Northern Gateway Pipelines
JRP Hearing Notes

Day 2 - September 5, 2012 - Edmonton

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Features for enhanced use:
- Link to the day's transcript
- Links to specific topics and discussions

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Examination by Leanne Chahley for the AFL (continued) 15214

At the close of the session on September 4, Ms. Chahley was focussed on analyses of market prospects and public interest benefits authored by Mr. Earnest and Dr. Mansell, originally filed by the applicant in 2010 and updated in 2012. Dr. Mansell had stated that he uses models produced by Statistics Canada, but modifies them for specific considerations of the Northern Gateway Pipelines project. She begins the day exploring those changes to the models and the impacts they have on the price uplift attributable to the NGP. It is not an easy conversation, since both Ms. Chahley and Dr. Mansell are struggling – she to articulate her questions, and he to reply to them.

Ms. Chahley establishes that Dr. Mansell's modelling is based on an economic profile at a given year, eg., 2008, and does not attempt to forecast changes in the economy from year to year as they work through the model. Dr. Mansell states that would be phenomenally complicated and difficult and could push the modelling “off the rails”, whereas the fixed base makes for robustness. 15315

Negative effects of price uplift

Ms. Chahley asks whether Dr. Mansell took into account any negative effects that the price uplift that's projected might have had on the Canadian economy. 15319 He replies that the increased cost of petroleum would be absorbed by the producing sector, the refineries, and were it passed through to consumers it might add one and a half cent to a litre of fuel. Insignificant, too small to measure, in terms of inflation, he claims. 15339

Ms. Chahley: “What I understand is that you put all of the impacts of the economy that you felt were relevant into the model. …But you did not think it would be necessary to include consumer impacts because they were not significant enough.” Dr. Mansell: “That's correct. Anything that was material we captured, I believe, in the model.” 15348

Ms. Chahley leaves Dr. Mansell at this point, although she intends to return with more detailed questions and may have a request for an “undertaking” by Dr. Mansell – homework, with a report as deliverable, if you will.

Muse Stancil report & Northern Gateway pricing benefit

She then turns to Mr. Earnest, to explore the transparency of his methods and models and begins with his Muse Stancil “Market Prospects and Benefit Analysis” report (Application, Vol2, Appendix A). 15373

The Muse Stancil report states that “In the early years of the forecast period, the Northern Gateway pricing benefit is primarily derived from two elements: 1) higher delivered (to the refinery) non-Canadian crude prices in Northeast Asia versus the U.S. Gulf Coast, and 2) a northward shift in the market-clearing point within North America due to the reduction in supply to the North America market.”

Mr. Earnest clarifies this as not meaning a shortage of supply in North America, but a question of shifting where supply might come from to serve North American refineries, including Western Canada, the USA, or waterborne imports from somewhere else in the world.

This effect would arise because Northern Gateway represents a redistribution of the crude flows from Western Canada. Rather than pushing it all south and east into the U.S. and Eastern Canada, a portion now flows west to California and/or Northeast Asia. 15416

California

Ms. Chahley seizes on the mention of California. Mr. Earnest explains that the Canadian crudes which are permitted to flow to California are the conventional lights and mediums, which wouldn't have the same issue with California’s proposed low-carbon fuel standard. Oil sands derived crudes are currently permitted to be processed in California. He describes California as “hideously complicated” and says they elected to leave it out of the analysis. 15417

CAPP forecast of increased production to 2025

Continuing her exploration of the pricing effect of NGP, Ms. Chahley first notes that the 2012 CAPP forecast is for approximately half a million barrels per day more than its 2011 forecast, then suggests that the effect of that would be to negate the price increase forecast in the Muse Stancil report. The essence of Mr. Earnest’s reply is that “the dynamic of the parity point … may not be there anymore.” 15497

The benefit of an alternative, and commitments on NGP
In the midst of a lengthy discussion about access to other markets, Mr. Earnest confirms that a second and longer-term benefit of NGP is the “market diversification attribute whereby you’re not compelled to sell to the lowest -- the customer who sees the lowest value for particular grade of Canadian crude within North America but you have the option [of] shipping it offshore.” 15529

Mr. Carruthers jumps into this conversation to point out that there’s “there’s a far greater value in terms of optionality” – meaning an alternative route for product. It was unquantified in the Muse Stancil report, however, and Ms. Chahley’s next questions confirm that more than 500,000 barrels per day - most of the capacity of NGP – is already committed to long term shippers, and thus not available on an opportunistic basis to be used as suggested by Mr. Carruthers. Mr. Earnest describes how there is more “optionality” than the committed volumes suggest. 15532

Rail 1

Ms. Chahley has mentioned rail briefly to this point in the hearing, but left it ticking in the background. Now she addresses it directly, referring to the 2012 Muse Stancil update (B83-3). Rail has emerged as a viable shipping alternative to pipelines, both out of Alberta and for oil producers in the US. Rail has advantages compared to pipelines: most of the track is in place, rail is “nimble” – shipments can be redirected quickly, anywhere, and bitumen doesn’t need so much dilution. 15654

A “train” – a set of cars – can carry 60,000 barrels of bitumen. With the greater dilution required in a pipeline, this is approximately equivalent to 80,000 barrels in a pipeline. Six or seven trains per day, could transport the equivalent volume of bitumen as NGP.

Some of the witnesses note that cars and terminal facilities are expensive, and that the terminal facility in Kitimat for NGP will cost about $1 billion.

It’s a lengthy discussion, and interesting reading, leaving rail for an examination of price-setting mechanisms and how benefits are realized as a result of NGP. Mr. Earnest argues that NGP will continue to contribute a price uplift effect for 18 years once it is in operation, but fails to explain how this is so, and on this point he and Ms. Chahley “emphatically disagree.” 15995

Price uplift absorbed by refineries

Ms. Chahley returns to the statement made earlier by Dr. Mansell that the price uplift would be absorbed by the producing sector, the refineries, and not passed through to customers. She refers to Exhibit B83-4, Dr, Mansell's updated Public Interest Benefit Evaluation, specifically to Table 2.4.

Table 2.4: Summary of Incremental Revenues For WCSB Crude Oil Production and Sales Resulting from Northern Gateway (in millions of year 2012 Cdn$)

	Gross Revenue Uplift	Increased Costs to Refineries	Net Revenue Uplift
Year	**C$million**	**C$million**	**C$million**
2019	5,260	999	4,261
2020	5,193	931	4,262
2025	4,111	596	3,514
2030	3,996	440	3,556
2035	4,555	296	4,259
Annual from 2035 to 2048	4,555	296	4,260
Total for 2019 to 2048			114,804

Source: Tables 15-17, Muse, Stancil & Co., ***Market Prospects And Benefits Analysis For The Northern Gateway Project,July 2012.***

Dr. Mansell reiterated that in his model, the increased costs to refineries will be absorbed by the refineries. That is a choice he made for two reasons, one being that if refineries were to pass the costs through to consumers, it would cause demand to shift to products which would not have the extra costs attached, specifically, imported refined products, and the second reason being because, he argues, the effect of passing that through to consumers would be negligible.

Ms. Chahley notes that over 30 years, the increased costs total $12.6 billion, a significant amount. She argues that in most circumstances, including these, costs will be passed through. Dr. Mansell doesn't accept the point. She further argues that the impacts won't just be felt at the pump, and using agriculture and food as an example, says they will have impacts through the economy. 16269

Still not finished with Dr. Mansell's contention that these increased costs will be absorbed by the refiners, and given that the refineries are typically operated at high capacity rates (ie, they won't cut back on production), Ms. Chahley notes that the next big cost for refineries is labour, so the industry may look to cutting labour costs to offset higher feedstock costs. Dr. Mansell counters that they might instead let their shareholders take the hit, in the form of reduced profits. Ms. Chahley is skeptical: "We're going to keep our employees and make shareholders pay?" 16331

Declining relative cost of feedstock

Mr. Earnest joins the discussion with a different perspective on the question of increased costs to Canadian refineries. He refers to the Muse Stancil report in which it is forecast that the cost of feedstock will decline over the period relative to costs of other feedstocks borne by refiners at the Gulf of Mexico. Therefore, "with or without Northern Gateway, the cost of their feedstocks would be moving down." 16355

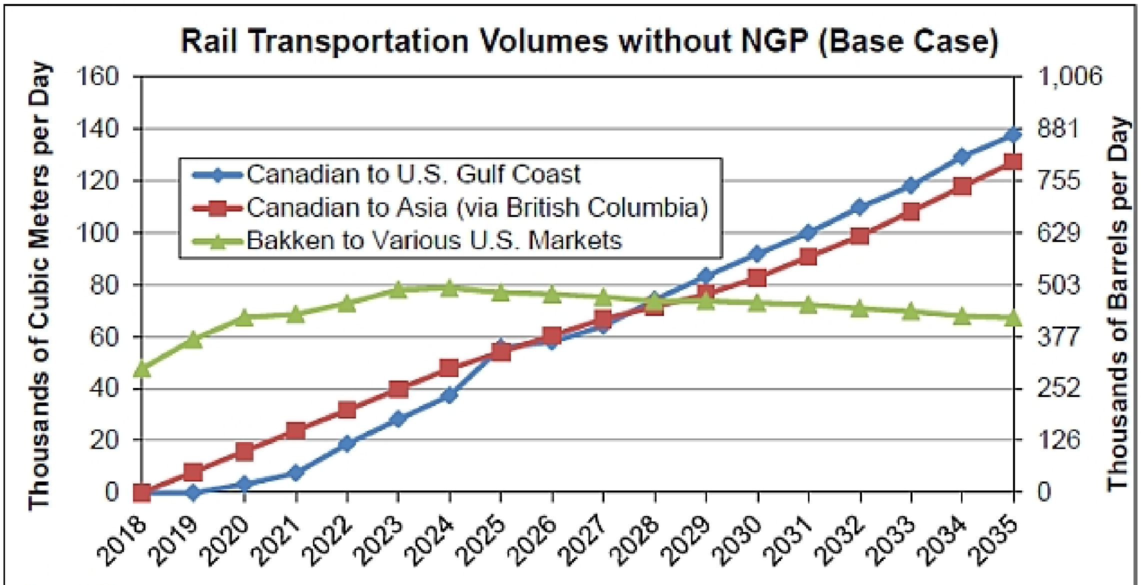
Products shipped and destinations

The examination then shifted to products that would be shipped on NGP, and where they would ultimately be delivered. Tables A-11 and A-12 in Muse Stancil provide answers to those questions. In 2018, it is projected that of 500 barrels per day shipped on NGP, 419.8 bpd will be going to northeast Asia, 12.5 to Puget Sound and 67.8 to California. Approximately 60% of this will be heavy grades of oil, the remainder will be "sweet synthetic" and light and medium conventional crude oil. 16595

Rail 2

By 2021, however Table A-12 shows volumes of heavy crudes exceeding the nominal capacity of NGP. Ms. Chahley: You've got far too much to fit into Northern Gateway. Mr. Earnest: Oh, absolutely. And as you can see, looking at the red line, that is the volume of Canadian crude flowing to Asia via rail. The base case against which we're measuring the benefits of Northern Gateway already includes very sizeable volumes of crude moving to Asia already. 16631

Figure 8



Source: Muse

Asian uplift

Finally, Ms. Chahley begins to explore the NGP "prediction that there will be a premium paid for barrels because they're being sold in the Asian market." She is interested in this because she wants to understand how that effect might be of benefit to Canada, not just to the industry. 16674

Mr. Easton explains that it doesn't matter to Canadian producers how great the price differential is between what Asian refiners are paying for oil and North American prices. The consequence of there being a positive differential in Canada is that it provides the economic justification for the NGP pipeline to BC's coast. The benefit of that differential, however, accrues to the shippers on the pipeline, not Canada's producers.

He adds that it is "absolutely irrelevant" what internal pricing policies happen in China because "the price in Asia for waterborne imports is primarily -- is heavily influenced by … mid-East crude producers." 16754

Ms. Chahley says this answer is not what she was expecting, and she needs time to regroup, so perhaps it would suit the Panel to close for today, and she will continue in the morning.

The Panel Chair, Ms. Leggett, agrees. She also notes that Ms. Chahley had estimated she would need eight to twelve hours for questioning, and she is now at the eight hour mark. Will she be able to complete within the estimate? Ms. Chahley thinks so, barring unexpected points or tangents.