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Submission of Evidence

To: **Standing Committee on Natural Resources,**
Study of Federal Assistance For Various Natural Resources Industries

From: **West Coast Environmental Law Association**

Date: **November 25, 2022**

In October, 2022, West Coast Environmental Law released a new report that delves deep into government records to reveal that the federal government is using accounting magic and corporate shells to hide Trans Mountain's losses from Canadians.

The report, *Trans Mountain: Compromised viability to cost taxpayers more than $17 billion*[1] projects that Finance Minister Chrystia Freeland is preparing to forgive up to $17 billion in debt loaned to Trans Mountain by Canadian taxpayers in order to continue the illusion of commercial viability. This would amount to another massive subsidy to the oil and gas industry.

In February 2022, Trans Mountain announced that the construction cost for the Trans Mountain Expansion Project had ballooned to $21.4 Billion – more than double the estimated cost when Canada bought the company from Kinder Morgan in 2018.

In response to the astronomical cost increase, Finance Minister Freeland proclaimed that *"the government will spend no additional public money on the project"* and that "*"despite the increased cost estimate and completion timeline, the project remains commercially viable."*[2]

This report reveals that both claims are false. By piecing together CDEV reporting and Corporate Plans, plus Trans Mountain Corporations financial statements, the report reveals that TMP Finance is being used to hide Trans Mountain's losses by acting as a shell corporation, and Finance Minister Freeland is preparing to forgive $17 billion owed back to the Canadian public.

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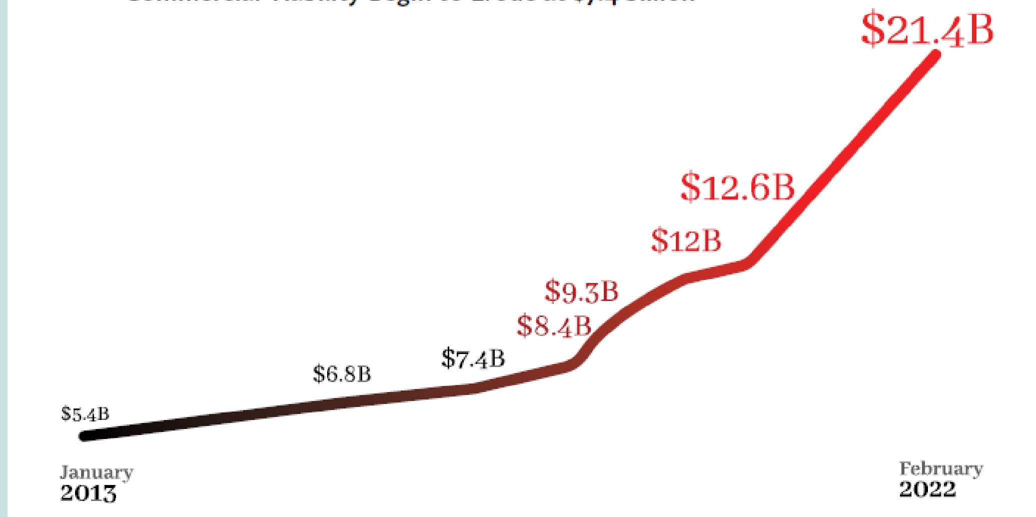
[1] Full report available for download here: https://wcel.org/publication/trans-mountain-compromised-viability-cost-taxpayers-more-17-billion

[2] *Department of Finance, News Release, Government Announces Next Steps on Trans Mountain Expansion Project, February 18, 2022.*

Figure 6 Trans Mountain Expansion Cost Increases Saw Commercial Viability Begin to Erode at $7.4 billion



Trans Mountain uses its corporate structure and capital structure to hide its losses

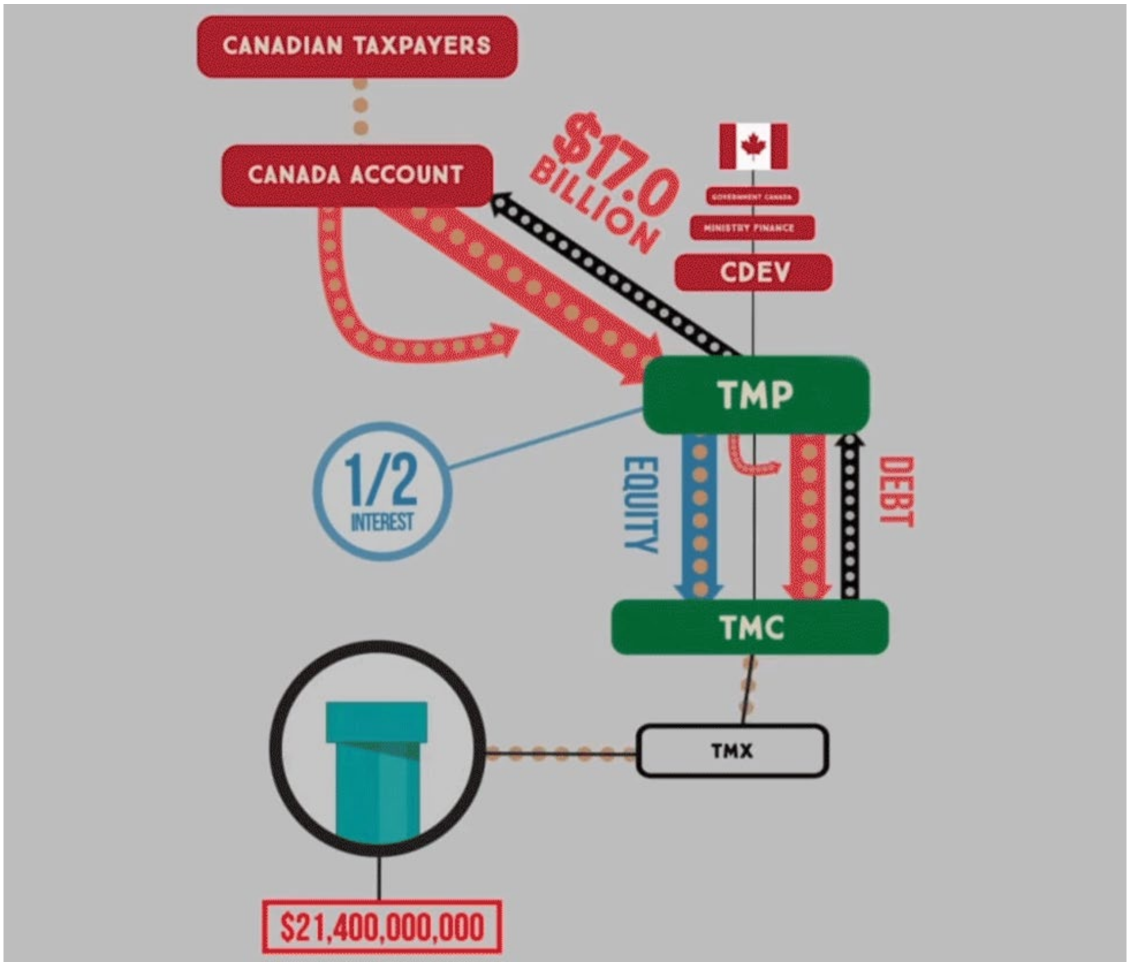
TMP Finance is a classic shell corporation. It has no employees, and its board is comprised of CDEV staff.

TMP Finance:

1) was set up to hide Trans Mountain's losses and mask the expansion project's compromised viability;
2) is being retained to provide public support for Trans Mountain's ongoing financing needs when Canadians were told it would stop; and
3) will be used in the future to book the debt write-offs necessary to continue Trans Mountain's façade of profitability and viability

TMP Finance's financial statements would reveal Trans Mountain's commercially compromised financial picture, but those financial statements have not been made publicly available. Instead, CDEV consolidates TMP Finance's financial performance in its quarterly and annual statements, effectively hiding Trans Mountain's poor financial performance. If CDEV revealed TMP Finance's results in publicly available reporting, the statements would also show that Trans Mountain has suffered ongoing losses since it was purchased.

In contrast, TMC publishes its quarterly and annual financial statements on its website. TMC reports profits. TMC represents itself as profitable because TMP Finance is taking on Trans Mountain's losses. Ottawa accomplishes this sleight of hand through TMC's capital structure.



The public record states that TMP Finance has borrowed $15.8 billion[3] from the Canada Account, primarily funded by Canadian Taxpayers, to finance Trans Mountain's purchase and construction for the expansion.

When TMP Finance passed that money down to Trans Mountain Corporation (TMC) to complete the transactions, it used accounting magic to split 100% debt into 55% debt and 45% equity.[4] As a result, TMP Finance is only collecting interest on about half of the money it borrowed and owes interest for. The resulting 'operating cash flow deficiency' means that TMP Finance will borrow an estimated $1.2

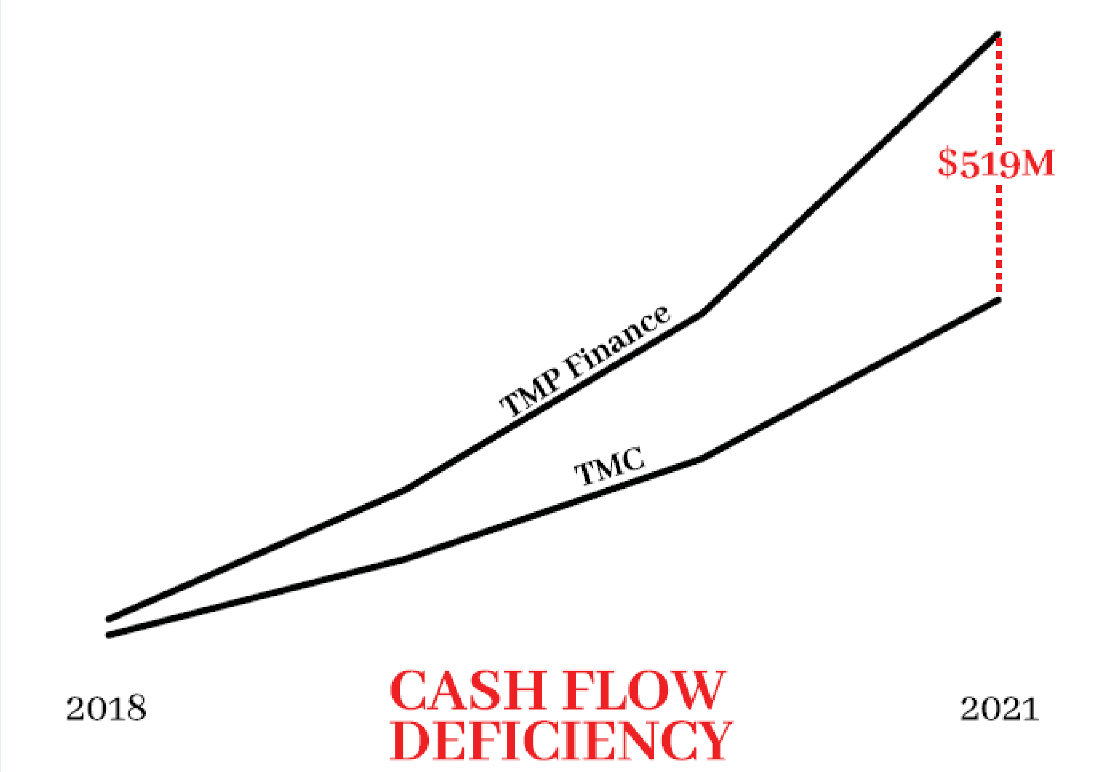
[3] CDEV, Q2 2022 Financial Statements. Loans Payable $15.754 billion – $4.67 billion for acquisition and $11.084 billion for construction, p. 22, note 10. Additional $10 billion in Canadian banks' credit facility drawn as required takes total to $25.8 billion. As at June 30, 2022, $2.598 billion has been drawn. https://www.cdev.gc.ca/wp-content/uploads/2022/08/CDEV-Q2-2022-Quarterly-Report-FinalENG.pdf

[4] In exchange for an equity injection of $2.1 billion for Trans Mountain's purchase, TMC issued 2,064,150 common shares at $1000 each. TMC, Q3 2018 Financial Report, Note 16, p. 33. With a negative net present value those shares have no market value.

billion from the Canada Account in 2022 and 2023 to cover unpaid interest, bringing the debt owed to Canadians close to $17 billion.[5]

The loan guarantee provided by the federal government for the $10 billion syndicated bank loan is another source of public backing for Trans Mountain which could increase as construction costs increase.

Figure 5 Cash Flow Deficiency, TMP Finance and TMC, 2018-2021



Trans Mountain's 2013 Toll Structure is the Achilles Heel of the pipeline's viability

The report also discusses the Trans Mountain Expansion's toll (or fee) structure as the 'Achilles Heel' of the pipeline.

The tolls, negotiated in 2013, limit the amount the pipeline's owner can charge its oil company customers for using the pipeline. Commercial viability began to erode when construction costs approached $7.4 billion, at which point nearly 80% of all cost overruns will be absorbed by the pipeline's owner.

As a result, at least $10 billion of the current $21.4 billion construction cost will not be recuperated from tolls, leaving the owners, the Canadian public, holding the bag.

[5] *Trans Mountain: Compromised viability to cost taxpayers more than $17 billion* See p. 8-10

The tolls also create a perverse financial incentive to spend less on safety, spill preparedness and pipeline integrity.

In short, the tolls mean that it is impossible for Trans Mountain to be commercially viable at a cost of $21.4 billion. As a result, the report predicts that Finance Minister Freeland is preparing to use her ability to forgive TMP Finance's $17 billion debt owed to Canadians in order to maintain the illusion of the pipeline's commercial viability.

The report also delves into the various unlevered discount cash flow (DCF) analyses over the years by Kinder Morgan, TD, BMO and the Parliamentary Budget Officer. It notes that unlevered DCF does not consider the significant debt obligations intertwined with the pipeline and thus, is an incomplete analysis.

Two variables in DCF, discount rate, and time horizon greatly influence the conclusions of the analysis. The report reveals that Kinder Morgan used a 15% discount rate and 20-year time horizon, while TD and BMO's 2022 analysis, referenced by Finance Minister Freeland, used an unknown (but likely below 10%) discount rate, and a 100 year timeline, and concludes:

> "Relying on a 100-year time horizon is professionally irresponsible. It requires heroic assumptions to predict revenues and expenses ten decades into the future. The inability to repay debt owed to Canadians for at least 100 years is implicit in the banks' cut-off date. Ottawa promoting TD Securities and BMO analysis with a 100-year time horizon indicates it has already decided Trans Mountain cannot, and will not, repay the debt owed to Canadians."[6]

Table 1 **Comparing Unlevered DCF Analyses Over the Years**

	Year	Rate of Return (%)	Cut-Off (years)
Kinder Morgan **$5.4B**	**2012**	**12 - 15**	**20**
TD Securities **$9.3B**	**2018**	**10**	**40**
Parliamentary Budget Officer **$21.4B**	**2022**	**7.8**	**40**
TD and BMO **$21.4B**	**2022**	**?**	**100**

Writing off $17 billion in debt would result in one of the largest subsidies to the oil and gas sector yet, and flies in the face of the federal government's promise to eliminate these subsidies.[7]

The report reveals that Canadians are being deliberately misled about Trans Mountain's commercial viability through corporate shells and accounting wizardry, to the tune of $17 billion.

[6] See P.29

[7] https://liberal.ca/our-platform/eliminating-subsidies-and-public-financing-for-fossil-fuel/

The full picture:

Canadians want to know:

1) is Trans Mountain profitable?
2) is the expansion project commercially viable?
3) will the debt owed to Canadians be repaid? and
4) will there be a return from the investment available to fund a transition off fossil fuels?

Bring TMP Finance into the picture, recognize the obfuscation embedded in TMC's accounting treatment, and incorporate an understanding of the toll subsidies Ottawa has given to oil producers, and the answer to all these questions is a clear 'no'.

This is the picture Finance Minister Freeland doesn't want Canadians to see:

- TMP Finance continues to borrow from the Canada Account to cover its interest obligations, which will add approximately $745 million per year, compounded, to TMP Finance's debt load;
- The debt obligation for financing Trans Mountain's purchase and building its expansion will reach $27 billion by the end of 2023;
- TMC receiving 49% of its capital from TMP Finance as equity without an obligation to provide a rate of return or repay, distorting TMC's financial reality;
- There is insufficient free cash flow to repay the debt and equity TMP Finance has advanced to TMC, so TMP Finance will be unable to repay the debt it owes to the Canada Account and by extension, the debt it owes Canadians; and
- The inability to repay the debt owed to Canadians suggests Ottawa is preparing to forgive more than $17 billion in debt in order to make TMC attractive to the private sector.

The report concludes that the economically prudent and responsible solution is to cancel Trans Mountain's expansion unless the oil companies who benefit from the pipeline agree to pay the full cost of construction.

You can download the full report at: https://wcel.org/publication/trans-mountain-compromised-viability-cost-taxpayers-more-17-billion