

TRANS MOUNTAIN

*Compromised viability to cost taxpayers
more than \$17 billion*



October 2022

ROBYN ALLAN

Cover Image:
Laidlaw Pipe Storage Yard Shortly after 2021 Flood

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Executive Summary

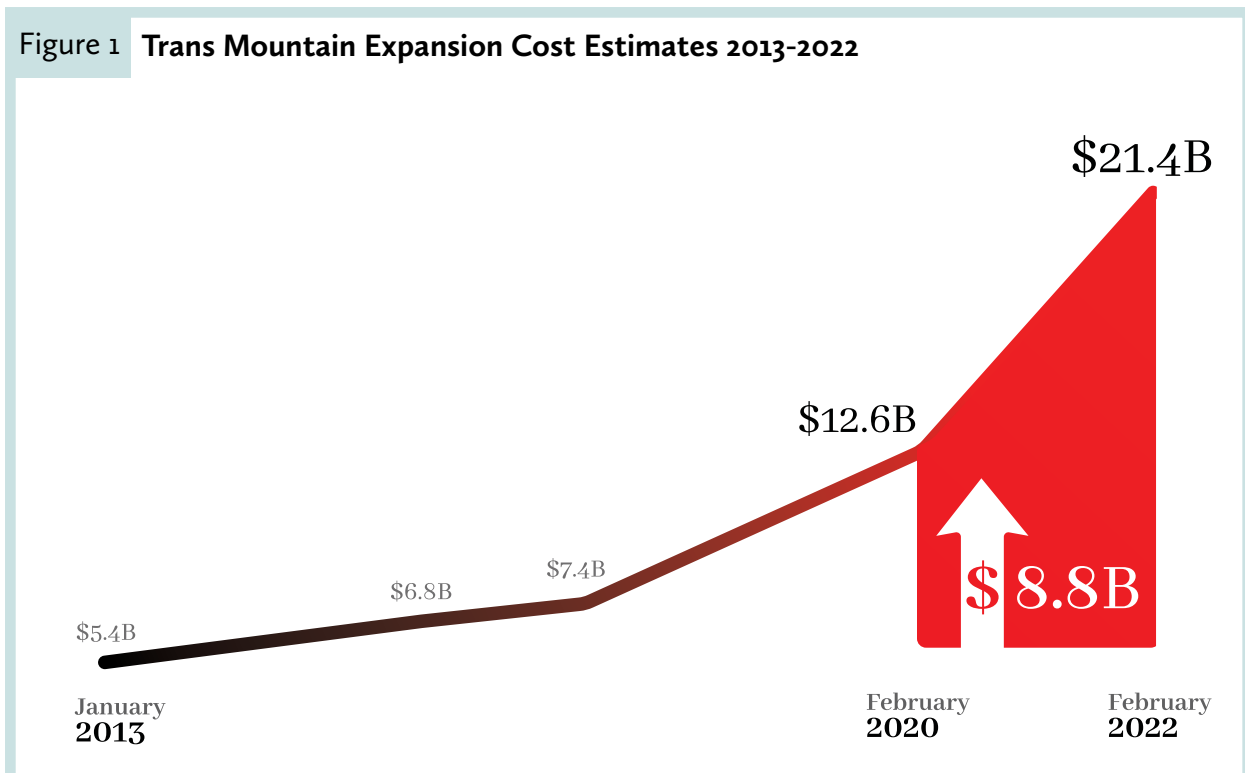
The cost of the Trans Mountain pipeline expansion project rose from \$12.6 billion to \$21.4 billion on February 18, 2022, triggering the need for an additional \$10 billion in debt financing.¹

The increased cost means Trans Mountain's debt burden has jumped from \$15.8 billion to \$25.8 billion, comprised of \$4.7 billion in debt incurred for Trans Mountain's purchase and \$21.1 billion in debt for the expansion.² Of Trans Mountain's \$25.8 billion debt load, \$15.8 billion is currently owed to Canadians.

The remaining \$10 billion is a government guaranteed one-year revolving bank facility.

When the project cost increase was announced, Canadians were told "*the government will spend no additional public money on the project.*"³ This is not the case. In 2022, Ottawa will spend over \$750 million more in public money on Trans Mountain and an estimated \$800 million more in 2023. This is because Trans Mountain is not profitable and is unable to pay the interest on the debt already owed to Canadians. Trans Mountain's

Figure 1 Trans Mountain Expansion Cost Estimates 2013-2022



- 1) TMC, [Trans Mountain Corporation Updates Expansion Project Cost and Schedule](#), February 18, 2022. All figures in this report are in CAD unless otherwise indicated.
- 2) 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.
- 3) Department of Finance, News Release, [Government Announces Next Steps on Trans Mountain Expansion Project](#), February 18, 2022.

shortfall will be added to its loan balance. By the end of 2023, Trans Mountain's debt to Canadians will be approximately \$17 billion.⁴

When the project cost increase was announced, Canadians were also told that *"despite the increased cost estimate and completion timeline, the project remains commercially viable."*⁵ This is not the case.

Trans Mountain's full financial picture is being hidden from Canadians. Dig into and piece together financial information on Trans Mountain from the Canada Development Investment Corporation (CDEV) and other sources, and a very different picture emerges than the one presented by the government. These sources tell us that Trans Mountain has not been profitable since Ottawa bought it; Trans Mountain is not commercially viable; and, this lack of profitability and commercial viability means more than \$17 billion in debt owed to Canadians will not be repaid. Debt forgiveness is looming.

The contracts Trans Mountain has with its oil product shippers are the source of Trans Mountain's lack of profitability and commercial viability since the revenue stream determined by the toll methodology is insufficient to cover the cost of financing, debt repayment and all the operating expenses. The economically prudent and responsible solution is to cancel Trans Mountain's expansion unless the beneficiaries – the oil producers who plan to use the pipeline – pay the full cost.

When the cost jumped to \$21,400,000,000, Canadians were told *"the government will spend no additional public money on the project"* and *"the project remains commercially viable."* This report disproves both claims and shows how the federal government is hiding Trans Mountain's compromised viability.



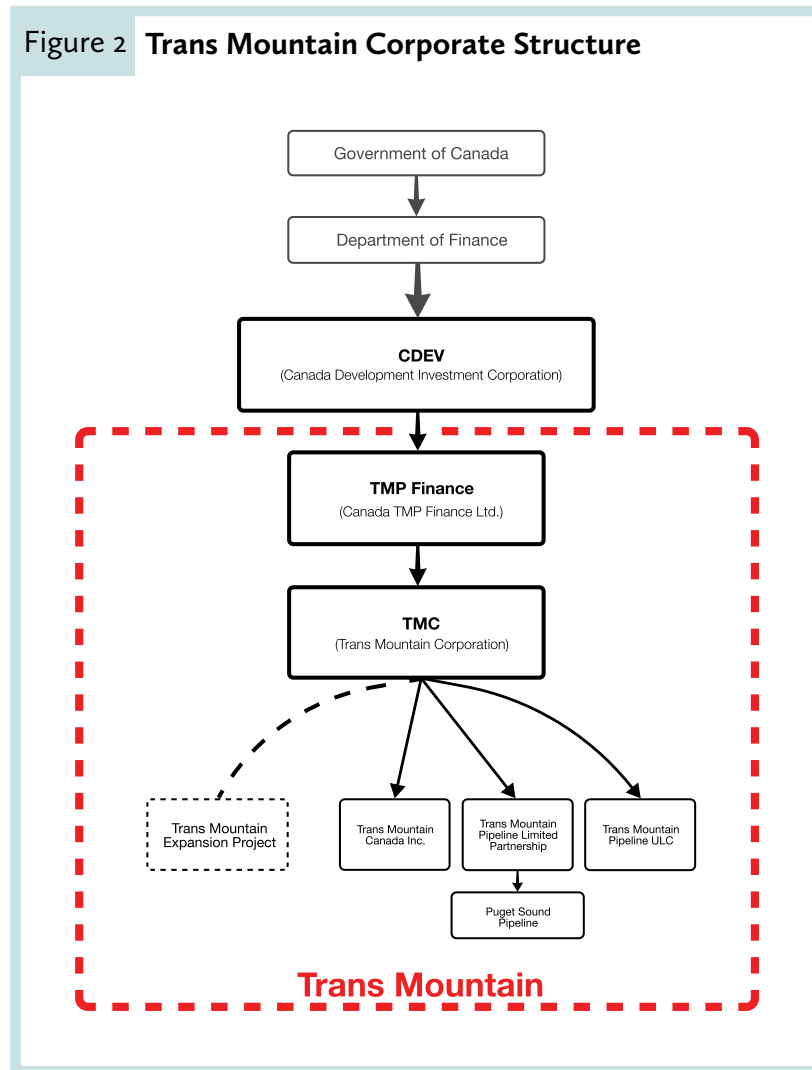
A scene along highway 5 near the North Thompson River and the Trans Mountain Pipeline expansion route between Valemount and Blue River.

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- 4) CDEV, [Q2 2022 Financial Statements](#), Canada Account debt of \$15.8 billion on June 30, 2022. Semiannual interest and fees second half 2022 of approximately \$400 million and 2023 interest and fees expense of approximately \$800 million takes Canada Account debt to \$17 billion.
- 5) Department of Finance, News Release, [Government Announces Next Steps on Trans Mountain Expansion Project](#), February 18, 2022.
-

Follow the Money

HOW TRANS MOUNTAIN'S FULL FINANCIAL PICTURE IS HIDDEN

Figure 2 **Trans Mountain Corporate Structure**



CDEV is a Crown corporation established by the Government of Canada to manage its investments. CDEV reports to Parliament through the Minister of Finance. On August 31, 2018, CDEV's subsidiary, Trans Mountain Corporation (TMC), purchased Trans Mountain's four corporate entities from Kinder Morgan through a share and unit purchase agreement.⁶

Between the CDEV and TMC corporate entities lies another CDEV subsidiary: Canada TMP Finance Ltd. (TMP Finance). TMP Finance is TMC's parent company, who borrowed billions of dollars to buy Trans Mountain and finance the expansion project. TMP Finance passed this funding through to TMC. TMP Finance is where Trans Mountain's losses, lack of financial viability, evidence of ongoing public support, and looming debt forgiveness can be found.

6) Share and Unit Purchase Agreement, Between the Government of Canada and Kinder Morgan, May 29, 2018.

WHY DOES TMP FINANCE EXIST?

When TMP Finance was established, its owner CDEV told Canadians the entity was needed to “acquire, finance and provide strategic direction of Trans Mountain Corporation.”⁷ It’s hard to see how TMP Finance provides strategic direction to TMC when TMP Finance has no employees: “TMP Finance is a wholly-owned subsidiary of the Canada Development Investment Corporation (“CDEV”) and has no employees. Day to day operations are administered by CDEV employees in Toronto, Ontario.”⁸

TMP Finance’s board of directors are also CDEV employees. The Federal Corporate Registry lists TMP Finance’s three directors as Elizabeth Wademan, CDEV’s President and CEO, Andrew Staffl, CDEV CFO and Al Hamdani, CDEV VP.⁹ TMP Finance does not need to exist to provide strategic direction to TMC.

When it comes to acquiring and financing TMC, TMC did not need TMP Finance. TMC could have entered into the agreements with the Canada Account on its own behalf. Had it done so, Trans Mountain’s losses and compromised commercial viability could not be hidden from view. And herein lies the function of TMP Finance.

TMC represents itself as profitable because TMP Finance is taking on Trans Mountain’s losses.

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.

The legislative authority for Ottawa to forgive Trans Mountain’s debt to Canadians already exists. It is contained in Section 23 (6) of the *Export Development Act*. All or part of the debt obligations owed by TMP Finance to the Canada Account can be forgiven through Ministerial direction. Trans Mountain’s debt to Canadians can be written off whenever Ottawa deems “it is necessary or desirable” to do so.¹⁰

TMP Finance’s financial statements would reveal Trans Mountain’s commercially compromised financial picture, but those financial statements have not been made publicly available.¹¹ Instead, CDEV consolidates TMP Finance’s financial performance in its quarterly¹² and annual¹³ 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.¹⁴ 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.

7) CDEV, Q3 2018 Financial Report, p.3.

8) Canada TMP Finance Ltd., Access to Information Act, Annual Report to Parliament, April 1, 2018 - March 31, 2019, p.2.

9) Corporate Federal Registry accessed June 21, 2022. and CDEV, Board and Officers.

10) Export Development Act, Section 23 (6). In March 2018, the Federal Government wrote off a \$2.6 billion loan to auto maker Chrysler. The debt forgiveness included \$1.1US billion for the loan principal lent in 2009 and accrued interest over 9 years. This illustrates how an obligation can be non-performing for years without action being taken to write it off, and when the write off occurs it is done without accountability or transparency. CBC, Liberal government writes off \$1.1B US loan to Chrysler, plus interest, docs show, October 28, 2018.

11) Email requests for TMP Finance’s quarterly and annual statements were refused by both Finance and CDEV.

12) See <https://www.cdev.gc.ca/interim-reports/>

13) See <https://www.cdev.gc.ca/interim-reports/>

14) See <https://www.transmountain.com/corporate-reports>

CAPITAL STRUCTURE: DEBT AND EQUITY

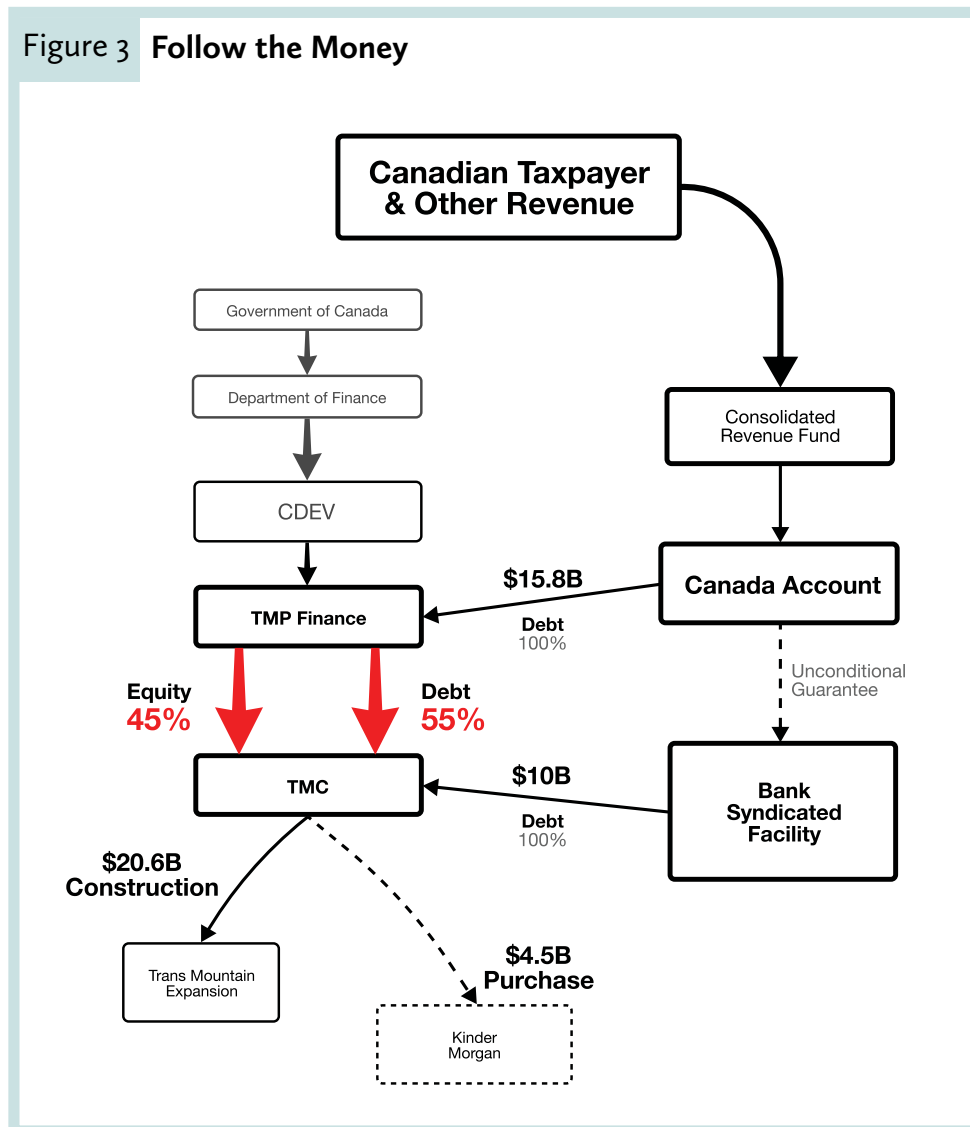
Companies can draw on debt and equity financing to fund acquisitions, operations, and growth plans. The relationship between a company's debt and equity is referred to as its capital structure with capital being another term for financing.

Debt is money borrowed from lenders with a stated interest rate and obligation to repay, while equity is money invested by owners with no obligation for repayment and no specified rate of return.

TMP Finance has borrowed 100% of the capital needed for Trans Mountain's purchase and the expansion project from the Canada Account administered by the Economic Development Corporation (EDC). Since all the financing TMP Finance has secured is debt, TMP Finance's capital structure is 100% debt.

The Canada Account obtains its money from the Consolidated Revenue Fund which obtains most of its money from taxpayers.

Figure 3 Follow the Money



Up until February 18, 2022, the taxpayers of Canada were Trans Mountain's sole lenders and its sole source of capital.¹⁵

When debt is incurred, the borrower pays interest and is obligated to repay the principal at a certain date. The money TMP Finance has borrowed from Canadians carries an interest rate of 4.7%. Department of Finance officials decided this interest rate represented commercial terms when the loan facilities between the Canada Account and TMP Finance were entered into in 2018. The construction facility was initially scheduled for repayment in August 2019, but repayment dates have been pushed back and debt repayment is currently scheduled for August 29, 2025.¹⁶

The loan facilities TMP Finance has with the Canada Account include an Acquisition Facility for buying Trans Mountain and a Construction Facility for funding the construction of the expansion project. The Acquisition Facility's outstanding balance is \$4.7 billion. The balance on the Construction Facility as of June 30, 2022, is \$11.1 billion. These two loans bring total debt advanced from the Canada Account to TMP Finance to \$15.8 billion. TMP Finance has retained \$700 million advancing the remaining \$15.1 billion to TMC.

While TMP Finance's capital structure is 100% debt, TMC's capital structure is not. TMP Finance did not advance all the funds to TMC as debt. TMP Finance sent 45% of the financing as equity which carries no interest expense and no obligation to repay.¹⁷ This is why TMC's balance sheet shows a debt load payable to TMP Finance in the amount \$7.7 billion¹⁸, while TMP Finance's debt load payable to the Canada Account is \$15.8 billion – more than double TMC's debt payable to TMP Finance.

On April 29, 2022, TMC entered into a \$10 billion loan agreement with a syndicate of Canadian banks (Syndicated Facility).



Trans Mountain Pipeline Blackpool Pump Station on the Yellowhead Highway.

15) When revenues are insufficient the government runs a deficit. The Consolidated Revenue Fund will then borrow from debt markets by issuing Canadian bonds. Canadian bonds are backed by taxpayers' ability to pay. Thus, the financing to buy Trans Mountain, and build the expansion, even when Ottawa runs a deficit, comes from the taxpayers of Canada.

16) CDEV, Q3 2018 Financial Report, Note 12, p.29 and CDEV, Q2 2022 Financial Report, Note 10, p.22.

17) 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.

18) TMC, Q2 2022 Financial Report, p.4 and Note 6, p.11. TMC drew on the Syndicated Facility to repay \$1.6 billion drawn from the Canada Account post February 18, 2022. It was returned as repayment of debt, not repayment of debt and equity as received by TMC. The debt equity ratio for funds advanced by TMP Finance as reported in TMC's Q2 2022 Financial Reports is no longer 55/45, but 51/49. The relative increase in equity increases the proportion of taxpayer-funded financing bearing no interest or obligation to repay.

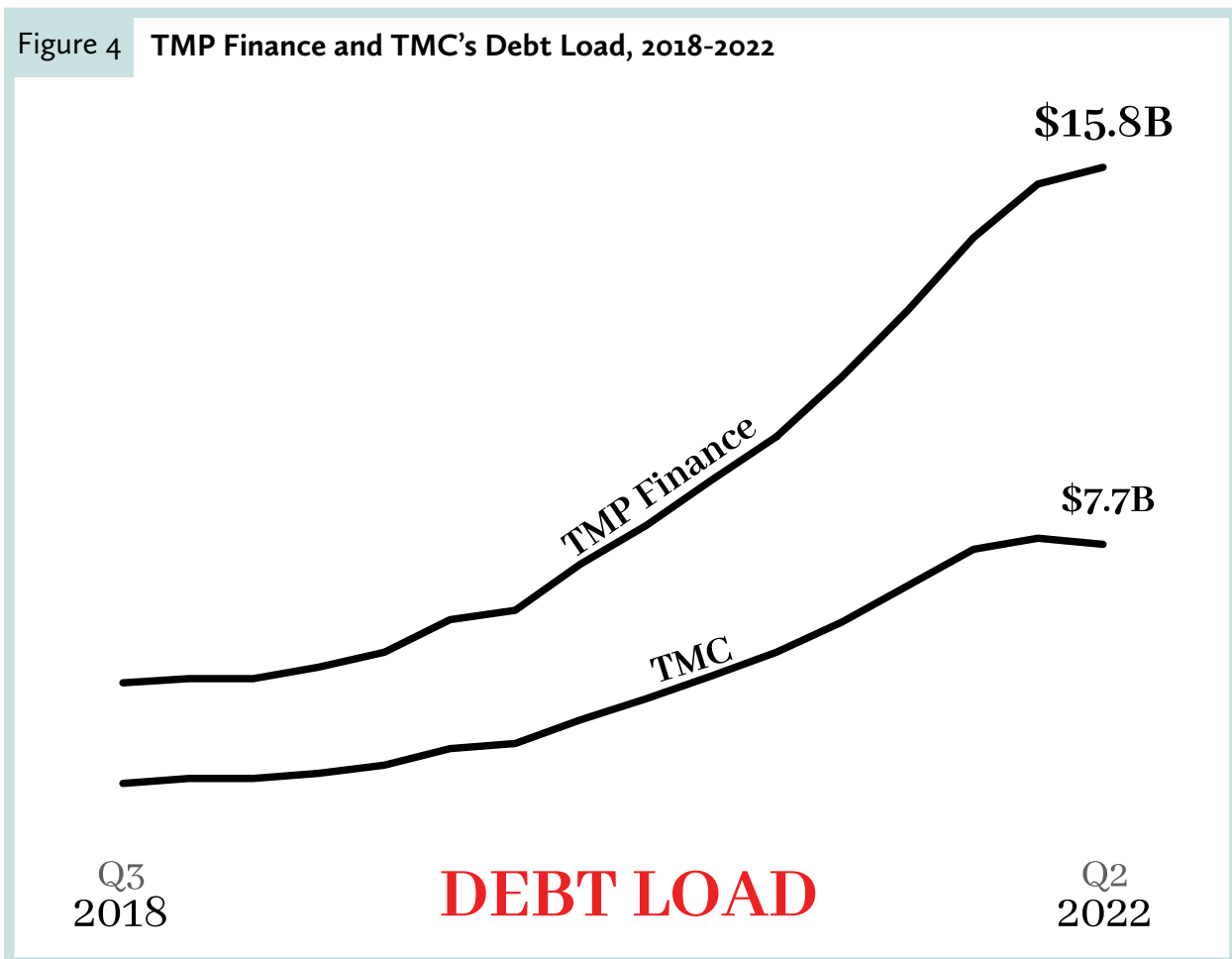
DEBT LOAD

As illustrated in Figure 4, the current debt TMP Finance has with the Canada Account is \$15.8 billion comprised of \$4.7 billion for the Acquisition Facility and \$11.1 billion for the Construction Facility. TMP Finance retained some of the borrowings to fund its cash flow deficiency and passed through to TMC \$7.7 billion treated as debt and \$7.4 billion treated as equity, for a total of \$15.1 billion. Kinder Morgan was paid \$4.5 billion in 2018 with TMC retaining \$200 million as working capital. Working capital is included in the

\$20.6 billion allocated to the expansion, comprised of \$10.6 billion from the Canada Account via TMP Finance and \$10 billion from the Syndicated Facility.¹⁹

Figure 4 illustrates how TMP Finance's debt load has grown to \$15.8 billion since Trans Mountain was purchased. TMC's debt load is also illustrated and shows how its burden has been truncated due to the transformation of debt into equity by way of TMC's contrived capital structure. While TMP Finance is

Figure 4 **TMP Finance and TMC's Debt Load, 2018-2022**



19) The Syndicated Facility will be drawn as needed for construction, with the entire \$10 billion expected to be drawn prior to loan expiry in April 2023. Therefore, it is expected that bank financing will exceed \$10 billion before Trans Mountain's expansion is in service. However, an estimate of the increased requirement beyond the announced \$10 billion is not included in this report. Interest expense for debt outstanding will be added to TMP Finance's loan balance with the Canada Account biannually. By December 31, 2023, Trans Mountain's total debt load is expected to reach at least \$27 billion.

paying interest on \$15.8 billion at a rate of 4.7% to the Canada Account, TMC is paying interest on \$7.7 billion at a rate of 5% to TMP Finance.

The impact of Ottawa's decision to transform debt into equity when transferred from TMP Finance to TMC is to reduce TMC's interest expense by approximately \$370 million a year, compounded, on a go forward basis.²⁰ TMP Finance is obligated to pay approximately \$745 million in interest to the Canada Account on an outstanding debt balance of \$15.8 billion, while TMC is only obligated to pay approximately \$385 million to TMP Finance on its outstanding debt balance of \$7.7 billion, even though TMP Finance's entire debt obligation has been entered into for the sole benefit and purpose of TMC. The difference between TMP Finance's current interest obligation and TMC's current obligation is a subsidy of \$360 million a year, growing each period due to compounding interest on interest.

During 2022, Ottawa increased the subsidization of TMC by further enhancing the debt to equity ratio in favour of TMC. This has the effect of increasing the relative debt burden for TMP Finance while decreasing it for TMC. As Figure 4 illustrates, by Q2 2022, TMC's debt load had fallen while TMP Finance's debt load, incurred to fund TMC, had increased.

This increased subsidization of TMC's financial results was made possible when TMC entered into the \$10 billion Syndicated Facility provided by Canadian banks. TMC drew \$1.6 billion from the facility to repay

advances TMP Finance had made subsequent to February 18, 2022. However, when TMC drew on the bank facility it was returned to TMP Finance not as a repayment of debt and equity as it had been received by TMC, rather the repayment was booked entirely as a repayment of debt. The debt equity ratio for all funds advanced from TMP Finance to TMC as calculated from figures provided in TMC's Q2 2022 Financial Report is 51/49, not 55/45 as initially agreed in the funding agreements.²¹

Additionally, TMC's Q2 2022 Financial Report does not explain this revised funding arrangement that has TMP Finance giving TMC 49% of its financing requirements effectively as free money. The impact of this new financing arrangement is to reduce TMC's interest expense lower than it was before Finance Minister Chrystia Freeland's pronouncement that no more public money would be provided. This arrangement also further inflates TMC's appearance of profitability because TMC's truncated interest expense obligation is further reduced.

Despite Canadians being told on February 18, 2022 that no more public money would be spent on Trans Mountain, there is another source of continued public support. A recent amendment to the Construction Facility Agreement between TMP Finance and the Canada Account waived TMP Finance's requirement to pay cash interest on its outstanding debt to the Canada Account. Instead, TMP Finance's interest expense – at a rate of 4.7% per year or a cost of approximately \$745 million – will be added

20) Equity of \$7.4 billion advanced as debt would cost $\$7.4B \times .05 = \370 million, increasing as interest is compounded.

21) TMC, Q2 2022 Financial Report. TMC's share and paid-in capital received from TMP Finance is \$7,414,650 thousand (p. 6), its debt to TMP Finance is \$7,659,701 thousand for a total from TMP Finance of \$15,074,351 thousand. Debt is 51% with equity representing 49%.

to TMP Finance’s loan balance as interest in kind: “As part of the amendments made on April 28, 2022, TMP Finance will pay interest in kind...and this amount will be added to the loan balance.”²²

Interest in kind is interest expense owed but not yet paid — it is deferred and added to the outstanding loan balance. The debt incurred to cover the interest will also have a 4.7% interest rate applied to it, compounding the burden. Trans Mountain’s loan obligations with the Canada Account will increase from \$15.8 billion to \$17 billion by year-end 2023 due to interest in kind being added to the balance. An increase in loan obligations with the Canada Account is increased public funding for Trans Mountain.

When a lender supports a company’s cash flow challenge by agreeing to interest in kind in lieu of cash payments, the interest rate on the loan is typically higher. This is because interest in kind defers the lender’s receipt of cash and increases the lender’s repayment risk. In Trans Mountain’s situation, no further interest will be paid to the Canada Account by TMP Finance until at least August 2025.

Amending the Construction Facility Agreement between TMP Finance and the Canada Account presented a commercially prudent opportunity to raise the interest rate on the loan – even more so given the rising interest rate environment – yet this opportunity to protect the commercial interests of Canadians was missed.

With respect to TMC’s outstanding loan balance with TMP Finance, TMC’s requirement to pay cash interest on its debt to TMP Finance has also been waived:

“On April 28, 2022, amendments were made (to TMC’s Credit Agreement with TMP Finance) whereby unpaid interest and commitment fees incurred under the Credit Agreement are to be added to the principal amount of the credit facility debt semiannually.”²³

Beginning with the June 30, 2022, semi-annual interest obligation, TMC will pay the 5% annual interest owed to TMP Finance as interest in kind with the amount added to TMC’s loan balance on a semi-annual basis.²⁴ Given TMC’s current debt obligation of \$7.7 billion, this means approximately \$385 million will be added to its loan balance with TMP Finance over the next twelve months with the amount growing due to the compounding of interest.

The remaining \$10 billion of the \$27 billion debt obligation Trans Mountain will face by December 2023 arises from the external financing agreement TMC has entered into with a syndicate of Canadian banks. Signed April 29, 2022, the Syndicated Facility is a one-year senior unsecured revolving facility with a six-month extension option and includes a Government of Canada unconditional guarantee. The guarantee is provided through the Canada Account, and is ultimately secured by taxpayers.

A taxpayer-backed guarantee is a third source of public support for Trans Mountain. Should Trans Mountain’s expansion project budget increase again, its in-service date be further delayed, or unforeseen operating challenges arise, this debt is at risk of being borne by taxpayers.

22) CDEV, Q1 2022 Financial Report, p.34.

23) Trans Mountain Corporation, Q2 2022 Financial Report, p.11.

24) *Ibid.*, p.10.

CASH FLOW DEFICIENCY

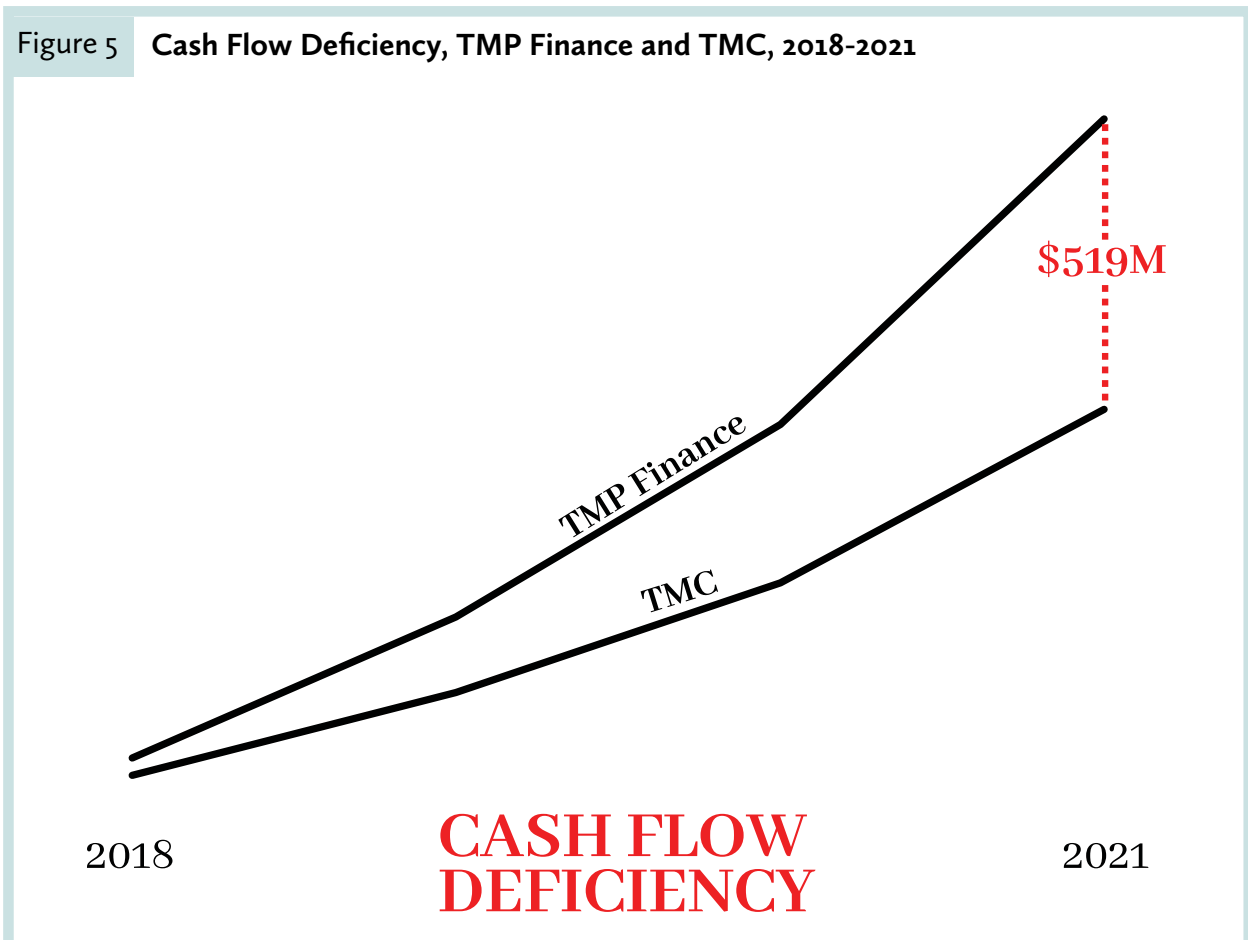
TMP Finance has not been able to pay all the cash interest expense it is obligated to pay to the Canada Account since Ottawa bought Trans Mountain in 2018. TMP Finance has always suffered a cash flow deficiency and reported losses because it is collecting revenue from TMC only on the amount of debt it loaned to TMC, not on the equity portion.

CDEV was aware that TMP Finance advancing debt as equity to TMC would put TMP Finance into an operating cash flow deficiency and lead to ongoing and mounting losses. CDEV knew TMP Finance would need to cover this deficiency by borrowing more money from the Canada Account: “TMP

Finance...will fund TMC in a ratio of 55% Debt/ 45% Equity. Given that TMP Finance borrows 100% of its financial requirements (at 4.7% interest) but only lends 55% of this to TMC (at 5.0% interest) it has an operating cash flow deficiency. To fund this deficiency, it will borrow to remain in a positive cash position.”²⁵

Between August 2018 to year-end 2021, TMP Finance’s interest obligation on debt borrowed from the Canada Account was \$1,226 million while TMC’s obligation for its truncated debt borrowed from TMP Finance was \$707 million. The difference between the cash interest TMP Finance paid to the Canada Account and the cash interest TMC paid to TMP Finance resulted in TMP

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



25) CDEV, 2019 - 2023 Corporate Plan Summary, p.10.

Ottawa promised Trans Mountain was a sound investment when it was bought, that it would be managed in a commercial manner and that financial reporting would be transparent. None of this has occurred.

Finance's cumulative operating cash flow deficiency reaching \$519 million by year-end 2021. From 2018 to 2021, TMP Finance borrowed from the Canada Account to fund its cash flow deficiency.²⁶

Figure 5 illustrates TMP Finance's cumulative cash flow deficiency from Trans Mountain's purchase to year end 2021.

TMC has paid TMP Finance \$707 million of the \$1,226 million interest expense obligation TMP Finance owed to the Canada Account, but TMC was unable to pay this truncated interest obligation out of its earnings. Just as TMP Finance borrowed from the Canada Account to cover its cash flow deficiency, TMC has also had a cash flow deficiency and has borrowed from TMP Finance to pay interest it owed to TMP Finance.

CDEV recognized TMC's need to borrow to pay its interest obligation early on, even though almost half of TMC's financing needs have come at no cost – a form of subsidy. TMC has not been profitable or financially viable even with the magical transformation of debt into equity. As CDEV's Five-Year Corporate Plan Summary explains, TMC's

lack of earnings to cover its truncated interest obligations mean that *"TMC will also need to draw funds to pay its semi-annual interest payments."*²⁷

Ottawa promised Trans Mountain was a sound investment when it was bought, that it would be managed in a commercial manner and that financial reporting would be transparent.²⁸ None of this has occurred.

The 4.7% rate of interest the Canada Account charges TMP Finance was established to reflect commercial terms: *"To maintain commercial discipline in the project, the Government charges TMP Finance commercial interest rates through the Export Development Canada (EDC) Canada Account."*²⁹

The government may charge TMP Finance rates of interest to maintain commercial discipline but passing 45% (now 49%) of Trans Mountain's financing through to TMC as equity means the government failed to pass the commercial discipline along with it. Trans Mountain's commercial terms are a façade.

Effectively, the equity financing TMC has received through TMP Finance is free money, padding TMC's financial results so they appear healthy. Bring TMP Finance's burden of carrying Trans Mountain's debt into the picture and we find that Trans Mountain has been losing money since Ottawa made the purchase in 2018.

26) CDEV and TMC Annual Reports 2018 - 2021. Includes standby fees and lease interest. Calculated as the difference between the interest paid by TMC to TMP Finance on 55% of the funding received from TMP Finance as debt and interest paid by TMP Finance to the Canada Account. Since year-end 2021, the interest expense terms between TMC and TMP Finance, and TMP Finance and the Canada Account have been changed. TMP Finance and TMC no longer pay interest in cash as the interest owed is added to their respective loan balances as interest in kind.

27) CDEV, *2020 - 2024 Corporate Plan Summary*, Appendix B, p.23. Similar references were contained in the 2021 and 2022 Five Year Corporate Plan Summaries.

28) *Mandate Letter*, Minister Bill Morneau, August 27, 2018, in CDEV 2020 - 2024 Corporate Plan Summary, Appendix A-3, pp.26-28.

29) Committee of the Whole (House of Commons) 2021-22 *Supplementary Estimates* (B) December 7 and 8, 2021.

ONGOING AND MOUNTING LOSSES COMPOUNDED BY INSUFFICIENT TOLLS

While it is possible to piece together TMP Finance's cash flow deficiency from quarterly and annual financial reports, putting together an accurate picture of Trans Mountain's losses is more challenging due to a lack of transparency. Although CDEV will not provide TMP Finance's financial reports which would reveal Trans Mountain's net loss, an appreciation of the magnitude of TMP Finance's losses can be obtained from limited information contained in CDEV's Five-Year Corporate Plan Summaries.

CDEV's 2019 - 2023 Five-Year Corporate Plan Summary's base case includes a scenario where Trans Mountain's expansion does not proceed. A Federal Court of Appeal judgment on August 30, 2018, quashed the Order in Council approving the expansion and therefore, invalidated the National Energy Board (now Canada Energy Regulator or CER) certificate of approval.³⁰ Under a scenario where the expansion project was not being built, CDEV forecasted TMP Finance's cumulative net loss for the existing pipeline would reach \$707 million between August 2018 and December 2023.³¹

Trans Mountain's existing pipeline is not profitable or commercially viable because Ottawa overpaid for the existing system and failed to ensure that Kinder Morgan's windfall gain embedded in the purchase price would be recovered through the tolls oil product shippers pay to use the

current system. Ottawa was aware of this toll subsidy from the beginning since the subsidy is reflected in TMP Finance's cumulative loss projection.

To fully appreciate the ongoing toll subsidy received by the oil producers who have been using the legacy pipeline since its purchase, it is necessary to understand that the tolls charged for the existing pipeline are determined on a cost-of-service basis. Under a cost-of-service methodology, the CER approves tolls based on the cost of the operating assets minus depreciation. The regulator refers to this as the pipeline's 'net rate base'.³²

Of the \$4.7 billion borrowed from the Canada Account to buy Trans Mountain, Ottawa used \$3 billion to purchase the existing pipeline system with the remaining \$1.7 billion used to buy the right to build the second pipeline and cover working capital needs. The net rate base under a cost-of-service toll determination methodology should be the value of the assets reflected in the \$3 billion purchase price for the existing pipeline. However, Trans Mountain's net rate base is not the \$3 billion Ottawa paid for the operating system. The net rate base is \$1 billion – the same net rate base that would exist if Kinder Morgan still owned Trans Mountain.³³

How could it be that the cost to buy assets that support the existing system is not reflected in the tolls oil producers pay to

30) *Tsleil-Waututh Nation v. Canada (Attorney General)*, 2018 FCA 153 (CanLII), [2019] 2 FCR 3.

31) CDEV, *2019 - 2023 Corporate Plan Summary*, p.14. The \$707 million TMP Finance cumulative net loss from August 2018 to December 2023 should not be confused with TMC's cumulative interest paid between August 2018 to December 31, 2021, of \$707 million. This loss does not include repayment of the \$4.7 billion principal amount of debt incurred to purchase Trans Mountain. That burden would be in addition to the cumulative loss.

32) Trans Mountain Pipeline ULC, *2022 - 2023 Incentive Toll Settlement*, Schedule 2, ITS-3, March 2022.

33) Using \$1 billion instead of \$3 billion for the net rate base represents a subsidy of \$3.4 billion over five years. See: Robyn Allan, *Are Canadians Subsidizing Trans Mountain*, December 4, 2019, pp.6-7.

use those assets? The answer lies in how Ottawa made the purchase. When Ottawa bought Trans Mountain it purchased Trans Mountain's shares and units rather than Trans Mountain's assets.³⁴ Had Ottawa purchased the assets, the price paid would be included in the net rate base. However, when shares and/or units are purchased, the regulator has the option not to include the increased value of the underlying assets in the rate base that is used to determine the tolls.

When Trans Mountain applied for approval from the CER for the tolls that would apply in 2019, the regulator was advised that the tolls would be insufficient to cover the cost of owning the system or recover the principal of the debt incurred to buy it. The CER was asked to address the unfair burden on Canadians and protect the public interest but refused to do so.³⁵

The CER decided against *"including the fees incurred by the GOC (Government of Canada); interest expense, principal repayment and administrative fees on the purchase of Trans Mountain"* because, although incurred to own and operate the existing pipeline, *"the Board is of the view that it would not be appropriate for... Trans Mountain's shippers to be responsible for them."*³⁶ The CER concluded that it would not be appropriate for the shippers who use Trans Mountain to fully cover the cost of owning it on commercial terms, but rather two-thirds of the cost should be subsidized

by taxpayers.

Trans Mountain's existing system is not profitable or viable because the tolls charged to oil product shippers who use the system reflect a value of assets of \$1 billion, not the \$3 billion Ottawa paid. The tolls do not recover all the interest expense or principal borrowed to own the existing pipeline system. The Minister of Finance, CDEV and the CER are all aware of, and actively support, this ongoing subsidy.

Once the expansion is complete, tolls will not be determined under a cost-of-service methodology. The tolls for both pipelines will be determined by the negotiated settlement embedded in the 20-year take-or-pay contracts Trans Mountain has with its committed shippers.³⁷ This negotiated toll methodology was approved by the CER in 2012.³⁸ Completing Trans Mountain's expansion and moving to a toll regime whereby revenues are determined by the negotiated toll settlement will increase Trans Mountain's ongoing losses and lead to a greater deterioration of Trans Mountain's commercial viability than that which would have existed without the expansion.

The reason Trans Mountain's losses will increase and its commercial viability further compromised once the expansion is complete, is because the negotiated contracts Trans Mountain has with its shippers do not fully pass through to them the capital cost for Trans Mountain's

34) Share and Unit Purchase Agreement, Between the Government of Canada and Kinder Morgan, May 29, 2018.

35) Robyn Allan, Letter to NEB, Trans Mountain Pipeline ULC Application for Incentive Toll Settlement 2019-2021, January 14, 2019.

36) Canada Energy Regulator, Letter to Trans Mountain in response to R. Allan, March 5, 2019, pp.4-5.

37) Trans Mountain has one 15-year take-or-pay contract for service on the existing pipeline and expansion, once the project is complete, while all other contracts are for twenty-years.

38) Canada Energy Regulator, Application for Approval of the Transportation Service and Toll Methodology for the Expanded Trans Mountain Pipeline System, June 29, 2012.

expansion or the operating expense increases that are likely to occur over the life of the contracts.³⁹ Once project costs exceed \$7.4 billion, 78% of the overruns will not be recovered in oil product shipper tolls. The negotiated contracts do not provide tolls that are high enough to pay all the interest expense, repay the debt that has been incurred, or cover all the operating expenses. When costs are not fully covered and debt is not repaid, a company is not profitable and over time is not commercially viable.

When CDEV includes Trans Mountain's expansion project in subsequent five-year plans we see that losses increase with the expansion project as compared to the losses CDEV projected for TMP Finance without the expansion project. The limited information CDEV provides on TMP Finance's losses and lack of viability is referred to in one line item CDEV calls "*TMP Finance (net losses) before capitalized interest.*"⁴⁰

CDEV's 2021 - 2025 Five-Year Corporate Plan Summary, for example, assumes Trans Mountain's expansion proceeds at a cost of \$12.6 billion with an in-service date of December 2022.⁴¹ Under these assumptions, CDEV projected TMP Finance's cumulative net loss before capitalized interest would reach \$1.5 billion by year-end 2022.⁴²

In CDEV's subsequent five-year plan – the 2022 - 2026 Five-Year Corporate Plan

Summary⁴³, a concerning development occurs. CDEV no longer provides TMP Finance's net losses before capitalized

Once project costs exceed \$7.4 billion, 78% of the overruns will not be recovered in oil product shipper tolls. The negotiated contracts do not provide tolls that are high enough to pay all the interest expense, repay the debt that has been incurred, or cover all the operating expenses.

interest – the line item showing Trans Mountain's ongoing losses has disappeared.

In July 2022, CDEV was requested to provide TMP Finance's projected losses as it had released in prior five-year plans. An update would be expected to reflect CDEV's anticipated losses for TMP Finance with a \$21.4 billion capital cost and delayed in-service date. CDEV would not respond to the request for updated estimates despite follow-up requests. Given the increase in capital costs and related interest obligations, TMP Finance's cumulative losses – and hence Trans Mountain's – will exceed \$1.5 billion by year-end 2022.

39) Trans Mountain, Facility Support Agreement, March 27, 2012. For a more detailed explanation see: Robyn Allan, Are Canadians Subsidizing Trans Mountain, December 4, 2019.

40) CDEV, 2021 - 2025 Corporate Plan Summary, p.16.

41) *Ibid.*, p.4.

42) This plan assumes TMP Finance continued to provide 100% of the financing for Trans Mountain's expansion. The cumulative losses are \$1.3 billion in the plan for 2020 - 2022, with \$117 million reported for 2019 and \$45 million reported for 2018 in prior plan documents, taking the total to \$1.5 billion.

43) CDEV, 2022 - 2026 Five-Year Corporate Plan Summary.

OPERATING EXPENSE RISK

In addition to the constrained passthrough of capital cost overruns, there are two operating features embedded in the contract terms Trans Mountain has with its oil product shippers that are important to any discussion of the revenue stream Trans Mountain might expect once the new pipeline is operational.

The first feature is that the fixed tolls will be increased by an escalator of 2.5% per year once the project is operational. This serves to increase revenue by a guaranteed amount every year over the term of the 20-year contracts.

The second feature is that Trans Mountain bears the majority of operating cost increases. The operating costs that Trans Mountain is at risk for are salaries and wages, operations and maintenance, environment, safety, security management, land and right of way management, property taxes, insurance, and CER cost recovery.

The cost increases that can be passed through to shipper tolls include power, greenhouse gas construction offsets, Indigenous accommodation, and pipeline abandonment.

Although there is an increase in the fixed toll of 2.5% per year, this revenue will likely not be enough to cover the operating cost increases that are Trans Mountain's responsibility. Staffing requirements, climate-change related maintenance, and insurance costs are much higher than Kinder Morgan anticipated they ever would be when its toll methodology was designed

more than a decade ago.

If operating costs increase by more than revenue, Trans Mountain's financial performance will deteriorate further than that caused by its huge debt load and interest expense. That means Trans Mountain faces significant capital cost and debt repayment risk, and it faces operating cost risk once the pipeline is operational.

CDEV does not publicly release projections for Trans Mountain's revenue and expenses beyond those provided in its five-year corporate plan. The most recent five-year plan presents figures out to 2026.⁴⁴

CDEV's five-year plan does not provide operating expense estimates on a disaggregated basis that would allow for evaluation of the operating expenses that fall on Trans Mountain. The aggregation in CDEV's reporting makes it extremely difficult to identify the expense risk Trans Mountain faces. It also makes it difficult to evaluate the reasonableness of the assumptions CDEV has incorporated in its estimates of Trans Mountain's future revenues and expenses.

However, it is possible to see how CDEV underestimates operating expenses by comparing estimates to actuals contained in five-year plans. For example, CDEV's 2019 – 2023 Corporate Plan Summary estimates Trans Mountain's 2021 operating expense. The expense estimate (net of depreciation) was \$59 million below the actual expense (net of depreciation) for 2021 as provided in CDEV's 2022 – 2026 Corporate Plan

44) CDEV, [2022 - 2026 Amended Five-Year Corporate Plan Summary](#).

Summary Amendment.⁴⁵ What this means is that in 2019, TMC underestimated operating expenses only two years into the future by almost 30%. This is a significant forecasting error. Trans Mountain's 2.5% revenue escalator would not have covered the shortfall.

Underestimating operating expenses fundamentally misrepresents viability analysis. The cash flows generated by an unlevered discounted cash flow analysis become overstated allowing Trans Mountain to appear as if it has a sustainable revenue to operating expense ratio when experience suggests it will not.



The Fraser Valley flood of 2021 exposed portions of the existing Trans Mountain Pipeline to the elements.

45) CDEV, 2019 - 2023 Five-Year Corporate Plan Summary, Appendix 1: Financial Statements, p.24. Projected operating expense net of depreciation for 2021 in CDEV's 2019 plan were \$203 million. CDEV, 2022 - 2026 Amended Five-Year Corporate Plan Summary, Appendix B, p.27 provides actual operating expenses net of depreciation for 2021 at \$262 million, for a forecasting error of \$59 million. The annual escalator of 2.5% on tolls expected once the expansion is operational would not cover this amount.

Accounting Standards

IFRS AND US GAAP

The government is representing Trans Mountain as profitable when it is not – and it does not stop with TMC’s contrived capital structure, ongoing borrowing to finance interest expense, and mounting losses hidden from public view. While CDEV and TMP Finance are required to prepare their financial statements under Canadian accounting standards (International Financial Reporting Standards or IFRS), TMC applies for and receives permission every year to prepare its financial statements under US Generally Accepted Accounting Principles (US GAAP).⁴⁶

There are unique opportunities afforded to TMC when it does not provide its results under Canadian accounting standards. While Trans Mountain’s expansion is under construction, US GAAP allows the company to treat a portion of the equity it receives from TMP Finance as revenue on its income statement. That is, Trans Mountain’s financing is 100% debt, but with a stroke of the pen, 45% is transformed to equity and advanced to TMC, most of which is applied to funding the expansion project. Under US GAAP, 9.5% of the equity used for Trans Mountain’s expansion can be treated by TMC as income on an annual basis.⁴⁷ This allows TMC to distort its financial situation by making it appear healthier than it is.

TMC’s press release announcing its Q2 2022

financial results states that net income for the six months ending June 30, 2022, was \$236 million.⁴⁸ What TMC fails to explain to its readers is that \$299 million is related to TMC’s equity from TMP Finance that has been spent on Trans Mountain’s expansion and has been included as revenue as allowed under US GAAP. That is, instead of paying interest on the funds and booking that as an expense, not only has TMC received equity funds without cost, but it also calculates a return on those funds and reports that as income. On TMC’s Q2 2022 income statement, this \$299 million is reported in the line item “*Equity allowance for funds used during construction.*”⁴⁹

Turning TMP Finance debt incurred into TMC equity, and relying on US GAAP when it reports its financial situation to Canadians gives the illusion that Trans Mountain is profitable and viable – when it is not – in three significant ways:

1. TMC’s debt/equity ratio on its balance sheet appears sound when it is based on a contrived capital structure, while in reality, Trans Mountain is 100% debt financed;
2. TMC’s income statement records interest expense that is much lower than the interest cost incurred to finance Trans Mountain because

46) The most recent exemption granted by Innovation, Science and Economic Development Canada is dated November 2, 2021. It states, “THIS EXEMPTION is made subject to the following terms: 1. The Corporation operates in rate-regulated activities; and 2. The Corporation is a wholly-owned subsidiary of Canada TMP Finance Ltd.” Decision NO. F-072/21, File No. 108041-2.

47) Trans Mountain Pipeline ULC, 2022 - 2023 Incentive Toll Settlement, Schedule 2, ITS-3, March 2022.

48) TMC, [Trans Mountain Corporation Releases Second Quarter 2022 Results](#), Press Release, August 29, 2022.

49) CDEV, [Q2 2022 Financial Statements](#), p.2.

TMC does not pay interest on the equity capital it receives from TMP Finance; and

3. TMC's income is overstated by a unique feature in US GAAP standards where a portion of the equity used to finance Trans Mountain's expansion is recorded as income every quarter.

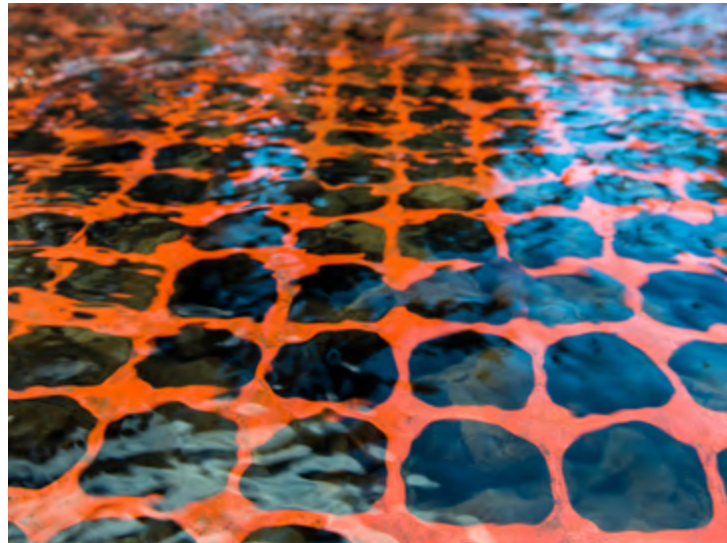
TMC reporting under US GAAP is not inherently problematic as a number of regulated pipeline companies in Canada use US GAAP to report their financial results. As CDEV has stated: *"US GAAP is the typical accounting method used by TMC's Canadian peer rate-regulated companies."*⁵⁰

The problem is that TMC does not have 'peers'. Other regulated pipeline companies are not gifted their equity; they earn it. TMC's financial statements do not reflect the complete picture of Trans Mountain's financial burden or how TMC's financing costs are subsidized.

Looking at TMC's financial statements in isolation, and thinking this represents Trans Mountain's profitability and viability, leads to materially misleading conclusions. A full accounting that includes the performance of TMP Finance should have been provided to Canadians from the beginning.



North Thompson River just north of the community of Blue River. The Trans Mountain Pipeline route runs along the western shore of the Thompson River for a large section of the River here.



Anti Salmon-Spawning fish nets were illegally installed in 2017 in preparation for construction of the Trans Mountain pipeline expansion. These nets were photographed along a salmon stream just outside of Valemount, B.C. as one of several examples along the pipeline route.

⁵⁰) CDEV, [2018 Annual Report](#), p.14.

Profitability and Viability

RELATED, BUT NOT THE SAME

Profitability measures how well a company is doing by calculating whether revenue exceeds expenses within a reporting period. If revenues are greater than expenses, the company reports net income or profit. If expenses exceed revenues, the company is not profitable and reports a loss. The simple formula is 'Revenue – Expenses = Profit or (Loss)'. If a company reports a loss year after year, its viability comes into question.

Viability is the ability of a company to achieve sufficient revenue to cover its operating costs, meet its debt obligations, maintain service levels, allow for growth, and provide a commercial return to its owners year after year.

Viability analysis typically looks to the future which requires assumptions about likely performance. Based on those assumptions, free cash flow is estimated for future years. A discount rate of interest that reflects a desired, or required, rate of return, is applied to the estimated cash flows to arrive at a present value. This approach to viability analysis is referred to as discounted cash flow analysis (DCF).

Typically, when discussing Trans Mountain's commercial viability, it is in reference to the expansion project and whether the revenues expected from the 20-year take-or-pay contracts Trans Mountain has with its oil product shippers will be sufficient to cover claims on those revenues. The claims against the revenues that are important to Canadians include operating expenses, interest expenses, debt repayment and

the commercial return Canadians were promised when Ottawa bought Trans Mountain from Kinder Morgan.

Viability analyses that have been conducted on Trans Mountain's business model, however, rely on unlevered DCF which stops short of addressing the key issues that matter to Canadians. Unlevered DCF does not consider Trans Mountain's financing obligations including the payment of interest or repayment of debt.

While it is obvious to experienced investors that the payment of financing obligations is missing from unlevered DCF analysis, it is not immediately obvious to everyone. The viability analyses that have been conducted on Trans Mountain do not consider, and therefore do not indicate whether the payment of interest, repayment of debt or return of surplus can, or will, be provided. When consideration is given to these important issues, we find that Trans Mountain's future cash flow is insufficient to cover its obligations to Canadians, and we find that the availability of surplus funds is out of the question.



Coquihalla Canyon Provincial Park outside of Hope B.C. The Trans Mountain pipeline expansion would run within about a kilometer of its northern border.

Trans Mountain is Not Commercially Viable

FUTURE REVENUES INADEQUATE

Trans Mountain's commercial viability hinges on two key factors:

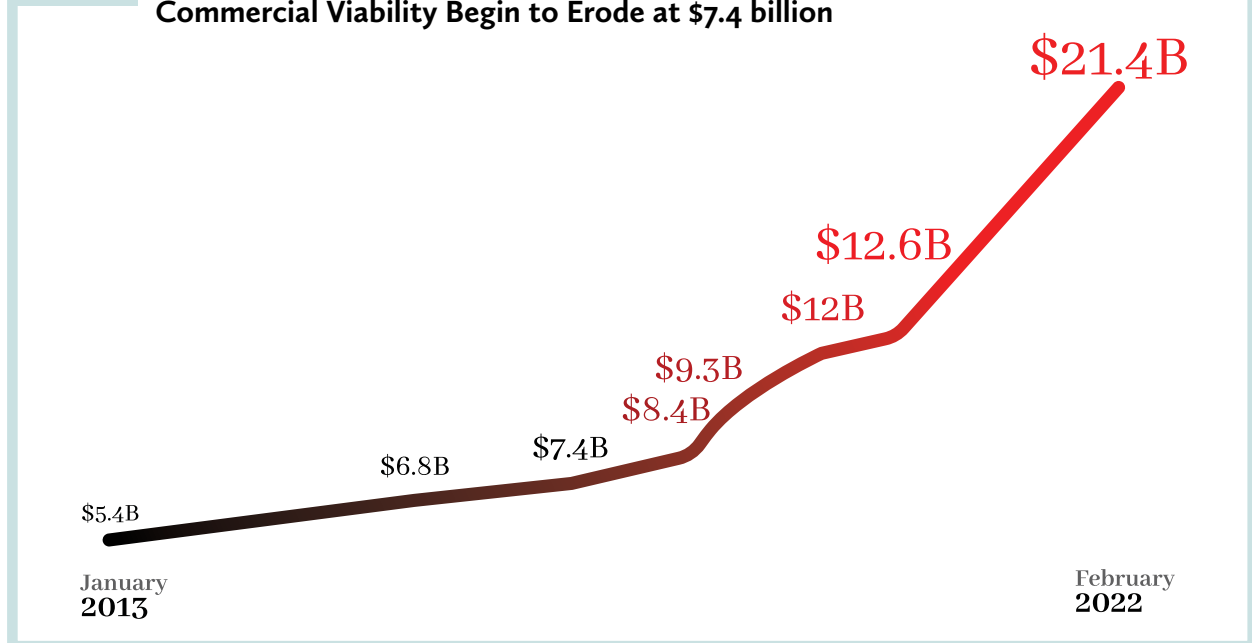
- 1) the cost to build and operate the expanded system; and
- 2) the revenue stream from the tolls determined by the 20-year take-or-pay contracts Trans Mountain has with its oil product shippers.

As discussed earlier, even if Trans Mountain's expansion had not been pursued by Ottawa, Trans Mountain would not be profitable or commercially viable because revenues generated from the cost-of-service toll methodology used to determine toll rates for

the existing system are insufficient to cover the interest expense and repay the principal borrowed to own and operate the existing system.

If Trans Mountain's expansion becomes operational, revenue generation for both pipelines will be determined by negotiated contracts. The terms embedded in these negotiated contracts mean Trans Mountain's losses will mount by more than they would have if the expansion project had not proceeded causing its viability to deteriorate more significantly and more rapidly than if the project had not proceeded.

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



As the capital cost to build Trans Mountain's expansion has increased, the tolls shippers will pay to cover these costs have not kept pace. This means Trans Mountain's future revenue stream is constrained while Trans Mountain's capital costs are not. The project's capital costs have risen to such an extreme that Trans Mountain will not be able to repay its debt obligation owed to Canadians, and this debt obligation is on track to being forgiven.

Historically, Trans Mountain's commercial viability began to erode as soon as the capital cost estimate for Trans Mountain's expansion exceeded \$7.4 billion. This began while Kinder Morgan still owned Trans Mountain, and this is the core reason why Kinder Morgan abandoned the project.

The original cost of construction when Kinder Morgan filed its application for Trans Mountain's expansion in 2013 was \$5.4 billion. This capital cost was used during the hearing process that approved the toll methodology that would be applied if the expansion project was approved. It is this toll methodology – the negotiated tolls – that are behind Trans Mountain's lack of commercial viability.

Since then, Trans Mountain expansion's capital cost has increased a staggering \$16 billion. Given Trans Mountain's monthly spend on the project, we have likely not seen the last of project cost increases.

In October 2015, Kinder Morgan told its US shareholders that the project's cost had risen to \$6.8 billion.⁵¹ At a capital cost of \$6.8 billion, tolls continued to be determined by a 100% cost passthrough to shippers and thus the project continued to be commercially viable.

In March 2017, the project's cost rose to \$7.4 billion. Trans Mountain's shippers agreed to pay tolls that reflected this higher capital cost, so the project continued to meet Kinder Morgan's commercially determined criteria.

Kinder Morgan expected the project would be commercially viable at \$7.4 billion, but not above this cost. This is because subsequent increases in project costs would see only 22% of the burden passed onto shippers in the form of higher tolls.⁵² The viability of Trans Mountain's expansion project began to erode quickly even while under Kinder Morgan's ownership.

According to publicly available TD Securities' unlevered DCF analysis prepared for Kinder Morgan in early 2018, a \$900 million increase in the project's capital cost and further one year delay, eroded commercial viability by 34%.⁵³ Once Trans Mountain's capital cost exceeded \$7.4 billion – which it did in 2017 reaching \$9.3 billion by the time Kinder Morgan sold it – the expansion project no longer met Kinder Morgan's required rate of return. Kinder Morgan was desperate to get out.

51) Robyn Allan, Cost of Kinder Morgan's Trans Mountain Expansion quietly rises to \$6.8 billion, National Observer, November 17, 2015.

52) Bloomberg News, Trans Mountain Says Shippers Are Mostly Shielded From Cost Rise, February 22, 2022 and Access to Information and Privacy, ATIA.01.0004.2019, p. 47.

53) TD Securities Fairness Opinion, May 2018, pp.27-28. Net present value of the expansion fell from \$2,097 million to \$1,394 million for a decline of 34%.

Federal Government Misleads Canadians

On May 30, 2018, then Finance Minister Bill Morneau announced Ottawa would buy Trans Mountain. He said, *“the core assets required to build the Trans Mountain Expansion Project have significant commercial value”* and *“this transaction represents a sound investment opportunity.”*⁵⁴

Before Morneau’s announcement the government knew project costs had jumped to at least \$8.4 billion because a *“new costing and scheduling for \$8.4 B project”* update was *“already in place”* on April 15, 2018.⁵⁵ Ottawa knew Trans Mountain’s commercial viability was quickly eroding and that the project was not the sound investment on commercial terms Canadians were being promised. Ottawa kept this important information from the public and maintained the official cost estimate at \$7.4 billion until February 2020.⁵⁶

Access to Information and Privacy (ATIP) documents show the project’s expected cost had risen to \$9.3 billion by June 2018.⁵⁷ Ottawa knew this higher cost meant incomplete cost recovery and compromised viability but continued the charade that the project’s budget was \$7.4 billion with full cost recovery from shipper tolls.

When Prime Minister Trudeau approved Trans Mountain for a second time on June 18, 2019, officials continued to mislead

Canadians that the project cost was \$7.4 billion although project costs had ballooned beyond \$9.3 billion. TMC’s Board recommended to Cabinet on June 17, 2019, that a \$12 billion expansion project be approved (\$12.8 billion including a probability factor of 90%), not a \$7.4 billion project.⁵⁸

Ottawa didn’t back away from its reliance on an unrealistic and stale-dated \$7.4 billion cost estimate until February 2020 when it was announced that Trans Mountain’s project cost had risen to \$12.6 billion.⁵⁹

TMC’s press release issued at the time stated that *“The Trans Mountain Corporation Board of Directors recently approved a Project cost estimate of \$12.6 billion to bring it into service by the end of 2022.”*⁶⁰ What the press release failed to point out is that eight months earlier, TMC’s Board approved a project cost estimate of \$12 billion with a probability of 50% and \$12.8 billion with a probability of 90%. By refining the project cost to \$12.6 billion, TMC could state the Board approved a \$12.6 billion estimate in 2020, but representing that this budget replaced the \$7.4 billion budget publicly announced three years earlier was deliberately misleading.⁶¹

54) Canadian Press, [Morneau explains federal decision to buy Trans Mountain pipeline](#), May 30, 2018, 0:52.

55) Access to Information and Privacy, A 2018_0001 Records, p.220.

56) Canadian Press, [Cost to twin Trans Mountain pipeline could go \\$1.9B higher, Kinder Morgan says](#), August 7, 2018.

57) Access to Information and Privacy, ATIA.01.0004.2019, p.58.

58) Access to Information and Privacy, ATIA.01.0004.2019, pp.66-67. CDEV publicly references TMC’s Board approval for a \$12.6 billion budget in June 2019. “The in-service date for the expansion remains December 2022 and the approved and budgeted cost of the expansion including financing costs remains \$12.6 billion as approved in June 2019 by the TMC Board.” CDEV, [2021 - 2025 Corporate Plan Summary](#), p.3

59) TMC, Press Release, [Trans Mountain Expansion Project Construction Accelerating](#), February 7, 2020.

60) *Ibid.*

61) Toronto Star, [‘It’s much, much more’: Trans Mountain’s pipeline expansion cost jumps to \\$12.6 billion](#), February 7, 2020.



a)



b)



c)



d)



e)



f)

The 1953 Trans Mountain Pipeline was shut down after large sections were exposed during the 2021 atmospheric river, which caused historic flooding and landslides along the Trans Mountain route.

(a) Crews clearing debris from a landslide across the pipeline path; (b) a portion of the pipeline exposed by the flood is supported with pieces of lumber; (c) water rising in the Coldwater area submerges a portion of the pipeline exposed by flooding; (d) crews work to support the exposed pipeline; (e) river water rushes past the exposed pipeline in the Coldwater Valley; (f) crews utilize temporary supports while examining the pipeline.

Unlevered Discounted Cash Flow Analyses

Unlevered discounted cash flow (DCF) analysis attempts to estimate the value of Trans Mountain's expansion by predicting the free cash flow over a given time horizon that will be generated from the expansion project once operational. Free cash flow is represented by the difference between revenues and expenses (net of depreciation) and does not include interest expense, repayment of debt or dividends.

Over the past decade, there have been a number of unlevered DCF analyses undertaken to estimate Trans Mountain's viability under various capital costs, in-service dates, revenue, operating expense, discount rates and time-horizons or cut-off date scenarios. None of these analyses have adequately incorporated the expense risk Trans Mountain is exposed to once the expansion is operational. Additionally, none of these analyses have considered Trans Mountain's interest expense or debt repayment obligations.

The word 'discounted' in DCF represents the discount rate (rate of return or interest rate) that is applied to each of the annual cash flows to bring the nominal dollar value in the future back to a present value. This is done because of the time value of money and the generally understood principle that a dollar today is worth more than a dollar in the future. The DCF value represents the present value of all anticipated future cash flows.

In DCF analysis, it is important to know that as the discount rate falls, commercial viability improves. Discount rate assumptions must be carefully watched. When analysts

adopt progressively lower discount rates that do not reflect commercial terms, this significantly improves a project's appearance of viability.

In DCF analysis, a time horizon or cut-off date over which the free cash flows are estimated is selected. The cut-off dates for the unlevered DCF analysis applied to Trans Mountain have progressively lengthened from 20 years to 40 years to 100 years. **In DCF analysis it is important to know that as the cut-off date is pushed outward, viability improves.** Cut-off date assumptions must be carefully watched, because when analysts adopt progressively longer time horizons this also significantly improves a project's appearance of viability.

Understanding that the selection of progressively lower discount rates and progressively longer cut-off dates will significantly improve estimated free cash flow provides a reason for skepticism over the reliability of the DCF analyses for Trans Mountain that have been made available. However, the most important source of misinformation and misrepresentation about Trans Mountain's viability hinges on the fact that the analyses are 'unlevered' DCF analyses, not 'levered' DCF analyses. In short, none of the viability analyses provided have ever considered what matters to Canadians – can the interest be paid, can the debt be repaid, and can a surplus be made available.

Unlevered DCF analysis does not take into consideration the interest expense incurred on debt borrowed to build the expansion, nor does it include the repayment of that

debt. Unlevered DCF analysis ignores debt completely – that’s why it’s called ‘unlevered’. Unlevered DCF analyses is analyses prepared for potential investors, not for owners or lenders who expect interest to be paid and principal to be repaid.

An unlevered discounted cash flow analysis is prepared by or for potential investors who will apply their capital structure to the free cash flow to determine how free cash flow will be spent on interest expense, debt repayment obligations, dividends and/or re-investment in growth opportunities according to a potential investor’s capital structure.

If the net present value of a project is negative – which Trans Mountain’s is under any reasonable analysis – there are no funds available on a net present value basis to pay interest, principal, dividends, or fund new growth opportunities. Bottom line, Trans Mountain is not commercially viable.

KINDER MORGAN’S REQUIRED RATE OF RETURN AND PROJECT CUT-OFF DATE: 12 - 15% AND 20 YEARS

When Kinder Morgan appeared before the energy regulator for approval of the toll methodology to be applied once the expansion was in service, the company explained its evaluation of commercial viability: “KMP targets its unlevered internal rates of return for pipeline infrastructure investments over their economic life in a typical range of 12% to 15%.”⁶²

Kinder Morgan determined, for commercial reasons, that it would need to achieve a 12 - 15% rate of return over 20 years reflecting the life of its long-term take-or-pay contracts. Kinder Morgan considered the re-contracting risk with its shippers to be too great and,

therefore, would not base its investment decision on a projection of what might happen to pipeline demand once the contracts expired. Put another way, Kinder Morgan required a project cut-off date of 20 years as the time horizon under which its project viability was conducted.

As Trans Mountain president Ian Anderson explained to the National Energy Board under oath:

*The process we undertook...would have been to having (sic) established what the investment requirements would be for a project of this sort and having full knowledge of what the hurdle rate is that we have to accomplish, is then go through some really internal proprietary consideration of pro formas and scenarios that give some comfort that a projected IRR -- unlevered IRR of 12 percent, you know, could be achieved...And the investment decision was made based upon that and the decision was made to support the project on the basis that we had a probability of achieving that unlevered IRR hurdle through the period of the 20 years of the investment.*⁶³

Kinder Morgan was clear that the company “would not proceed with a project that did not meet its targeted IRR for pipeline infrastructure”⁶⁴ and expected the project could pay for itself before the contracts expired.

As long as the capital cost of Trans Mountain’s expansion was fully incorporated into the tolls shippers pay for 20 years – as it was up to a project cost of \$7.4 billion – Kinder Morgan met its hurdle rate within its cut-off date. Once project costs exceeded \$7.4 billion, viability began to erode because shipper tolls did not keep pace with capital cost increases.

62) Trans Mountain Expansion Toll Methodology Hearing, [Information Request Response to CAPP IR 3\(c\)](#), p.5. IRR is a discount rate that brings the value of a future stream of cash flows to zero.

63) Trans Mountain Expansion Toll Methodology Hearing, February 13, 2013, [Volume II Transcripts](#), Paras 1894 - 1895.

64) Trans Mountain Expansion Toll Methodology Hearing, [Information Request Response to CAPP IR 3\(c\)](#), p.4.

TD SECURITIES COMMERCIAL RATE OF RETURN AND PROJECT CUT-OFF DATE: 10% AND 40 YEARS

In May 2018, TD Securities presented an unlevered DCF analysis on Trans Mountain's commercial viability at a project cost of \$8.4 billion and \$9.3 billion.⁶⁵

TD Securities made two major adjustments to Kinder Morgan's prior viability analysis; the first was to reduce the rate of return from 12-15% to 10%. The second major adjustment TD Securities made was to double the cut-off date for the receipt of free cash flow. TD Securities extended the time horizon of its analysis from 20 years to 40 years.

According to TD Securities' unlevered DCF analysis, with a lower required rate of return (10% discount rate) and a longer time horizon (40 years), Trans Mountain's expansion was viable at a project cost of \$9.3 billion with an in-service date of December 31, 2021. However, there was no accommodation for interest expense or debt repayment in TD's analysis.

At a capital cost of approximately \$10 billion with a further two-year delay, TD Securities' 2018 analysis tells us Trans Mountain's expansion would not be viable – even on an unlevered basis – since its net present value would be negative.

PARLIAMENTARY BUDGET OFFICER DISCOUNT RATE AND CUT-OFF DATE: 7.8% AND 40 YEARS

The Parliamentary Budget Officer (PBO) has also undertaken unlevered DCF analyses on Trans Mountain's commercial viability.⁶⁶ The PBO's most recent analysis confirmed that at a cost of \$21.4 billion and an in-service date

of December 31, 2023, Trans Mountain has a negative net present value of \$600 million. PBO used a rate of return of 7.8% and a cut-off date of 40 years.⁶⁷ PBO's analysis tells us that Trans Mountain is not profitable even under a favourable discount rate and 40-year cut-off date.

The PBO's analysis also tells us that Trans Mountain's expansion debt obligations will not be repaid and that on a net present value basis, taxpayers are on the hook for about \$23.2 billion in loan forgiveness.⁶⁸

FINANCE MINISTER FREELAND'S DISCOUNTED CASH FLOW ANALYSES: 100 YEARS

Finance Minister Chrystia Freeland points to new TD Securities and BMO Capital Markets' analyses as confirming that Trans Mountain remains commercially viable, despite the fact that TD Securities' 2018 analysis conducted for Kinder Morgan shows the opposite.

Citing confidentiality considerations, Minister Freeland will not make the banks' analyses available to Canadians for review. TD Securities made its analysis publicly available when it undertook unlevered DCF analysis for Kinder Morgan in 2018. Why would things be different now? If TD Securities and BMO Capital Markets' analyses are not available for review, Canadians should not believe what we are being told.

There are a number of ways TD Securities and BMO Capital Markets could massage their analysis to suggest Trans Mountain is viable including lowering the discount rate and expanding the cut-off date. Despite the secrecy surrounding their analyses, we learned the time horizon TD Securities and BMO

65) Kinder Morgan Canada Limited, [TD Securities Fairness Opinion](#), pp. 25 - 29.

66) All reports are available on the [Parliamentary Budget Officer's website](#).

67) Office of the Parliamentary Budget Officer, [Trans Mountain Pipeline — Update, June 22, 2022](#), p.5 and p.6.

68) Net present value incorporates the time value of money. PBO estimated expected cash flows and netted off a purchase price of \$4.4 billion for a NPV of -\$600 million. Debt of \$27 billion anticipated by December 2023 means Trans Mountain cannot cover \$23.2 billion of its debt on a net present value basis.

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

Capital Markets are relying on is 100 years of cash flows.⁶⁹

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 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.

It is surprising that Minister Freeland would accept analyses extending a century into the future when Canadians were told by the then Minister of the Environment, Jonathan Wilkinson that the project is only expected to have a life expectancy of 30 to 40 years: *“What you’re going to start to see is declining demand for oil over the coming 30 years — 40 years ... and so in that context, I would say that the utilization of the Trans Mountain Pipeline is probably in that order of 30 to 40 years.”*⁷⁰

It is also surprising that Minister Freeland would accept analyses that forecasts the project’s life a hundred years into the future when CDEV warns that demand for the pipeline’s capacity is at risk within the next two decades:

*TMC has started to evaluate climate-related physical and transition risks (i.e., risks related to the transition to a low carbon economy) ... Two important transition-related risks for TMC are carbon tax and oil demand reduction...changes in oil demand can potentially have more direct impacts. However, TMC has several long-term “take-or-pay” contract commitments in place with its shippers...which makes TMC more resilient to those impacts.*⁷¹

After the long-term contracts expire, TMC is no longer resilient to the expected decline in oil demand. The commercially prudent cut-off date for any unlevered DCF analysis is 20 years – the life of the contracts.

Regardless, any unlevered DCF analysis is meaningless when Canadians want and need to know the impact of future cash flows on Trans Mountain’s interest expense, debt repayment and surplus. Any unlevered DCF approach offered in support of Trans Mountain’s viability should be summarily dismissed.

69) National Observer, [Canada’s case for Trans Mountain assumes pipeline will operate for 100 years. PBO disagrees](#), June 24, 2022.

70) Global News, Brian Hill, [Liberals say Trans Mountain pipeline could stay open until 2060](#), September 14, 2021.

71) CDEV, [2020 Annual Report](#), page 7.

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.



Coquihalla Canyon Provincial Park outside of Hope, BC was severely impacted by the 2021 floods, which damaged nearby Othello Tunnels, shut down the Trans Mountain pipeline and set back construction work by months.

Conclusion

Canadians are being seriously misled about Trans Mountain's profitability and commercial viability through clever corporate structures, accounting wizardry, misleading cash flow analysis and toll methodologies that heavily subsidize oil producers. It has become increasingly clear that Trans Mountain cannot generate the cash flow necessary to cover its interest expense or repay the debt owed to Canadians. At least \$17 billion in debt owed to Canadian taxpayers will need to be written off.

The take-or-pay contracts Trans Mountain has with its shippers is the Achilles heel of Trans Mountain's commercial viability. The revenue stream determined by the toll methodology, at best, pays for a \$10 billion project on commercial terms. By December 2023 Trans Mountain's debt is expected to reach at least \$27 billion which means taxpayers will be on the hook for the difference between what the revenues can support and what is owed.

What is the economically prudent and responsible solution? Cancel Trans Mountain's expansion unless the beneficiaries – oil companies – pay for the project as they intended to when they signed the contracts.⁷² If they want Trans Mountain's expansion so desperately, they'll pay for it. Prime Minister Trudeau only needs to summon the political will to put the interests of Canadian taxpayers ahead of the interests of Alberta's oil companies.

72) Clause 5.4(b)(i)(B) of the FSA identifies the right for Trans Mountain to terminate its contracts with shippers if Leave to Open from the CER is not received within 54 months of the issuance of the CPCN. The CPCN was issued on June 21, 2019 which means if Leave to Open is not received by December 21, 2023, and Trans Mountain has not waived this right, the contracts can be cancelled.



Mount Robson Provincial Park, near the headwaters of the Fraser River. Trans Mountain pipeline skirts the eastern shore of the Fraser River in this area.



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