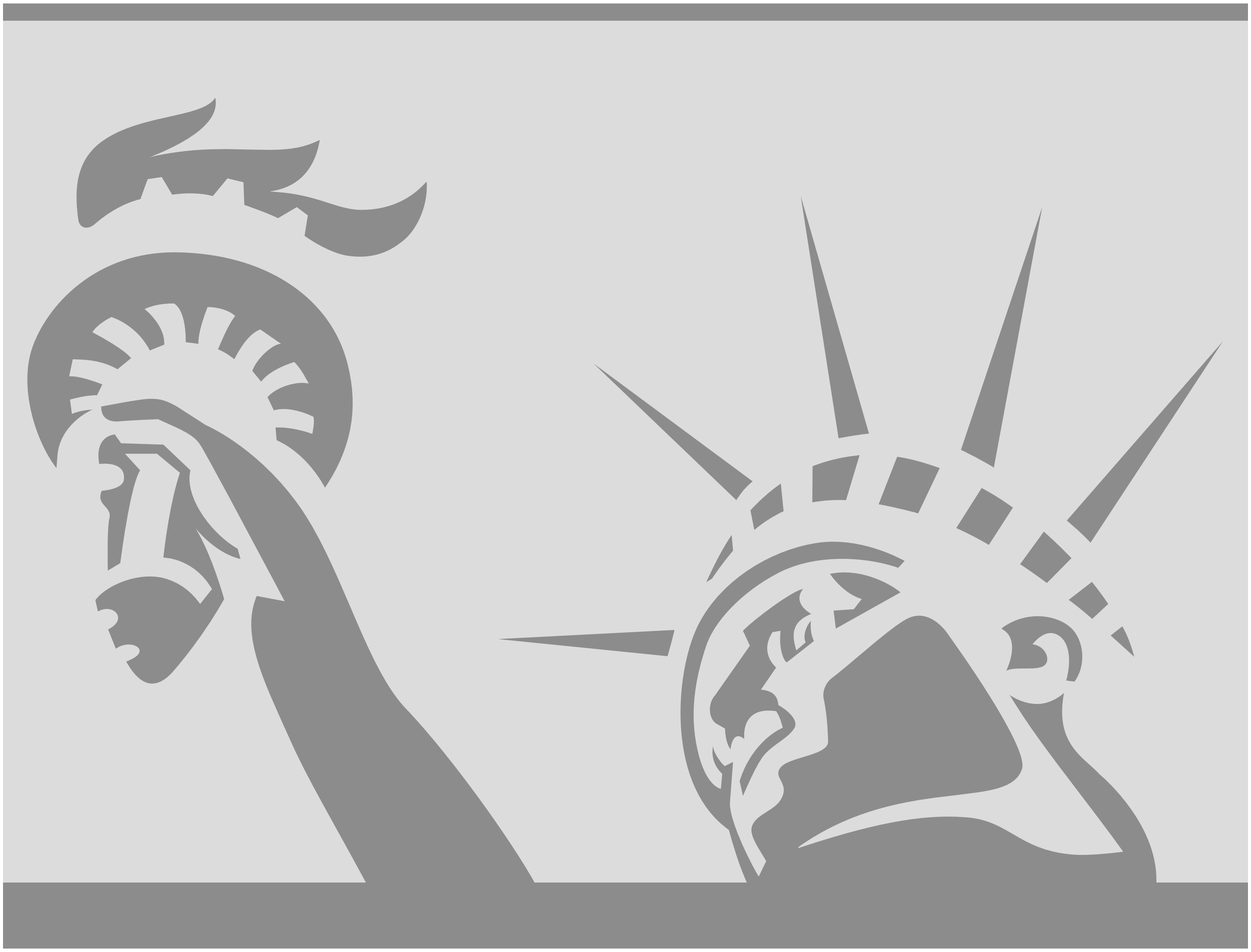


America Can’t Afford The Keystone Pipeline

Pipeline Project Serves Canadian and Chinese Interests, But Likely Will Result in Higher U.S. Energy Prices

Acknowledgments

This report was written by Tyson Slocum, director of Public Citizen's Energy Program.

About Public Citizen

Public Citizen is a national nonprofit organization with more than 300,000 members and supporters. We represent consumer interests through lobbying, litigation, administrative advocacy, research, and public education on a broad range of issues including consumer rights in the marketplace, product safety, financial regulation, worker safety, safe and affordable health care, campaign finance reform and government ethics, fair trade, climate change, and corporate and government accountability.

Public Citizen's Energy Program
215 Pennsylvania Avenue SE
Washington, D.C. 20003
P: (202) 546-4996
F: (202) 547-7392
http://www.citizen.org

Summary of Findings

- By diverting oil from the U.S. market, the Keystone XL pipeline is likely to increase gasoline prices for consumers, a reality directly at odds with proponents' claims that the pipeline will tamp down rising gas prices.

- By diverting tar sands from the Midwest refineries, the Keystone pipeline is likely to have particularly significant impacts on prices in the Midwest. TransCanada documents indicate that generating a higher price for tar sands oil is a primary purpose of the pipeline project.

- A Public Citizen analysis finds that, absent increased exports of refined gasoline, average U.S. gasoline prices over the past year would have been as much as 3.5 percent lower. The Keystone pipeline will intensify the trend of increasing exports relative to domestic supply, putting further upward pressure on consumer prices.

- Because the Keystone XL pipeline is designed to promote exports of refined tar sands oil, it will, if anything, reduce national energy security. This directly contradicts the claims of pipeline proponents, who routinely state or imply that the pipeline will increase U.S. energy security.

- Further confounding claims that the pipeline will advance U.S. energy security is rapidly increasing Chinese national government interests in Canadian tar sands. China has every right to undertake its investments in Canadian tar sands, but those investments do not advance U.S. energy security.

Introduction

The Keystone XL pipeline has emerged as the most controversial U.S. large-scale energy project in recent memory.

Critics have denounced the pipeline project for facilitating development of Canadian tar sands oil. An especially carbon-intensive form of energy, critics say the tar sands will speed the planet to catastrophic climate change. Critics have also denounced the impact of tar sands development on the Canadian environment and raised questions about how a pipeline spill might imperil water aquifers and the natural environment.

Proponents have advocated equally vociferously for the pipeline. They say it will create new jobs, but even the high-end estimates project fewer than 4,000 jobs. Key to proponents' case for the pipeline have been the claims that it will enhance U.S. energy security and lower prices for consumers.

This report focuses on, and disputes, these latter claims.

The first section notes changing U.S. market dynamics and the recent turn to exports from the United States of refined petroleum. Because of limited domestic refining capacity, increases in exports are associated with a rise in prices at the pump for consumers. Our analysis of the correlation between gasoline prices, crude oil prices and gasoline demand shows that, beginning in January 2011, gasoline exports are associated with an increase in prices from 2.1% to 3.5%.

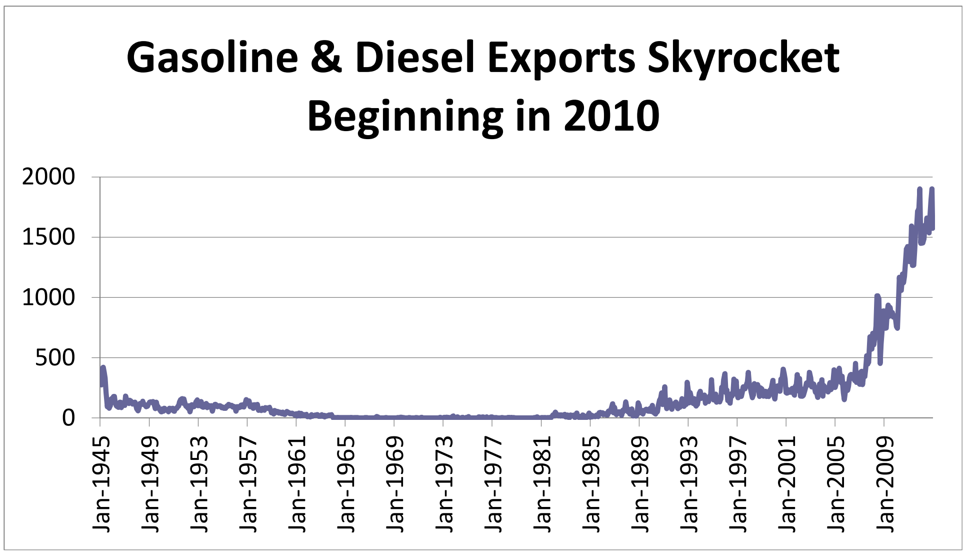
The second and third sections emphasize that the core purpose of the Keystone XL pipeline is to divert tar sands oil exports from refineries in the Midwest to Gulf Coast refineries. That diversion will enable tar sands oil to be exported and to be priced in accord with a much higher international benchmark price. The direct result will be higher prices for consumers in the U.S. Midwest, contrary to the far-reaching claims and insinuations by Keystone proponents that the pipeline will lower consumer prices. The brief fourth section suggests a policy response to the price-raising impact of refined petroleum exports: a U.S. licensing system to restrict such exports.

The fifth section highlights the complete disconnect between the core export orientation of the Keystone pipeline and the notion that it will enhance U.S. energy security. The diversion of tar sands oil will, if anything, reduce U.S. energy security. The rapidly increasing Chinese national investment in the Canadian tar sands also undermines claims that the pipeline will enhance U.S. energy security.

I. Gasoline exports are raising prices for U.S. consumers

Long defined by periods of domestic supply scarcity and unquenchable demand, U.S. energy policy has been characterized by a psyche that emphasizes increasing access to domestic oil production as a primary solution to energy security and energy price spikes. But American oil and gasoline markets are now undergoing fundamental changes.

U.S. oil and gasoline demand dropped after the 2008 financial crash and during the Great Recession, and will continue to decline or at least moderate thanks to increasing transportation fuel efficiency and alternatives. At the same time, domestic production is spiking due to the proliferation of unconventional onshore and offshore production.



The United States features the largest petroleum refining infrastructure in the world, and the industry has responded to these dynamic market shifts with a combination of refinery closures (reminiscent of the response to lower oil prices in the 1990s) and market redesign: turning America into a net exporter of refined products for the first time since 1949. The United States now exports over 3 million barrels of refined petroleum every day – the largest export in the economy. These exports result in less spare refining capacity to meet domestic supply/demand fluctuations, creating tighter refined product markets.

A Public Citizen analysis of exports and domestic motor gasoline demand shows a predictive relationship between retail gasoline prices and the level of gasoline exports.

Beginning in January 2011, gasoline exports are associated with a price increase of 2.1% to 3.5%. This translates to a price hike between 8 and 12 cents per gallon, or more than a dollar every time a driver fills his or her tank.

The price volatility of retail gasoline prices is influenced by numerous variables, including, obviously, the price of crude oil and changes in domestic demand. The Public Citizen analysis controlled for these factors. While our analysis does not account for the impact on gasoline markets if exports are replaced with reduced levels of refining capacity, we do not believe that restricting exports through regulation will result in significant capacity changes, and therefore do not expect a significant price impact from regulating refined product exports.

If this export trend continues, or if an even greater volume of oil is sent to export-centric refineries in the Gulf Coast (or on the West Coast), Public Citizen expects this "export premium" to rise.

II. Keystone: Pipeline to the World

Canadian fossil fuel production and infrastructure have historically been designed to serve U.S. markets. Canadian oil production is essentially landlocked. As U.S.-consumed petroleum products enter a period of stagnation and decline, Canadian producers must find new export markets.

Meanwhile, U.S. Gulf Coast refineries are increasingly export-driven, for many of the same reasons (declining U.S. demand) that Canada is looking to new export markets. Representing 44 percent of U.S. refining capacity, the region accounts for roughly 75 percent of refined product exports. Annual exports of crude oil and refined petroleum have increased more than 266 percent from October 2006 to October 2012. And Texas Gulf Coast refineries are exporting more than 60 percent of the gasoline they produce.[1]

While most of these exports have been to Mexico and Latin America, in December 2012, four shipments totaling one million barrels of gasoline left the West Coast and the Gulf Coast for Asia, and analysts expect such Asian gasoline shipments to continue.[2] A new, 28 million-barrel-capacity oil storage terminal is under construction in Ulsan, South Korea, "to attract refined product imports from Canada and the U.S."[3]

The Keystone XL pipeline is designed to connect Alberta tar sands to the Gulf Coast refineries. As TransCanada acknowledges, for the medium term, this is not about providing sufficient pipeline capacity to export the tar sands production to the United States; current pipelines already provide such capacity. The Keystone XL project aims to enable tar sands producers to divert their oil from the U.S. Midwest to the Gulf Coast. TransCanada, in its May 2012 permit application to the U.S. State Department, states:

> *While there is existing transboundary pipeline capacity to accommodate projected additional imports of WCSB crude in the short to medium term, there is extremely limited pipeline transport capacity to move such crude oils to PADD III refineries [Petroleum Administration for Defense District III, encompassing states from New Mexico to Mississippi and inclusive of the Gulf Coast refineries].*[4]

This is not a revelation. TransCanada has made the same claims for many years. In authorizing construction of the pipeline, the Canadian National Energy Board's 2010 "Reasons for Decision" stated:

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[1] http://priceofoil.org/2013/03/14/keystone-xl-refineries-already-exporting-60-percent-of-their-gasoline/
[2] http://blogs.platts.com/2012/12/19/asia_exports/
[3] "Export Nation," Petroleum Intelligence Weekly, October 8, 2012.
[4] http://keystonepipeline-xl.state.gov/documents/organization/189504.pdf (p16)

> *Keystone submitted, however, that the Keystone XL Pipeline is not an expansion of existing infrastructure in a conventional sense, such as a line looping project or an increase of capacity on an existing line through the addition of pumps, but a bullet line facility designed primarily to satisfy volume requirements in the USGC market and operate effectively and efficiently as one part of an integrated system.*[5]

Similarly, TransCanada had not claimed any medium-term need for the pipeline: "Based on its own supply forecast, the PGI [Purvin & Gertz Inc., which prepared a report for TransCanada] analysis concluded that additional pipeline capacity for total crude would be needed around 2020."[6]

Keystone proponents frequently imply that the pipeline will increase supply to the U.S. domestic market. For example, TransCanada's website states, "Keystone XL Pipeline Project has the potential to reduce the amount of oil America imports from Venezuela, the Middle East and other unstable regions of the world by up to 40 per cent." Tar sands oil piped to Gulf Coast refineries, "can displace much of the higher-priced oil those refineries currently import from overseas," according to TransCanada.[7]

But note the phrasing: "has the potential" and "can displace" (not "will displace"). TransCanada already exports tar sands oil to U.S. refiners in the Midwest, with refined product sold to U.S. consumers. The whole point of building a pipeline to connect the tar sands production to Gulf Coast refineries is to do something entirely different.

The very purpose of the Keystone pipeline is to take landlocked tar sands oil to the export-oriented refineries of the Gulf Coast, refine the low-grade oil in specially equipped refineries, and then ship the refined product onto world markets. Although this basic fact runs contrary to much of the rhetoric from Keystone proponents, it is not in dispute. As Canadian Energy Minister Ken Hughes said recently, "for Alberta, the strategic imperative is that we get our [petroleum] products to the ocean, so that we secure global prices for our products … The solutions are additional pipelines to the West Coast, to the East Coast [and] to the Gulf Coast."[8]

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[5] https://www.neb-one.gc.ca/ll-eng/livelink.exe/fetch/2000/90464/90552/418396/550305/604643/604441/A1S1E7_-_OH-1-2009_Reasons_for_Decision.pdf?nodeid=604637&vernum=0&redirect=3 (p9)

[6] https://www.neb-one.gc.ca/ll-eng/livelink.exe/fetch/2000/90464/90552/418396/550305/604643/604441/A1S1E7_-_OH-1-2009_Reasons_for_Decision.pdf?nodeid=604637&vernum=0&redirect=3 (p11)

[7] http://keystone-xl.com/about/energy-security/

[8] www.edmontonjournal.com/business/Group+wants+move+bitumen+rail+Alaska/7763076/story.html

III. Keystone and the Price at the Pump

Proponents of the Keystone XL pipeline regularly say or imply that it will reduce gasoline prices for U.S. consumers:

- Chairman of the House of Representatives Energy and Commerce Committee, Fred Upton (R-Mich.): "[A]s part of our American Energy Initiative, the House passed bipartisan legislation to streamline the permitting process for Alaskan oil exploration and a plan to approve the Keystone XL oil pipeline — both measures would increase supplies of safe North American energy and reduce gasoline prices."[9]
- U.S. Senator John Hoeven (R-N.D.): "Here we have rising gas prices, putting a strain on our consumers, on business, on the economy, and yet the administration turns down a project that would help us reduce gasoline prices."[10]
- David Holt, president of the Consumer Energy Alliance: " [T]he steady flow of North American oil will provide consumers and businesses with lower gas and diesel prices."[11]
- Heritage Foundation's Nicolas Loras: "10 actions that Congress can take to help lower gas prices" listed "Approve Keystone XL" as the number 2 action.[12]
- Newt Gingrich: " We should take eight steps immediately to address these skyrocketing gas prices and jumpstart production of American energy: 1. Approve the Keystone XL pipeline."[13]
- The American Energy Alliance, a subsidiary of the industry-funded Institute for Energy Research: Obama "blocked the Keystone pipeline, so we will all pay more at the pump."[14]
- GOP presidential candidate Mitt Romney implied the link when he said, "Gas is at twice the price as when (Obama) came in. He cut in half permits for drilling. He said no to the Keystone Pipeline."[15]
- Joe Petrowski, president and CEO of Gulf Oil, said Keystone XL pipeline approval will lead to "lower energy prices."[16]

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[9] www.rollcall.com/issues/57_137/Upton-Common-Sense-Fixes-to-Pain-at-the-Pump-214569-1.html
[10] http://hoeven.senate.gov/public/index.cfm/news-releases?ID=415dc2ab-dec2-4e95-8643-d0fe23471e15
[11] http://energy.nationaljournal.com/2011/10/what-factors-should-drive-keys.php
[12] www.heritage.org/research/reports/2012/05/ten-actions-congress-can-take-to-lower-gas-prices
[13] www.humanevents.com/2012/02/15/250-gallon-gasoline-and-energy-independence/
[14] www.factcheck.org/2012/03/more-pipeline-piffle-and-an-alaskan-absurdity/
[15] www.foxnews.com/politics/2012/10/14/romney-making-gas-prices-domestic-energy-top-campaign-issues/
[16] http://video.foxbusiness.com/v/1270848937001/gulf-oil-ceo-on-the-keystone-pipeline-delay/

Naked assertions about reducing gas prices notwithstanding, the evidence suggests that the Keystone XL project will push prices up, not down.

From a U.S. perspective, TransCanada's Keystone XL pipeline is a solution in search of a problem. The project seeks to build more than 800,000 barrels of oil a day of pipeline capacity to primarily link landlocked Albertan tar sands oil with refineries on the U.S. Gulf Coast. But even without the proposed Keystone pipeline, Canada currently exports nearly 1.2 million barrels of tar sands crude to the U.S. each day,[17] most of which is processed in Midwestern refineries, for subsequent sale in U.S. and Canadian markets. The existing pipelines to the Midwest and elsewhere in the United States have the capacity to transport almost double the current flow of tar sands oil.[18]

The key impact of the Keystone pipeline will be to shift tar sands oil exports from Midwestern to Gulf Coast refineries, a move that will raise prices for Midwestern consumers. The North American petroleum market is furcated into numerous oil benchmark prices, with the Midwest linked to WTI (West Texas Intermediate), and the Gulf and East Coasts linked to Brent (the international benchmark). Since 2010, WTI has traded at a significant discount ($10 or more a barrel) to Brent.[19] That's because of the surge of production from oil fracking in the United States, and perhaps also the increase in tar sands production. What TransCanada hopes to achieve with Keystone XL is the ability to sell its tar sands oil at Brent prices, both to Gulf Coast refiners – and in the Midwest, where prices are currently much lower.

In a May 2012 report, the Natural Resources Defense Council (NRDC), Oil Change International and Forest Ethics explain the impact on the United States quite plainly: "The Keystone XL pipeline would allow tar sands producers to ship crude to Texas Gulf Coast refineries at higher international prices. In the process, it would divert oil from Midwestern refineries until decreasing oil supplies in that region force prices there to reach international levels."[20]

TransCanada statements support this basic analysis. According to TransCanada's 2009 *Western Canadian Crude Supply and Markets:* "The Keystone XL Pipeline to the large USGC [U.S. Gulf Coast] market would expand the market for Canadian heavy crudes and increase demand. **This should allow the price of Canadian heavy crude to increase at least as far as USGC parity with Maya [Mexican crude]. The price for Canadian heavy crude could increase further if the Keystone XL Pipeline causes the available supply in the**

[17] Table A1-16, www.ihs.com/images/Oil-Sands-Dialogue-Appendixes-2012.pdf
[18] http://priceofoil.org/wp-content/uploads/2007/12/KeystoneXL_GasPrices_May2012_FINAL.pdf (p6)
[19] http://www.businessweek.com/articles/2012-06-15/oil-prices-keep-falling-but-a-strange-gap-persists
[20] http://priceofoil.org/wp-content/uploads/2007/12/KeystoneXL_GasPrices_May2012_FINAL.pdf (p8)

Midwest to be less than the demand, resulting in a price equivalent to Midwest parity with imported Maya crude" [emphasis added].[21]

Raising prices is in fact the core logic of the Keystone XL project for TransCanada. In seeking permission to build the pipeline in Canada, TransCanada stated that it expected to see increased revenue of $1.8 billion to $3.9 billion thanks to higher prices:

> *PGI [Purvin & Gertz Inc., which prepared a report for TransCanada] indicated that historical price discounts at the USGC suggest that the supply of Canadian heavy crudes has exceeded demand in traditional markets. Existing markets for Canadian heavy crude, principally PADD II, are currently oversupplied, resulting in price discounting for Canadian exports of heavy crude oil. It further stated that access to the USGC via the Keystone XL Pipeline is expected to strengthen Canadian crude oil pricing in PADD II by removing over supply.*
>
> *Since 2006, the price of Cold Lake Blend has been discounted compared with the price of Mexican Maya heavy crude oil at the USGC. This price discount suggests that the supply of Canadian heavy crudes has exceeded demand in their main markets north of the USGC. PGI submitted that in 2008, the average discount for Cold Lake Blend at the USGC was approximately US$3.24 per barrel. It indicated that by increasing market access for Canadian heavy crudes, this discount should be avoided in the future. If the Keystone XL Pipeline causes the USGC price discount to be eliminated, PGI estimated the annual revenue increase to the Canadian producing industry at US$2.0 billion. In addition, if the Keystone XL Pipeline causes the Midwest price to rise above USGC parity, the annual revenue to Canadian producers could increase by a further US$1.9 billion, reaching approximately US$3.9 billion.*
>
> *In April 2009, PGI completed an updated forecast projecting continued growth in crude oil supply, but at a lower rate than that previously forecast. Due to lower supply volumes, PGI submitted that the increase in revenue to Canadian heavy crude oil producers in 013 would decrease from the earlier estimate of US$2.0 to US$3.9 billion to US$1.8 to US$3.4 billion.*[22]

NRDC and colleague organizations have pointed out that the differential between tar sands and Maya prices has now grown dramatically since the TransCanada analysis. Updating in

[21] Feb. 12, 2009, pg.26 https://www.neb-one.gc.ca/ll-eng/livelink.exe/fetch/2000/90464/90552/418396/550305/556487/549220/B-1f_-_Supply_and_Markets_(Tab_3)_incl._Appendix_3.1_-_A1I9R7?nodeid=549324

[22] https://www.neb-one.gc.ca/ll-eng/livelink.exe/fetch/2000/90464/90552/418396/550305/604643/604441/A1S1E7_-_OH-1-2009_Reasons_for_Decision.pdf?nodeid=604637&vernum=0 (pp21-22)

light of these changed circumstances, they estimate the United States would pay $27 billion more for Canadian crude as a result of Keystone.[23]

The impact of diversion of oil away from processing at Midwestern refineries, combined with continued increased exports from the Gulf Coast, puts the lie to the claim that Keystone will help consumers at the pump. There is very good reason to believe the impact will in fact be the opposite, especially in the Midwest region.

Building a pipeline that is designed to shift more North American oil to export markets will not only tighten the domestic supply/demand balance, but will increase U.S. refined product prices to match global benchmarks, resulting in even higher price impacts for consumers than our analysis shows.

[23] http://priceofoil.org/wp-content/uploads/2007/12/KeystoneXL_GasPrices_May2012_FINAL.pdf (p8) ("The disparity between tar sands and Mexican Maya is now between six and fourteen times greater than the price discount existing when TransCanada forecast that Keystone XL would increase the revenues of Canadian tar sands producers by up to $3.4 billion. If TransCanada were to do the same analysis today, it would likely find that the Keystone XL pipeline would increase the amount the United States paid for Canadian crude by up to $27 billion a year.")

IV. Controlling Exports

There is an available remedy to the consumer harm from increased exports of refined petroleum products. The U.S. Department of Commerce requires entities seeking to export domestically produced crude oil to obtain a so-called "short supply" license. A successful applicant must demonstrate that the export of the commodity will not result in supply shortages, and that exporting the product is in the national interest.[24] These rules were finalized in 1996 under the agency's 1979 Export Administration Act authority. Six companies—including BP, Shell and Swiss-based trader Vitol—recently applied for such short supply licenses to export significant quantities of crude oil.[25]

The Department of Commerce has authority to include refined petroleum products in the list of commodities requiring a short supply license. While some in Congress have offered legislation seeking to ban exports—particularly those linked to a completed Keystone XL pipeline[26]—the Department of Commerce could simply use its existing rulemaking authority to slow the steady export of refined products that is resulting in higher domestic gasoline prices.

In addition, the president of the United States has the authority, under The Energy Policy and Conservation Act of 1975, to restrict exports of coal, petroleum products and natural gas "by rule, under such terms and conditions as he determines to be appropriate and necessary to carry out the purposes of this Act."[27] This authority has never been invoked.

However, America's international trade commitments under The General Agreement on Tariffs and Trade (GATT) may conflict with executive branch efforts to regulate petroleum product exports. GATT forbids member countries from placing export restrictions to other WTO countries, but does allow exceptions if the restrictions are in response to a critical shortage. In addition, GATT allows an exemption for exhaustible natural resources (such as petroleum products) as long as such an export restriction is in conjunction with limits on domestic production, consumption and restrictions for reasons of short supply.[28]

In addition, Keystone developer TransCanada claims that the pipeline will improve American energy security.[29] This significant investment in tar sands, coupled with the

[24] www.gpo.gov/fdsys/pkg/FR-1996-03-25/pdf/96-4173.pdf
[25] www.ft.com/intl/cms/s/0/94933124-1322-11e2-ac28-00144feabdc0.html
[26] www.platts.com/RSSFeedDetailedNews/RSSFeed/Oil/6036314
[27] 42 USC § 6212 (a).
[28] Article XX(g), (i), (j).
[29] www.transcanada.com/energy-security.html

export-nature of the Keystone pipeline, raises concerns about whether the pipeline and the development of the tar sands are for the benefit of U.S. interests.

V. China's National Government Increasing Interest in Canadian Tar Sands

"We [Canada] need to sell our oil and they [China] need to buy oil"

The need to advance national energy security is a truism of American politics, and Keystone XL pipeline advocates have endlessly trumpeted the pipeline's purported benefits for national security.

"Keystone XL brings a secure supply of oil to the United States," announces TransCanada's promotional website for Keystone.[30] Keystone will "enhance[e] domestic energy and national security," declares the American Petroleum Institute.[31] "If the president is serious about job creation and energy security, now is the time to act on the Keystone XL pipeline," asserts U.S. Chamber of Commerce CEO and President Tom Donohue.[32]

Of course, the acknowledged fact that the purpose of the Keystone XL pipeline is to enable tar sands oil to be exported, and to divert it away from existing consumer markets in the United States, disproves the energy security claim.

There is, as well, another under-examined element to the Keystone energy security claims. While proponents allege that approval of the pipeline is needed to maintain cordial U.S.-Canada relations, they have systematically failed to note the rising role of China in tar sands development.

China is the largest foreign investor in Canada's tar sands, representing 52 percent of all foreign investment since 2003, according to a recent HSBC report.[33] The national government of the People's Republic of China (PRC) has six entities under its control making investments for sometimes controlling stakes in Canada's tar sands: China National Offshore Oil Corporation, PetroChina, Sinopec, China Investment Corporation, Bank of China and China Life Insurance Company. However, recent investments by six different entities controlled by China's national government will have power overnearly 1.1 million barrels of daily tar sands production by 2020.[34]

[30] http://keystone-xl.com/about/energy-security/
[31] http://api.org/policy-and-issues/keystone.aspx
[32] President and CEO Tom Donohue
[33] www.research.hsbc.com/midas/Res/RDV?ao=20&key=02PzuYR8NA&n=353878.PDF
[34] Public Citizen analysis

People's Republic of China Government Control Over Canadian Fossil Energy

Investing As a "Strategic Weapon"

Syncrude Canada	407,000 bpd active tar sands project	Sinopec +Cnooc control 16.23%
Nexen	Long Lake, Kinosis, Leismer & Cottonwood projects hold 6B barrels of oil sands reserves	Cnooc controls 100%
MEG Energy	Christina Lake tar sands	Cnooc controls 14.2%
Athabasca Oil Sands Corp	MacKay River & Dover tar sands	PetroChina controls 100%
Sunshine Oilsands Ltd	controls 7% of the Athabasca tar sands leases	China Investment Corp, Sinopec, China Life Insurance Co & Bank of China control 29%
Penn West Energy Trust	Seal North, Seal Main, Dawson Seal & Cadotte tar sands	China Investment Corp controls 45% of a joint venture
Northern Lights		Sinopec owns 50%
Teck Resources	Fort Hills, Frontier tar sands	CIP owns 17.6% of Teck's equity
Shell	shale gas in British Colubmia	PetroChina controls 20%
North Twining, Alberta	oil	PetroChina controls 16%
Alberta Gas Processing	gas	PetroChina controls 11.5%
Northern Cross (Yukon) Ltd	conventional oil+gas	Cnooc controls 60%
EnCana	Duvernay & Cutback Ridge (NatGas)	PetroChina owns 50%
Daylight Energy	shale oil	Sinopec controls 100%
Brookfield Asset Management Inc.	various	China Investment Corp partnership

Chinese national government investment raises the question of whether development of tar sands oil ultimately destined for export outside the United States will simply facilitate national security priorities of the Chinese government. Indeed, one should question whether increased Chinese control over tar sands development and production may result in Keystone ultimately serving as a U.S.-based conduit for export to Chinese gasoline markets. China has every right to undertake such investments, of course, and it has pressing and legitimate energy needs. But satisfying Chinese energy security interests is a far cry from the U.S. benefits touted for the pipeline project.

China National Offshore Oil Corporation (CNOOC) is controlled by the national government of the PRC. CNOOC Ltd. is its publicly traded subsidiary, of which the PRC controls 64.45 percent, with the remaining 33.55 percent owned by individual and institutional shareholders.[35] In May 2012, CNOOC Ltd. Chairman Wang Yilin made a speech on the launch of the company's first deepwater oil rig, announcing that "large-scale deep-water rigs are our mobile national territory and a strategic weapon,"[36] illustrating the overt political nature of CNOOC's business.

Mr. Wang headed CNOOC's successful efforts to acquire Nexen Inc., a Canadian oil sands developer and one of the largest leaseholders in the Gulf of Mexico,[37] with more than 200 blocks[38] and "proved reserves of approximately 116 million barrels of oil equivalent."[39] During the takeover, the Canadian Security and Intelligence Service, the nation's spy agency, issued a report warning of the risks of foreign government investment in the country, declaring that "certain state-owned enterprises and private firms with close ties to their home governments have pursued opaque agendas or received clandestine intelligence support for their pursuits here [in Canada]."[40]

Through Nexen, CNOOC also controls 100 percent of the Long Lake tar sands production project. In total, CNOOC's shares of current and soon-to-be producing tar sands projects give the company control over 155,000 barrels a day of tar sands production in Alberta alone.[41]

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[35] www.sec.gov/Archives/edgar/data/1095595/000095010312002051/dp29866-20f.htm
[36] Brian Spegele and Wayne Ma, "For China Boss, Deep-Water Rigs Are a 'Strategic Weapon,'" *The Wall Street Journal*, Aug. 30, 2012, Page B1, http://professional.wsj.com/article/SB10000872396390444233104577592890738740290.html
[37] www.energyvox.org/2011/12/01/chinese-govt-wades-into-us-offshore-drilling/
[38] Brian Spregele, "Cnooc's New Tack Shows in Oil Deal," *The Wall Street Journal*, December 28, 2012, Page B5.
[39] www.nexeninc.com/en/Operations/Conventional/GulfofMexico.aspx
[40] Paul Vieira, "Canada: Risks in Foreign Investment," *The Wall Street Journal*, Sep. 22, 2012, Page B3, http://professional.wsj.com/article/SB10000872396390444165804578010302225136128.html
[41] www.nexeninc.com/en/Operations/OilSands/OurOilSandsBusinesses.aspx

In 2011, CNOOC acquired Canadian Tar Sands producer OPTI Canada for $2.1 billion.[42] CNOOC controls 14.2 percent of MEG Energy's Christina Lake tar sands project.[43]

Although the Nexen acquisition was ultimately approved by Canadian authorities, similar Chinese government transactions weren't required to be reviewed under the country's Investment Canada Act. For example, the December 2012 $2.2 billion acquisition of 49.9 percent of EnCana's Duvernay natural-gas-and-liquids play in Alberta by PetroChina wasn't subject to a national security review.[44]

The China Petroleum and Chemical Corporation (Sinopec), is another PRC-controlled corporation. Sinopec controls 55.6 percent of Sinopec Shanghai Petrochemical Company Ltd., which is its investment arm.[45] In 2010, Sinopec acquired ConocoPhillip's 9 percent stake in Syncrude Canada's 407,000 barrel a day tar sands production facility for $4.65 billion.[46] Combined with CNOOC's stake in that project,[47] the PRC controls 16.2 percent of Canada's largest tar sands production facility. In November 2011, Sinopec acquired Canadian shale oil producer Daylight Energy for $2.1 billion.[48]

China National Petroleum Corporation is another PRC-controlled national oil company[49] that controls 86.5 percent of **PetroChina**.[50] In March 2012, PetroChina completed the 100 percent acquisition of Canadian-based Athabasca Oil Sands Corp.'s two oil sand projects in MacKay River and Dover.[51] In 2011, PetroChina acquired 20 percent of Shell's interest in its unconventional natural gas assets located in British Columbia. In June 1993, PetroChina acquired a 15.9 percent operating interest in Alberta's North Twining Oilfield and 11.5 percent equity of a natural gas processing plant in Alberta. In December 2012, PetroChina acquired 49.9% of EnCana's Duvernay natural-gas-and-liquids play in Alberta for $2.2 billion—after PetroChina had acquired 50 percent of EnCana's Cutbank Ridge assets, covering more than 1.3 million acres in British Columbia and Alberta in 2011.[52]

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42 www.cnooccanada.com
43 www.cnooccanada.com/index.php/operations/meg-project.html
44 Ben Dummett, "EnCana-PetroChina JV Not Subject to Investment Canada Act," *The Wall Street Journal*, December 19, 2012 http://professional.wsj.com/article/BT-CO-20121219-714443.html
45 http://sec.gov/Archives/edgar/data/908732/000119312512193739/d338922d20f.htm
46 http://dealbook.nytimes.com/2010/04/12/conocophillips-to-sell-syncrude-stake-to-sinopec/
47 http://sec.gov/Archives/edgar/data/16873/000110465912012059/a12-5169_140f.htm
48 www.bloomberg.com/news/2011-10-09/sinopec-agrees-to-buy-daylight-energy-for-2-1-billion-to-meet-fuel-demand.html
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China Control Over Canada's Tar Sands

	bpd	% of Canada's total daily production
Currently Producing	141,896	6.3%
Proposed/Permited/Under Construction	1,076,170	

China Investment Corporation (CIC) is the PRC's sovereign wealth fund. In 2011, CIC opened its first and only foreign office—in Canada, to better explore "investment opportunities for CIC in Canada."[53] Shortly after the office opened, CIC joined with Sinopec, **China Life Insurance Company** (of which the PRC directly controls 68.4 percent)[54] and the **Bank of China** (also controlled by the PRC),[55] to control 29 percent of Sunshine Oilsands Ltd.[56] Sunshine Oilsands controls 7 percent of the total amount of leases in the Athabasca tar sands region.[57] In explaining why Sunshine Oilsands has partnered with PRC-controlled firms, CEO John Zahary said "We need to sell our oil and they need to buy oil."[58]

China Investment Corp. owns 47 million shares (10.5 percent) of Penn West.[59] Penn West controls the Seal North, Seal Main, Dawson Seal[60] and Cadotte in-situ tar sands projects.[61]

China Investment Corp. also owns tens of millions of shares of oil and gas, financial and media companies, including 100,000 shares of oil refiner Valero, 200,000 shares of refiner Tesoro, 2 million shares of United States Oil Fund, 151 million shares of Morgan Stanley (or 7.8 percent of the company),[62] 9 million shares of Citigroup, 1.3 million shares of Bank of America, 1.15 million shares of Wells Fargo, 3 million shares of S&P Global Energy Fund, 4.1 million shares of International Energy SPDR and 300,000 of Fox News parent News Corp.[63]

China Investment Corporation "is ratcheting up its direct-investment efforts by teaming up with, rather than investing through," Canada's Brookfield Asset Management Inc. "The new

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[53] www.china-inv.cn/cicen/resources/news_20110322_782619.html
[54] http://sec.gov/Archives/edgar/data/1268896/000119312512183640/d331456d20f.htm
[55] www.boc.cn/en/aboutboc/ab1/200809/t20080901_1601737.html
[56] www.sunshineoilsands.com/uploads/investor/q2_2012.pdf
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[58] www.businessweek.com/news/2012-08-16/sunshine-oilsands-favors-a-venture-with-sinopec-to-tap-oil-sands
[59] www.sec.gov/Archives/edgar/data/1334388/000114420410031317/v187033_sc13g.htm
[60] www.energy.gov.ab.ca/landaccess/pdfs/oilsands_projects.pdf
[61] www.oilsandsdevelopers.ca/wp-content/uploads/2012/10/Oil-Sands-Project-List-October-2012.pdf
[62] www.sec.gov/Archives/edgar/data/895421/000119312512056199/d298632dsc13ga.htm
[63] www.energyvox.org/2010/03/24/china-owns-a-utility/

approach could allow CIC more control over assets it holds."[64] Brookfield Asset Management owns hundreds of billions of dollars worth of real estate, natural resources and equities. Five of Brookfield's board members have direct ties to Canada's tar sands: Marcel R. Coutu, president and CEO of Canadian Oil Sands Ltd. *and* chairman of Syncrude Canada, Ltd.; Frank J. McKenna, director of Canadian Natural Resources Ltd.; Dr. Jack M. Mintz, director at Imperial Oil Ltd.; James Gray, former CEO and founder of Canadian Hunter Exploration, now a unit of ConocoPhillips; and Maureen Kempston Darkes, a director at Enbridge, Inc.[65] In addition, the government of Singapore secured a Brookfield board seat in November 2012 with the addition of Dr. Seek Ngee Huat.

China's oil companies must be viewed in considerable measure as extensions of the PRC's official foreign policy and national security apparatus. One does not need to see any conspiracy in increased Chinese investment in Canada to find Chinese oil companies' investments noteworthy. China is cash rich and oil poor. It desperately needs secure and dependable oil supplies, and it has the resources to invest internationally. But a Chinese play to use the Keystone XL pipeline to run Canadian tar sands oil through the United States, so refined product can be exported, potentially to Chinese markets, is a far cry from Keystone XL proponents' claims that the pipeline will advance U.S. national energy security.

[64] Lingling Wei, "China's CIC Makes Investing Shift," *The Wall Street Journal*, Sep. 19, 2012, Page C1 http://professional.wsj.com/article/SB10000872396390443720204578003781099968180.html
[65] www.brookfield.com/content/board_of_directors-26685.html

Conclusion

In addition to making modest jobs claims, Keystone XL pipeline proponents are relying on two key arguments to urge the project to be greenlighted: national energy security and reduced prices for U.S. consumers.

Our analysis demonstrates that the pipeline is almost certain to fail to advance either of these objectives, and may actually result in reduced energy security and higher consumer prices. The business rationale for the pipeline is to divert tar sands oil from the Midwest to exporting Gulf refineries, and thereby to raise the price for tar sands oil and increase refined tar sands exports at the expense of the U.S. market.

Methodology Linking Increased Exports To Higher Gasoline Prices

Public Citizen's analysis relies on U.S. Energy Information monthly data on retail regular gasoline prices, gasoline demand and gasoline exports. Gasoline exports were measured as a share of total domestic demand plus exports. A gasoline price elasticity figure of 0.26 was assigned, based on Molly Espy's "*Explaining the Variation in Elasticity Estimates of Gasoline Demand in the United States: A Meta-Analysis.*"[66] The share of exports of demand + exports was then divided by this elasticity coefficient, providing the monthly percent increase in prices resulting from exports.

[66] The Energy Journal, Vol 17, No 3 pp 49-60.