

PETROLEUM INTELLIGENCE WEEKLY®

Vol. 55, No. 10



March 14, 2016

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Enbridge's Monaco Plots Path Through Turbulent Times

Canada's pipeline companies have found themselves at the eye of a storm in recent years, as social protests against fossil fuels zero in on new export lines — blocking projects and threatening upstream expansion. Al Monaco, chief executive of Canadian pipeline giant Enbridge, spoke to PIW about current political and industry challenges (PIW May26'14).

Q. Looking broadly at the oil market, does this feel to you like part of the normal commodity cycle, or something different?

A. This round has been much more dramatic, much more deep, much more difficult on our customers. We've been through this many times, but this feels to me like it's going to be more sustainable. We're probably going to see a change in the structure of the industry, and I don't think that's all necessarily that bad. The industry has acted very quickly and made changes to their cost structure. So I think they have reacted very quickly. Ultimately, even though we're in the depths of despair at the moment, I do think that once we get through this imbalance of supply and excess inventories, the industry, particularly in Canada, will be much better positioned going forward.

Q. And your sense on timing?

A. We are not forecasters, but we are close enough through our customers and the North American context. To us it looks like certainly not in 2016, but likely in early 2017, you are going to start to see the kicking in of the impact of the drilling reductions, that's the first step, then the working off of the excess storage. I think during that period of time, you are going to get some recovery, and ultimately it is probably going to be 2017. It's probably taken longer this time, but I think eventually we'll move forward.

Q. There's been a lot coverage of how upstream producers or integrated majors are being affected by low prices, less on the midstream. How is life in the midstream?

A. One thing that is a bit unique in our Western Canadian basin is that many of our customers are integrated or refiners, they take space in our system. Although the oil prices are not good for many of the producers who have a single source of revenue, obviously the lower feedstock costs are good for the downstream part of the value chain. So that's the structural thing that helps mitigate the current price conundrum. As far as the midstream space, the business model that we have is structured to withstand the storm. We try not to take much commodity or throughput risk, and we try and structure the business so that we're more predictable, so in cycles like this we are protected in

most cases, and when prices go up equally we are insulated from the upside, too. Having said that, when your customers are going through this kind of issue, you do everything you can to help them manage.

Q. You recently announced a strategic shift away from oil pipelines and towards power, natural gas and renewables, cutting oil pipelines from 70% of earnings to around 50%. What's the thinking behind this?

A. I need to clarify this. First of all, we've been on this move to increase natural gas and renewables for [years] — we bought Enbridge Gas Distribution in 1995, we started investing in renewables in 2002, we've been on a path to increase or diversify the sources of earnings for quite some time. I think it's just gotten more coverage right now because you've got a decline in oil development in Western Canada. From a strategic point of view, we concluded a long time ago that we need to move in this direction. We tend to be methodical, conservative when we're moving into new platforms, and so it's been a slow and steady increase. About 70% of our earnings are driven from liquids pipelines or oil, about 30% is from natural gas and renewables. In terms of the target you mentioned, we may have said we'd like to move the balance closer to 50-50, but it's important to know that that's not an "at all costs" type of strategy, because at the end of the day it depends on the capital projects and investment opportunities. We could get to 50-50 if we did some kind of major transaction, but we would be very careful about doing that — we tend to do things in more bite-size and organic-type steps. And the number itself is not the target. The target is to move gradually into these other areas.

Q. Does it reflect a negative assessment of the oil sands — that once current construction is completed, new investment will more or less dry up?

A. We are actually seeing more opportunities in North America on the liquids pipeline side of things. We have to look longer-term in our business — if we study the supply-demand fundamentals, it still indicates to us there's going to be great opportunities in the oil side of the equation. There's going to be more development in the oil sands once we get through this phase.

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Q. How do you move beyond the current polarization over the environment, and get the energy industry and social movements working together in a more constructive dialogue?

A. It comes down to both sides recognizing that action needs to be taken, because where we have been isn't working, it's not working from a climate change perspective, it's not working from an industry perspective. By default, there has to be more cooperation. I think the best example of this is the [November 2015] Alberta Climate Leadership Plan. You would have never seen this a few years ago — First Nations, environmental groups, producers, governments, all agreeing that change is needed. Probably the biggest thing that's happened, in the last two or three years only, is that business is there, business gets it, business is going to move forward with this, what we're looking for is transparency on what the rules of the game are going to be. Think about it: elimination of coal, a cap on emissions, methane reductions, renewables targets — this is a massive change for Alberta, and I think in one fell swoop it's gone from Alberta being branded as a laggard to a leadership position. And industry is there already.

Q. Is the industry finding it hard to focus on long-term issues such as the climate when it is facing a battle for survival?

A. There are probably two categories. Obviously, there's the category that is worried about survival — and we can't ignore that, it's difficult to talk about additional burdens and what's going to happen 10 to 15 years from now if you're worried about meeting your payroll. There is another side of the group who are very well-capitalized, large balance sheets, very strong capabilities, who look at this as an opportunity. In terms of those, the long-term thinking is there.

Q. There are now four major export oil pipelines at play in Canada, but they have all encountered unprecedented opposition and politicization. Can the industry turn things around or is it too late?

A. It's not too late. The one issue that I see is staying power — it goes back to size and balance sheet strength, and the ability to work through these bumps in the road. All of those projects have been designed well, and I think they will be able to withstand this downturn. What the slowdown has done is put a little less pressure on the amount of capacity required and when. The reality is that we're going to need a bunch more capacity — the question is when. Obviously under this kind of price environment, new capital investment decisions are likely going to be put out a little bit, so we're talking about a bit more breathing room. But we've got such a large system, and a number of options in that system — we've got six lines and right-of-way — that we've got flexibility there, and the guys are doing a good job of designing some projects that fit this kind of environment. So if you are a producer, and you don't want to expand too quickly, we have some options now that will allow them to expand incrementally. But it

doesn't change the reality that we need connection to tidewater — that's got to happen, it's just unsustainable for an export-driven economy with one current customer, you've got to have diversity of markets.

Q. How do you undo the politicization? Is there the political will at the federal and provincial levels to get behind you?

A. I think the game has already begun to change — the Alberta Climate Leadership Plan, we have a new federal government, the branding aspects of Canada and Alberta have now moved into positive territory. I think that, in addition, some of the things that the governments are doing to enhance the regulatory process, or at least people's trust in the regulatory process, will ultimately be positive. Now, those things take more time, and we need to work through that.

Q. How many of those four do you think will ultimately be built?

A. I don't have an answer to that right now. I think ultimately they could all be built, but certainly not on the same time frame that we were expecting. It's hard for me to pick winners — they've all got very good attributes.

Q. With the Northern Gateway pipeline, looking back, what would you have done differently that could have seen it built by now? Or did you fall victim to wider forces beyond your control?

A. Both are true. We started Gateway 12 or 15 years ago. You had legitimate concerns around climate change, then you had a number of safety incidents in the industry, you had a change in how people's voices were brought to the table — before the voices used to be focused at the landowner level; now these issues are wider spread, and each energy project effectively has the potential to become a national issue. Those are the things that were external that changed the game. As far as us, and we have to take responsibility for this, although we've been extremely successful in engaging with First Nations, we probably didn't spend enough time building the relationship, building the trust. It's a unique environment in BC [British Columbia], and we didn't do enough work upfront to ensure that we were building that trust as we went. Internally, that was something that we learned.

Q. You are doing a lot to build up incremental pipeline capacity, refurbishing and adding to existing oil pipelines, including a major project at Line 3. Will these be enough to fill the gap?

A. No, I think they probably would carry us through to 2020, 2021, if we were able to effect them all, including Line 3. But ultimately, it's going to depend on what happens to the production curve, and so, if we get back to where we were around new projects being sanctioned, costs being low enough to make them economic, then we

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will definitely need more pipeline capacity. There's another element at play here: traditionally, 10 to 20 years ago, people used to look at the production curve and say, "OK, great, we want the pipeline capacity to be matching that curve." The way business looks at it today is, "No, we need a buffer," because there's operational upsets, this buffer gives the industry some insurance. So if you are too tight on capacity, that hits your netbacks and it could result in an inability to get to market.

Q. How do you plan investments of this scale when there's so much uncertainty over where production is going?

A. It's tough to do in isolation, but we have very close contacts with our constituents, both on the producer side and on the refining side. So we take that information, we try and understand what's happening with macro-supply demand factors in North America, and we effectively build a model — with some volatility around that, or with some buffer zone. The next step is to say, "OK, if we're short, what do our customers want to do?" — and in many cases we'll ask them to support or underpin new investments. So the short answer is we take our lead from our customers. It's not in our DNA to build pipelines on spec — you've got to be pretty darn sure about your fundamentals, then you have to call your customers and ask them, "Do you guys really want to pay for this toll?"

Q. With the ban ending, how do you see the outlook for US crude exports?

A. First, it's a great outcome — just fundamentally, we all know that we need to see the right price signals, so it just

makes sense to have this interconnectivity between North America and the rest of the globe. It goes to the issue of North America's competitive advantage, because for such an energy success story, and with all the resources, skills and technologies we have, it just doesn't make sense not to have that connection to the rest of the world. From that perspective, it's a good thing that prices will provide the right signal to encourage more and more investment in the upstream.

Q. Will Enbridge get involved directly?

A. One of the initiatives we have is to explore whether or not we can transport our business model to the Gulf Coast, which really is a key infrastructure hub for North American markets. It would be nice if we had a Gulf Coast position. We really aren't there in any big way other than the Seaway pipeline and the Flanagan South route. So having a bigger presence there would make sense from the perspective of exporting crude.

Q. What about crude-by-rail — it is facing these familiar challenges of cost, safety and the environment?

A. The outlook looks pretty grim for the foreseeable future. Rail economics are driven by basis differentials, and with the price of crude coming down, those differentials are getting crunched. Until you start to see a widening of those back out, it's going to be a lower volume environment for them. Now, there are situations where it does make sense today — for example crude to the West Coast by rail is still working because there don't appear to be any other options to get the crude there.