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March 15, 2022

First Nations Leadership
Via email only

Open Letter: Investment in the TMX Poses Significant Financial Risks for First Nations

Dear First Nations Leadership:

Recent announcements that the new cost of the Trans Mountain Pipeline Expansion (TMX) has ballooned to $21.4 billion, and that the federal government will not invest further public funds into the project should be a major red flag for anyone considering economic participation or ownership of the controversial pipeline, which is also delayed by at least one year.

Because of this massive cost increase – 4 times the original cost estimate – any illusion of the commercial viability of TMX has collapsed and the pipeline is destined to become a stranded asset. The unique structure of TMX's tolls means that only 25% of cost overruns can be recovered from customers, meaning that the company and its owners will have to absorb $10 billion (and counting) of the cost overruns. Furthermore, the toll structure limits the ability for Trans Mountain to fully recover operating cost such as integrity and safety costs.

Financial analysts and industry veterans understand the risk:

The Parliamentary Budget Officer, Yves Giroux called TMX "Clearly non-profitable"

Analysis from the Institute for Energy Economics and Financial Analysis said "Investors beware: there are no profits here"

Former Encana CEO Gwynn Morgan stated "In the commercial (real) world, no one's going to finance a project running vastly over budget, with no firm remaining cost or start-up date. So the only way for the Feds to 'not spend another penny on it' would be to provide a full guarantee. Either way, taxpayers are on the hook."

The federal government's announcement that no further public money will be invested in TMX is also misleading, as pointed out by Morgan. The federal government will likely have to provide a guarantee to private sector lenders, including priority creditor status for any private party to even consider funding TMX.

Even then, the cost of capital will be higher than the government rate. This means that the financing costs will increase further, and will be borne by the Canadian public because any debt incurred by the Crown corporation is public debt.

UBCIC supports Indigenous self-determination and economic self-sufficiency. However, this cannot come at any cost nor in a way that undermines other Nations' title and sovereignty.

We are concerned that the government is using TMX as another divide and conquer project and is not providing a full and accurate account of the financial future of the project. Your due diligence must include an assessment of the commercial viability of TMX under its unique toll structure, and also include an analysis of future liability related to maintenance and spills. Otherwise TMX could be **modern-day economic version of a small-pox blanket**.

Before you make the decision to participate or not, here are some crucial and significant points that you should know.

The unique TMX toll structure means that construction cost increases and operating costs cannot be fully recovered

The construction cost of TMX has increased dramatically due to delays, mismanagement and cost overruns. These include major setbacks resulting from climate-related events such as the forest fires, floods and landslides that hit BC in 2021. The unfortunate reality is that we can expect more severe and frequent events that could further delay and disrupt the TMX's construction and operation.

The original cost for TMX in Kinder Morgan's 2013 application was $5.4 billion. That cost increased to $6.8 billion in 2015; $7.4 billion in 2017; $9.3 billion in 2018; and $12.6 billion in 2020.

The 2022 cost estimate of $21.4 billion is 4 times the original cost, and more than double the cost when Canada bailed out the project from Kinder Morgan in 2018.

The pipeline owners will have to recover the cost of acquisition through tolls, the fees charged to the oil producers who ship their product through the pipeline. Much has been made about the 20 year take-or-pay contracts providing a revenue stream for the project, but the toll structure represents a built-in and permanent discount for the oil producers paid for by TMX's owners.

The structure of the tolls (PDF) includes 'capped' and 'uncapped' costs, meaning that the owners of the pipeline will not be able to recover all cost overruns through tolls. Trans Mountain's estimate is that only 25% of the cost overruns will be recovered by tolls, leaving the owners to cover the remainder – about $10 billion and counting. This puts the viability of TMX in serious doubt.

Furthermore, the toll structure also limits Trans Mountain's ability to fully recoup ***operating costs*** of the pipeline in addition to the massive construction costs.

Here's why: The Toll Methodolgy (PDF) sets out two components of the toll: a fixed toll and a variable toll. The variable toll includes costs that are not controllable or anticipated by Trans Mountain, including the cost of electricity, tax increases, regulatory changes and other 'uncontrollable costs'. The fixed toll is all 'controllable' or 'anticipated' costs such as wages and salaries, insurance and operation and maintenance costs such as integrity and pipeline safety measures and spill response and clean-up.

As Trans Mountain VP of Regulatory and Finance Scott Stoness testified at the toll hearing (PDF see para. 4520 - 4531): **Every dollar spent on integrity or safety is a dollar that Trans Mountain cannot recover as return on capital.**

While the toll includes a 2.5% annual escalator to cover cost increases related to inflation, any cost increases over that amount would not be recovered by TMX tolls. It is almost certain that some or may of the fixed toll costs will exceed the 2.5% escalator.

In other words: If a cost factor in the fixed toll were to rise, then that would have the impact of decreasing the return on equity.[1]

This is problematic because it provides a disincentive for Trans Mountain's owners to spend money on the integrity and safety of the pipelines and oil spill response and clean-up. This would include the original 1951 TMPL which has spilled 85 times since 1961. This is significant because the liability for an oil spill from the pipeline could be unlimited.

Institute for Energy Economics and Financial Analysis

Recent analysis from the Institute for Energy Economics and Financial Analysis (IEEFA) found that the recent cost increases and toll structure could result in a loss of $26.1 billion, with $10 billion of the recent cost overruns left to the pipeline owner to absorb.

IEEFA's analysis also found that tolls would have to double to cover the cost of construction, operating and debt costs, which would make TMX tolls 42% higher than rail and therefore uncompetitive.

Any changes or increases to the toll structure will be fought fiercely by the shippers and would have to be approved by the Canadian Energy Regulator.

In 2019, the Parliamentary Budget Officer calculated that a 10 per cent increase in construction costs (based on $9.3B) or a one-year delay would render the project uneconomic. With both of these events

[1] https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90465/92835/552980/954292/828580/917792/918877/A3F4Y2_-_13-02-19_-_Volume_5.pdf?nodeid=918705&vernum=-2 para 6449

now far surpassed, the commercial viability of this project is as bad as it has ever been, and is likely to get worse.

While we expect further analysis from the Parliamentary Budget Office later this year, it is already obvious to PBO's Yves Giroux that "Now that we're talking about over $20 billion in construction costs, it is clearly non-profitable,"

Lack of transparency and updated economic information

Related to the cost overruns and delays, Indigenous groups and the Canadian public have been kept in the dark about TMX's economic prospects. Most of the economic analysis is out of date, and the lack of real data, including construction cost overruns, accurate cash flow projections and clarity on timing makes the due diligence needed for this multi-billion dollar project impossible. You should not rely on out-of-date, publicly available information to model the viability of TMX because it will paint a false picture.

At a very minimum, Trans Mountain, the Canadian Development Investment Corporation (CDEV) and the Minister of Finance should make real data for Trans Mountain public and provide a forecast of need for the life of the pipeline beyond 20 years.

The economics of oil are changing as governments and corporations wake up to the reality of climate change. Oil economics have fundamentally changed since the project was proposed in 2013, with new regulations and technology squeezing the economic viability of oil sands. We have seen world leaders, including the Canadian government, commit to reduce emissions to net-zero by 2050. In a world where demand for oil has peaked and is declining, the oil sands, which has higher costs and higher carbon emissions than other sources of oil, will be some of the first oil fields to be shut down. That is likely one of the reasons that oil giants like Shell, Cononco-Phillips, and Statoil have sold off their oil sands holdings. All of this means you could become the owners of a stranded asset before it is paid off.

Indeed, analysis by the International Energy Agency, and Canadian Energy Regulator confirms that TMX's capacity will not be needed in a net-zero 2050 world.

15 global insurers have stated they will not insure Trans Mountain. As the global financial sector reassesses its relationship with the fossil fuel sector, many leading insurers have already ruled out insuring TMX.

The operators of TMX will have to carry $2 billion in liability for the two pipelines, and could face unlimited liability in a spill. In 2021, Trans Mountain applied to the CER to keep the names of its insurers confidential, stating that insurance premiums were higher and there were challenges in maintaining adequate insurance coverage to fulfil its significant financial resource obligations under section 138 of the CER Act.

The company stated that in 2021, "Trans Mountain experienced a significant reduction in available insurance capacity. It sought and secured partial replacement policies to compensate for this reduction, but did so at a significantly higher cost."

Your due diligence must include an assessment of future insurance cost increases and the unlimited liability in the event of an oil spill. The original Trans Mountain pipeline reported 85 oil spills since 1961.

Opposition from other First Nations continues. A linear project like a pipeline will necessarily cross many territories. Opposition remains fierce among many of the First Nations whose territories are crossed by TMX, due to concerns about a spill on salmon and other wildlife as well as concerns about the climate crisis that hit BC hard in 2021. In short, TMX does not have the necessary Free, Prior and Informed Consent to proceed.

We would remind you that it would only take opposition from a single Nation to cause significant delays and further cost overruns.

The federal government cannot act as both owner (& seller) of the pipeline and as the representative of the Crown with fiduciary duties. This clear conflict of interest casts a long shadow over the consultation and sale process and should be cause for suspicion among would-be buyers.

With all of the political capital expended by the federal government on this pipeline, it is no surprise that they are clamoring to highlight some Indigenous economic participation in the name of 'reconciliation.'

The federal cabinet have stated repeatedly that TMX will operate on a commercial basis, and any would-be owners must be certain that it can be.

The pipeline and tanker project will affect the lands, rights, and resources of Indigenous Nations that the Canadian government has committed to protect but has so far imperiled instead. Along the proposed route, there are at least 400 unresolved specific claims – a vast number of historical losses yet to be redressed by the federal government. This does not include specific claims that could arise as a direct result of the pipeline expansion. In addition to these specific claims, the entire corridor from B.C. border to Burnaby is comprised of Indigenous Territories.

There are good reasons why Kinder Morgan chose to walk away from this project and you should carefully consider them before investing your Nation's money or debt. You should take a hard look at both the short-term profitability and long-term viability of this project. We believe that the government has clearly overstated both and their decision to invest in this project was clouded by their short-term political needs. We urge you not to make the same mistake and to carefully consider the enormous environmental, social, legal, and political ramifications before committing to this project.

It is telling that the most recent wave of media focused on a new non-profit organization, with the for-profit Iron Coalition dissolving. Other Indigenous consortiums are also promising ownership without equity or liability which again puts the commercial viability in serious doubt.

Finally, we will remind you that the members of our Nations are collectively the Proper Title Holders. Decisions of this scale and import are not ours to make alone, we must have consent from our members before making a critical decision on investment. We need to take collective action to ensure that the youth of the future will have clean lands and waters, not pipelines and tar sands that pollute our Mother Earth and exacerbate the man-made climate crisis.

On behalf of the UNION OF BC INDIAN CHIEFS

Grand Chief Stewart Phillip President	Chief Don Tom Vice-President	Kukpi7 Judy Wilson Secretary-Treasurer