed to the spot market, and therefore the light/heavy differential."[12] Thirty percent exported equates to about 25 percent of supply, so you can see how close our understanding of barrels exposed to spot market pricing are. Mr. Earnest's study pretends 100 percent of the barrels supplied are exposed to spot market pricing.

Then there is the second fundamental error in Mr. Earnest's analysis as I mentioned above. He relied on transportation costs for Trans Mountain based on a $5.4 billion capital cost for the project. Since producer revenues—netbacks—are the price producers receive **minus**

10 National Observer, Premier Notley's claimed $15 billion annual benefit from Trans Mountain exposed as false by her own budget, Robyn Allan, June 7, 2018
11 Vancouver Sun, Scotiabank's oil report a work of fiction, Robyn Allan, March 4, 2018.
12 Email Correspondence from Timothy Gardiner, January 7, 2019.

transportation costs, accurate pipeline tolls must be included in the analysis. Underestimating toll rates will over-estimate producer revenues.

It is the capital cost for the project that drives the fixed cost component of the toll rates shippers will pay to ship crude oil along Trans Mountain. I am sure it is becoming clear to you by now how flawed Mr. Earnest's revenue figure is when he erroneously exposed all barrels supplied and used toll rates for a $5.4 billion project budget when the project is now expected to cost $13.2 billion. Even if Mr. Earnest had properly identified the barrels exposed to spot market pricing, the toll rates he relied upon to predict producer returns are too low. This suggests enhanced revenues when none are likely to arise now that Trans Mountain's cost has skyrocketed.

The cost to build Trans Mountain when Mr. Earnest undertook his analysis was $6.8 billion, not $5.4 billion. Kinder Morgan supplied Mr. Earnest with toll rates to use in his calculation that the company knew were unrealistically low. The toll rates he should have used five years ago when he did his analysis were at least $1 per barrel higher than the tolls he relied upon.

Then in 2017, project costs rose to $7.4 billion raising fixed toll rates by $1.40 a barrel more than the rates Mr. Earnest used.

Now the project is expected to cost $13.2 billion—a project cost 144 percent higher than the one Mr. Earnest relied upon. Mega-projects such as Trans Mountain are known to have project cost overruns during construction that exceed contingency, so it is likely that the project cost will exceed $13.2 billion by the time it's in-service.

What this means is that if the analysis Mr. Earnest undertook were to be redone with today's expected capital cost, **revenues to producers would likely fall—not rise.** This is because of Trans Mountain's ballooning tolls.[13]

Mr. Earnest predicted that during the first year of Trans Mountain's operation the price for Western Canadian Select (WCS) would rise by an average of $2.15 per barrel and for Cold Lake Blend (CLB) the price would rise by an average of $2.54 per barrel net of toll charges. This was when he relied on a project cost of $5.4 billion.[14] Shipper tolls related to a $13.2 billion project are about $2.85 per barrel higher than what Mr. Earnest used, swamping the projected producer revenue gains.

The price lift benefit Mr. Earnest predicted is negated by higher transportation costs due to Trans Mountain's skyrocketing construction costs. As we see above, the price lift for CLB is $0.31 less a barrel than the increase in transportation cost since the analysis was conducted. Based on the

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[13] It should be noted that Mr. Earnest's tanker rates were also too low which further compromises the veracity of his analysis. For example, tanker rates are quoted in US dollars. Mr. Earnest assumed the US and Canadian dollars are at par reducing their impact by about 30 percent. Since pipeline toll rates triggered by the increased project cost are sufficient to show that there will be no increased producer revenues as a result of the project, a discussion respecting tanker rates has been excluded from this letter. However, you need to be aware that tanker costs to Asia provide another impediment to exports reaching that market.

[14] Earnest Report Table A-13 and A-14.

Earnest methodology, corporate revenues will be lower, not higher, than if Trans Mountain were constructed because of the negative impact from higher shipper tolls on producer returns.

It may be useful to detail for you how I calculated the toll rates since I am well aware that even though shipper tolls have gone up, they have not gone up by as much as they should have to cover burgeoning project costs.

Trans Mountain's contract with shippers confirms that for each $100 million in cost increase beyond $5.4 billion, toll rates increase by 7 cents a barrel. Once the project cost reaches $7.4 billion, any further project cost increases put Trans Mountain (and hence Canadian taxpayers) at risk for 'capped costs.'[15]

You may not be aware of the serious implications of the capped versus uncapped feature imbedded in the contracts since you have not mentioned this risk to Canadian taxpayers in any of your public presentations or during media interviews. The capped versus uncapped feature means that Trans Mountain bears a large portion of project costs beyond a $7.4 billion budget as cost overruns are passed on to shippers in a very limited way.

I need to also add that the contract with shippers was such that Trans Mountain could have ensured all increased construction costs were passed on in shipper tolls in June 2019 before Mr. Trudeau approved the project. Instead, Trans Mountain's Board approved a whopping $4.4 billion subsidy to shippers through reduced toll obligations and have unnecessarily put Canadian taxpayers at risk for these costs.[16]

Repeatedly over the past number of months I have asked your staff to provide a breakdown of capped versus uncapped costs in order to more rigorously estimate the public subsidy to shippers that Trans Mountain has unnecessarily provided to them. Despite promises that they would provide answers to my questions regarding this and other issues, my questions remain unanswered.

Kinder Morgan provided information about the allocation of capped versus uncapped components of the budget in its CER application when the company requested approval for the toll methodology based on a $5.4 billion budget. I urge you to update this information now that a revised budget has been prepared. It makes little sense to keep the capped versus uncapped risk of the project from Canadians.

The best information publicly available is that 75% of all costs over $7.4 billion are capped and therefore borne by Trans Mountain with 25% of the costs uncapped and passed on in fixed tolls to shippers.

Going from a project cost of $5.4 billion to $7.4 billion tolls went up by $1.40, but going from $7.4 billion to $13.2 billion tolls to shippers went up by about $1.45 a barrel, for a total increase

15 Trans Mountain contract with Shippers, Facility Support Agreement.
16 Robyn Allan, Are Canadians Subsidizing Trans Mountain? Yes, By About $8 billion, A Primer for Thoughtful Canadians, December 4, 2019.

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in transportation costs of $2.85 per barrel since Mr. Earnest did his estimate. Current transportation costs have nullified potential revenue gains to producers.

Fact #3: The Earnest Report egregiously exaggerated the barrels affected by spot market pricing and underestimated transportation costs shippers will face. These two errors erode the producer revenue projection, and by extension, any federal corporate tax revenue projection.

The study your department used to estimate corporate tax revenue from tar sands operators is fundamentally flawed and the revenue figure erroneously calculated. These two errors led to a positive estimate of corporate tax revenue by predicting increased revenue to producers when the factors that determine oil prices, market realities and project tolls tell us the opposite.

I was an expert witness at the Canada Energy Regulator (CER) hearing for Northern Gateway on behalf of the Alberta Federation of Labour (AFL) that represents 170,000 unionized workers in the province. The AFL intervened at the Northern Gateway and Trans Mountain public interest hearings because of **job losses,** despite proponents' claims of job creation.

Mr. Earnest was Enbridge's expert at Northern Gateway and prepared a Netback Analysis report similar to the one filed in support of Trans Mountain. I found numerous flaws and gross errors throughout Earnest's report and under cross examination not only were my conclusions substantially maintained, the Government of Alberta's expert witness Dr. York also disproved much of Mr. Earnest's analysis. That is, the Government of Alberta's expert confirmed under cross examination that the promised increase in revenues to oil producers, even if they could be expected to transpire, were expected to disappear within months of Northern Gateway's in-service date.[17]

I was an expert intervenor at the CER hearing for Trans Mountain and analyzed the Earnest Report wherein the $73 billion was calculated. As part of the First Nations consultation process, I prepared expert evidence for Tsleil-Waututh Nation outlining numerous failures in the analysis, particularly with respect to why the $73 billion revenue to producers was unrealistic and unreliable.

Despite my extensive writings discrediting Netback Analysis and cautioning against a reliance on it to predict economic benefits, there are a number of other Canadian and US energy experts who concur with my findings.[18]

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[17] Northern Gateway Hearing Transcripts Volume 82 and Volume 83, September 26, 2012 and September 27, 2012.
[18] See for example: Vancouver Sun, Scotiabank's oil report a work of fiction, Robyn Allan, March 4, 2018, National Observer, Premier Notley's claimed $15 billion annual benefit from Trans Mountain exposed as false by her own budget, Robyn Allan, June 7, 2018 and Bitumen's Deep Discount Deception And Canada's Pipeline Mania: An Economic and Financial Analysis, Robyn Allan, April 2, 2013.

These other experts include, but are not limited to, expert evidence filed during the CER's Trans Mountain Part IV Toll Methodology Hearing prepared by Trans Mountain's consultant Steven Kelly, the CER's Firm 50 Hearing prepared by Chevron's consultant Geoff McCutcheon, the CER Trans Mountain Part III Hearing prepared by Living Oceans' consultant Dr. Tom Gunton et.al., and Minnesota Public Utilities Commission Enbridge Line 3 Replacement Hearing in evidence commissioned by the Minnesota Department of Commerce.

The City of Vancouver submission to the CER Trans Mountain Hearing confirms that there are numerous "methodological inconsistencies and deficiencies" in the Earnest Report that "result in erroneous and unreliable conclusions regarding the price lift benefits attributable" to the expansion. The City of Vancouver found the Earnest Report to be "fatally flawed."

The Minnesota Department of Commerce reached similar conclusions on Earnest's methodology during the Enbridge Line 3 review as Earnest was Enbridge's consultant during that hearing as well. The department of commerce described the approach as "unrealistic and unreliable."

Fact #4: Netback Analysis has been widely discredited at numerous regulatory hearings

Mr. Morneau, you are relying on a false narrative based on a discredited methodology to convince Canadians that our looming climate catastrophe will be circumvented by taxes paid from tar sands operating profits. The contention is fallacious. The irony is palpable.

If you, or a staff member you trust on your behalf, have any additional questions, or require more information, I am happy to make myself available.

Regardless, you should cease relying on the claim of $500 million in additional corporate tax revenue from tar sands operators as a direct result of Trans Mountain's expansion. The methodology upon which it is based is fundamentally flawed and there are serious errors in the manner by which it has been estimated.

A Minister of the Crown should not mislead the public with a fabricated narrative and fictitious figures as you have been doing.

Sincerely,

(original signed by Robyn Allan)

Robyn Allan
Independent Economist

Cc Prime Minister Justin Trudeau