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Changing Markets – Evolving Expectations

The new realities facing Canadian energy

Thanks Darrel. And thanks to the AEG members for this opportunity to speak with you today.

Last fall, when AEG asked me to talk about the Canadian energy challenges, it wasn't a subject that was getting wide-spread attention outside the industry. That's changed in recent months, with more and more attention being paid to those challenges – and what they mean for our province, and for the economic future of our country.

We're facing a perfect storm of change and challenge.

- The good news is that rapid technological advancements have revolutionized the energy industry across North America, creating not only a massive surge in oil and gas production but also excellent progress on environmental protection;
- The bad news is that lack of access to markets for that production means that Canada is hemorrhaging billions of dollars a year - a result of the huge gap between world prices and what we receive for our oil and gas;
- And at the same time we're seeing unprecedented opposition to all forms of energy development and transportation.

To capitalize on our world class resources, we need to be able to get it to the best markets.

To do that we need a more balanced public discussion on both sides of the debate. We all need a clearer understanding of the role that the energy sector plays in creating and sustaining the prosperity and quality of life of all Canadians.

In Alberta, energy revenues account for about a third of provincial revenues and just over 1/2 of our total exports, and the energy industry employs - directly and indirectly - nearly one in every six workers.

Nationally, Canada is the most export-dependent country in the G-20, and oil and natural gas represent 18% of our exports - \$82 billion in 2011.

The oil and gas industry is the largest single investor in the Canadian economy – more than \$60 billion last year! It represents 25% of the Toronto Stock Exchange, creates work for more than 550,000 Canadians coast to coast, and generates more than \$18 billion in federal revenues each year.

Simply put – the oil and gas industry is a lynchpin of the Canadian economy. Oil and gas production drives investment and job-creation across the West and in Atlantic Canada - and sourcing of equipment and services in Central Canada.

- I was pleased that Ontario's Finance Minister Dwight Duncan recently acknowledged that the oil sands industry alone is projected to buy around \$63 billion in goods and services in that province over the next 25 years.

Clearly, the stakes – for our industry, for Alberta and for Canada – could not be higher.

Today I'll elaborate on those themes and describe what's driving the unprecedented challenges that confront Canada as an energy producer and exporter. And I want to propose a way forward – think of it as a path through the storm to bridge changing markets and evolving expectations.

To be clear, the path is not just about plowing forward with new energy infrastructure. The balance I'm talking about includes developing energy in a sustainable way. That's what the public expects

As a North American pipeline company, connecting supply with demand is what we do. So we're in a unique position to look at the big picture and provide a view on these critical issues.

This map shows the scope of our business. We operate the longest, most complex crude oil pipeline system in the world (blue).

- Our natural gas systems extend from Northern BC to the Gulf of Mexico.
- We're also the largest natural gas distributor in Canada, heating over 2 million homes.
- And we're a major generator of renewable power; including wind, solar and geothermal energy.

The pipeline business used to be a relatively calm part of the energy industry. Not any more: Projects such as Keystone XL and our own Northern Gateway have become the lightning rod for conflict and protest.

Why? Because pipelines are critical enablers of growth in energy production - and as such we're the point of attack for opponents of oil and gas development. Stop the pipelines - and you stop that development.

Because of that it often falls to us to convince stakeholders of the merits of the energy we transport, and to explain the changes re-shaping the industry. And they are indeed dramatic.

So let's begin with the changing energy landscape.

Over the coming decades, global growth in energy demand will not be driven by North America or Europe as in the past. Demand will be driven by emerging markets – especially Asia.

At the same time, US consumption will be flat at best - due to:

- slower economic growth,
- increasing fuel efficiency and the use of biofuels,
- and changing demographics which are leading to fewer vehicles and miles driven.

Global demand for gas is predicted to increase by 130 bcf/d over the next two decades: Again, driven by emerging markets.

I'm a big believer in the future of natural gas because of its relatively low emissions, abundance of supply, and responsiveness to demand. And Canada is in a great position to export gas offshore - to capitalize on the large gap between Asian demand and contracted LNG supply.

With respect to supply, only a few years ago North America was facing declining oil production, and the need for increased imports. Yet the continent is now on the road to energy self-sufficiency - and the United States could soon be the world's largest oil producer.

U.S. production is forecast to double to 12 million bpd over the next two decades. And Canadian oil production is expected to double to 6 million bpd over that timeframe - putting Canada in the top 4 oil producing nations.

What's driving such a turnaround? Well, the way I think about is that today's energy business is more akin to a large-scale manufacturing process than wildcat exploration.

New technology is unlocking massive unconventional reserves - through horizontal drilling, new reservoir stimulation methods, and economies of scale.

As a result, we're seeing explosive growth in energy production across the continent:

- In Alberta's oil sands; in the Bakken region of Saskatchewan and North Dakota;
- And in several large, unconventional resource plays.

This has been the biggest change in the energy business for decades. And it all sounds pretty positive: we're finding and extracting more energy, and there's a growing demand from emerging economies.

But there are challenges.

The most pressing issue we're facing is the significant transportation bottlenecks between growing supply and both continental and global markets. Don't get me wrong, there is well-developed pipeline infrastructure - but not enough of it, and it's not always in the right places, given the location of unconventional reserves.

This has serious implications for Alberta, and for Canada: our resources are landlocked, essentially with access to only one customer – our partners to the south. And even at that, we don't have access to the best U.S. refining centers in sufficient quantity.

This makes Canada an energy price-taker – with our resources being heavily discounted relative to world prices.

This chart captures the hefty price discounts the industry and all Canadians are facing that we saw just last week. If you look at the price received for Edmonton light crude, it was \$26/bbl less than the world price as measured by Brent traded on the East Coast or Gulf Coast.

Now look at the brown circles. WCS, which is the Canadian heavy crude marker, traded at \$37 below WTI compared to the normal difference of about \$20/bbl.

Most significant is the \$42/bbl disparity between western Canadian heavy and a comparable barrel in the Gulf Coast (Mayan heavy). The difference between the two regions should reflect the cost of transportation or 8- \$10 a barrel, not \$42.

And it gets worse if you compare Canadian heavy to Asian crude prices where you see a gap of nearly \$50/bbl.

The same story holds true for natural gas. Gas in Alberta and B.C. trades at ¼ of its value in Asia.

For a province and country so reliant on energy exports, this is an untenable situation. It means lost value of about \$75 million a day - billions of dollars a year, for oil alone.

At Enbridge it's been our top priority over the last year to address these challenges - through various market-access initiatives. I'll get to those in a minute. But it's important to recognize this is not just a problem for the energy industry. It impacts all Canadians.

It means lost royalties in Alberta, foregone taxes federally and lost jobs and GDP growth nationwide.

As Premier Redford mentioned recently, it means less money in the provincial treasury to pay for the public infrastructure and services that a growing province needs. It means less money available for investment in schools and hospitals, and it means lost opportunities for Canadians looking for well-paying jobs and rewarding careers.

Aside from the immediate loss of revenue that we're all focused on, I'm equally concerned about a potential slowdown in long term capital investment.

Oil sands crude is plentiful, but it represents the marginal cost barrel globally. That's another way of saying we need to attract world prices to promote continued investment in the oilsands. That's just the economic reality.

We don't want price discounting and uncertainty to hamper new investment --- and the serious knock-on effects that come with that scenario for the entire Canadian economy.

There's a terrible irony in all of this:

- Canada has the 3rd largest crude oil reserves in the world.
- We have the skills and technology to develop those resources responsibly.
- And Canada can access ½ the world's population from our west coast - the fastest growing economies on Earth.

Yet we lack sufficient infrastructure to access the best U.S. markets today, and we have virtually no export capability beyond the US market - forcing Canada to sell its most valuable export at a massive discount.

In my view, there is no more critical issue facing Canada today. Nobody's making any more oil and gas, so we'd better get fair value for those resources.

Fortunately, a solution is clear:

- We must build the infrastructure to connect our production with the best North American refining centers.
- And we need to come to grips with the fact that tomorrow's energy growth lies with the economies of Asia - requiring export capacity to the West Coast.

Enbridge recognized the importance of these market access issues quite some time ago, and we've been responding aggressively. Over the next three years we're investing \$15 billion in three initiatives that can provide additional markets for about one million barrels per day of Alberta production.

That's in addition to all the regional pipeline development we're undertaking in the oilsands and elsewhere.

Let me illustrate with 3 maps what we're doing right now to address this problem.

First our \$6 Billion Gulf Coast access program connects Canadian oil to the largest refining center in North America.

The Gulf Coast has some 8 million bpd of refining capacity and is configured to take Canadian heavy oil.

Canadian heavy supply and Gulf Coast refinery demand are simply made for each other. A portion of this project is already in place, and by mid-2014 we'll have 800,000 bpd of capacity on this path.

Second, through our Eastern Access program, we're establishing another path for Canadian crude to the Eastern part of the continent, including the US Midwest refinery market and Eastern Canada.

Part of that entails reversing the flow of one of our existing lines (blue line), which currently import crude from offshore. This will provide Ontario and Quebec refineries with access to light Canadian crude, which will enhance their competitive position. That's significant, in that Ontario and Quebec currently derive 18% and 90% of their crude from offshore sources, respectively.

And **third**, last month we announced our light oil market access program at over \$6 billion. This group of projects is geared to move growing production to several eastern points on the continent. And it will meet even more Canadian refinery demand.

Finally, to connect growing Canadian supply with robust Asian demand, we're proposing to build Northern Gateway (you may have heard of that project).

Gateway is not included in the \$15 billion I just talked about. But it would be a game-changer for sure, achieving the goal of diversifying Canadian energy markets, and maximizing the value of our resources. It would bring a huge boost to national and provincial GDP, jobs and tax revenue.

Let me emphasize: Gateway is designed to be a world-class project in every respect – from safety, to community consultation, to environmental protection.

Which brings me to my 2nd theme: evolving stakeholder expectations regarding energy development.

Those expectations, I think, are very clear. All stakeholders – regulators, employees, shareholders, political leaders and the public – expect more of energy companies. And because of that our regulatory process today is focusing more attention on consultation, and understanding and resolving environmental challenges.

As an industry, this is our new reality - and in my view a positive evolution, and we're all the better for it.

Without public understanding and support - it will be increasingly difficult to develop energy resources and build the infrastructure to access new markets. In other words, it's not just about receiving regulatory approval, it's important to have community support.

Make no mistake - how our industry responds to these evolving expectations will be as critical to our future success as the changing market conditions I've talked about.

So how do we adapt to this new reality? How do we generate that support?

Well, it's not enough to remind people that pipelines are the safest method of transporting large volumes of oil and gas. People want to know what we're doing to get better – to prevent incidents and to reduce our industry's environmental impact.

And the industry is responding. Most notable, the energy community has come to realize that economic benefits alone are no longer enough to ensure public support for resource development.

- If you look at reduction in per unit emissions, progress on reclamation and capital spending to enhance the safety and integrity of our infrastructure, it's clear the entire industry gets it.
- And in a ground-breaking move, Canada's oil sands producers have formed a new alliance to share technology, focused on accelerating the pace of improved environmental performance.

We're listening carefully and taking positive action.

As an industry we can't just complain about market access and opposition to energy development. We need to evolve – to keep pace with public expectations. We need to engage communities earlier and more often and spend time with them on all the issues.

We need to prove out the safety and environmental aspects of the project. And we need to have an open mind on routing and project design, and take advice from communities with local experience.

We need to reduce the industry's footprint by minimizing duplication and considering energy corridors where possible.

And we need to better communicate the benefits of what we do – how it translates into jobs, prosperity, and the social infrastructure that underpins Canada's quality of life.

We need to build consensus with communities. That means including producers, unions, service companies, pipelines, refiners and the public to carry the message and balance the discussion.

I believe we're beginning to see some success on that front, with a more balanced public debate taking shape over recent weeks - one that recognizes this is more than simply an industry problem, but rather an issue that impacts public finances and public services

One final point: as an industry we need to focus on further improving operational performance. And at Enbridge, we're placing significant emphasis on operational excellence.

Put simply, our goal is to be the industry leader in the key operational areas you see here. To accomplish that, we're investing heavily to further enhance safety and the integrity of our systems.

So let me summarize:

- The energy marketplace is undergoing profound and transformative change.
- It's being rewired in ways none of us have experienced before – driven in large part by technology and growth of developing economies.
- In response, pipeline expansion has become a national priority - to connect new energy supply with the right markets.
- At the same time, we know that more is expected of the energy industry in terms of operational performance and sustainability.
- Public attitudes have evolved, and economic benefits alone are no longer enough to generate support for resource development.

As an industry we've already begun responding to this new reality.

- We're moving forward with infrastructure to connect new supply to the best refining centers and we've proposed solutions to diversify markets.
- And we've recognized the public will only support these projects if we can demonstrate they can be built and operated safely, with respect for communities and the environment.

But the clock is ticking. What we need to do is encourage the more balanced national discussion I mentioned earlier.

We all have a stake in this. So I'm asking you today to help kick-start that discussion: Share your views on the importance of the energy industry to all Canadians with your supply chain, employees and business leaders across the country. Talk to the communities you operate in, and the governments and organizations you deal with, to ensure they understand what's at stake for Canada.

And we should welcome the active participation of First Nations and environmental groups in this discussion. The reality is that we need all forms of energy development to support our economy and growth. We can use their help to make projects better.

As I hope I've underlined, failure to develop a consensus around energy development will have serious consequences – for this generation of Canadians, and generations to come.

With so much at stake, this is no time to be standing on the sidelines. By working together we can get full value for the energy resources we've been blessed with – not simply for the energy industry, but for all Canadians. And, just as important, that we do that in an environmentally sustainable way.

Thank you for listening so patiently. I would be happy to take some questions.

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