

Intelligence MEMOS



From: Benjamin Dachis
To: The Hon. Bill Morneau, Minister of Finance
Date: May 17, 2018
Re: **BACKSTOPPING KINDER MORGAN MAKES SENSE**

The federal government is wise to indemnify Kinder Morgan from any losses it may suffer in its Trans Mountain pipeline expansion project due to political obstruction in British Columbia – as announced yesterday.

The Trans Mountain saga is well known by now. Kinder Morgan asked for certainty by May 31 on its proposed pipeline expansion from Alberta to the B.C. coast. Without it, it threatens to walk away, contributing to the land-locking of Alberta's oil. Ottawa has committed to making the project happen and has said it will use "all tools" available to get the pipeline built. The Alberta government has mused about buying the project from Kinder Morgan.

The project has been in the planning stages since 2004. Yesterday's announcement should help ease Kinder Morgan's frustrations over never ending delays.

Both Ottawa and Alberta want to see the twinning of the 65-year-old pipeline completed for good reason. A new pipeline to tidewater will increase the price Canadian oil fetches because of the Alberta supply glut, and a new pipeline means a stronger Canadian economy and higher government revenues.

What's the case for the government stepping in? Kinder Morgan is not mainly concerned about foregone government revenues and jobs losses would the pipeline stalls – its main interest lies in on the profitability of its investment.

With costs rising because of delays caused by the B.C. government, Kinder Morgan's prospect of making money is looking dicey. The resulting disconnect between the private incentive of the company and what's best for society creates the right conditions for governments to step in.

Business activity often creates societal costs external to the business, such as pollution, justifying government intervention. Pipeline-safety regulations prevent spills. Taxing pollution aligns the incentives of polluters with those of society. These steps make society better off by adding costs onto businesses. There can also be social benefits that a business wouldn't see in its bottom line. Governments can make society better off by having some of that social benefit make its way into a company's decision-making.

In that spirit, Ottawa is best placed to reduce Kinder Morgan's financial risks created by BC's resistance to the project.

Governments should not be in the pipeline business. Adding political involvement to daily operating and building decisions will bog down the project. Nor should government support be unlimited. Support for Kinder Morgan should be proportional to the benefits in terms of jobs, tax revenue and prosperity Canadians will receive from the project.

The best option would be a low-cost loan to support additional costs to construction, not an equity investment; a loan that would be repayable at the end of a successful project would share some of the political risks with private investors, and offer immediate support during the critical period.

And others may step in if Kinder Morgan walks away, now that there is a risk indemnification offer on the table.

So, all in all, the announcement is a step forward for Canada.

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