

HOW ENBRIDGE'S BANKERS FUND A TAR SANDS PIPELINE

Global investment firms fuel controversial Line 3 project

Canadian pipeline giant Enbridge Inc. is planning a major expansion of its so-called “Line 3” crude oil pipeline, which connects Alberta’s tar sands region with oil markets in the Midwestern US and eastern Canada. Enbridge hopes to replace the existing line with a new conduit boasting double the capacity.¹ Critics have blasted the project for boosting oil spill risks, threatening Native American and First Nations’ fishing and harvesting rights, increasing greenhouse gas emissions, and providing a financial windfall to Canada’s environmentally destructive tar sands industry.

Enbridge describes Line 3 as the largest project in the company’s history. Rightly so. Enbridge anticipates that the project will cost roughly Can\$9 billion. Costs for the Canadian portion of the project will total Can\$5.3 billion, while the US side will cost US\$2.9 billion, or roughly Can\$3.7 billion at today’s exchange rates.^{2*} Enbridge plans to spend nearly three-fifths of this total over the next 18 months, with the new pipeline slated to come into service in the second half of 2019.³

A review of the company’s finances shows that Enbridge will depend heavily on financing from major investment banks to complete the Line 3 project. Revolving lines of credit—akin to corporate

*For the rest of this report, dollar figures will be denominated in Canadian currency unless otherwise noted.

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KEY FINDING:

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credit cards—will provide crucial liquidity for construction spending. Investment firms will also facilitate financing for Line 3 by arranging asset sales and by giving the company access to capital markets.

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ENBRIDGE RELIES ON CREDIT FACILITIES FOR LIQUIDITY

Although Enbridge boasts well over \$40 billion in annual revenue, the firm keeps relatively little unrestricted cash on hand: only \$480 million at the end of 2017, and \$457 million as of the end of June 2018.⁴

To maintain liquidity for short-term spending, Enbridge supplements its cash reserves with revolving credit facilities arranged and financed by consortia of global investment banks. Enbridge employs these facilities the way many households use credit cards: the company pays for short term expenses by borrowing from its credit lines, and then pays them down as cash flows allow.

As of June 30, 2018, Enbridge and its corporate affiliates maintained credit facilities that allowed the firm to borrow nearly \$21.4 billion. The company had drawn on about \$9.3 billion of that total, leaving roughly \$12.1 billion in available credit.⁵

Enbridge's most recent annual report attests to the vital role that these long-term credit facilities play in the company's liquidity:

In the near term, we generally expect to utilize cash from operations together with *commercial paper issuance and/or credit facility draws* and the proceeds of capital market offerings to fund liabilities as they become due, *finance capital expenditures*, fund debt retirements and pay

common and preference share dividends.
[Emphasis added.]⁶

Enbridge credit lines also give the company access to short-term loans, known as “commercial paper.” Lenders extend short-term loans to Enbridge at favorable rates knowing that, in a pinch, the company will be able to pay back this debt by drawing on its committed lines of credit. Enbridge’s most-recent quarterly report underscores the point, going so far as to classify even its short-term borrowings as “long-term debt” because they are supported by long-term credit facilities.⁷

More generally, Enbridge has told investors that its credit facilities allow the company the liquidity to fund its expansion without continually returning to debt or equity markets to raise funds:

We target to maintain sufficient liquidity through securement of committed credit facilities with a diversified group of banks and financial institutions to enable us to fund all anticipated requirements for approximately one year without accessing the capital markets.⁸

Based on the company’s admissions, Enbridge’s credit facilities are critical to the company’s financial health. The company’s lines of credit allow the firm to borrow from short-term debt markets at favorable rates, while also guaranteeing steady funding sources for capital expansion projects and other cash needs.

ENBRIDGE RELIES ON BANKS FOR CAPITAL

Enbridge will rely on financial services provided by major investment banks to fund its capital expansion plans, including its Line 3 project.

The company’s presentations to investors spotlight plans to spend \$22 billion on capital upgrades by 2020.⁹ Some of this capital spending would simply maintain the company’s existing suite of physical assets, but the

majority would support growth projects such as the Line 3 expansion.¹⁰ As of early August, Enbridge expected to complete six major projects representing \$13 billion in total capital spending by the end of 2019.¹¹ Line 3 represents the bulk of those outlays. Enbridge has already sunk \$3.7 billion into Line 3, and plans to spend an additional \$5.3 billion by the second half of next year: \$2.7 billion for the Canadian portion of the project, and an additional \$2.6 billion on the US portion at current exchange rates.

Table 1. Selected Financial Data, Enbridge 2012-2018 (Q2 TTM)

All figures in Can\$B

	2012	2013	2014	2015	2016	2017	2018, Q2-TTM
Basic Information							
Total Revenues	24.7	32.9	37.6	33.8	34.6	44.4	45.6
Total Costs excluding tax provision	23.5	32.3	35.5	33.8	32.1	43.8	46.0
Net Income	0.7	0.6	1.4	0.3	2.1	2.9	2.8
Long Term Debt	20.2	22.4	33.4	39.4	36.5	60.9	59.9
Free Cash Flow to Equity							
Net Cash from Operating Activities	2.9	3.3	2.5	4.6	5.2	6.6	9.4
Additions to Property/Plant/Equip.	(5.4)	(8.4)	(10.7)	(7.4)	(5.3)	(8.9)	(8.4)
Free Cash Flow (FCF)	(2.5)	(5.1)	(8.2)	(2.8)	(0.0)	(2.3)	1.0
Share Distributions							
Dividends	0.8	1.0	1.2	1.5	1.7	3.4	3.5
Net Stock Buybacks (Issuance)	(3.1)	(2.1)	(1.8)	(0.1)	(3.0)	(2.0)	(1.6)
Net Distributions	(2.3)	(1.0)	(0.6)	1.5	(1.3)	1.4	1.9
Cash End of Year Balance	1.8	0.8	1.3	0.7	1.5	0.5	0.6

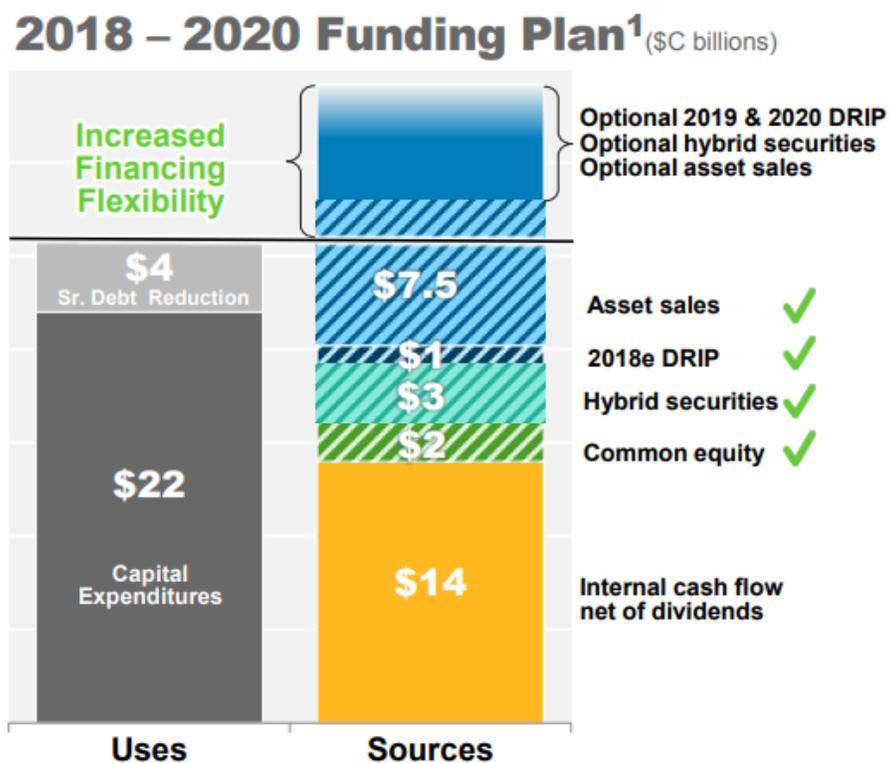
Source: Morningstar

In addition to its \$22 billion capital expenditure program, the company also plans to reduce long-term debt by \$4 billion through 2020. At the same time, the company still plans significant cash rewards to investors: in late 2017 Enbridge announced a 10 percent increase in its shareholder dividend, which totaled \$3.4 billion in 2017.

Put simply, Enbridge's business does not generate enough cash to fund all of its planned capital outlays. The company instead will gain access to capital through financial transactions—including asset sales and raising

money from debt and equity markets—arranged and facilitated by major investment banks. All told, these financial transactions will supply Enbridge with nearly as much cash for its capital expansion plans as its own business will. (See Figure 1.)

Figure 1. Enbridge Funding Plan, Sources and Uses



Source: Enbridge, Inc.¹²

ENBRIDGE RELIES ON CREDIT FACILITIES TO BACKSTOP OIL SPILL LIABILITY

Canada’s 2015 Pipeline Safety Act enshrined the principle of “absolute liability” for large pipeline companies.¹³ This doctrine holds pipeline companies responsible for at least \$1 billion in oil spill cleanup costs, no matter what the cause or who is legally at fault. Even earthquakes or accidents could force Enbridge to shoulder \$1 billion for cleanup.¹⁴ The law further requires companies to set aside cash or other financial resources to pay for a spill, and authorizes Canada’s National Energy Board (NEB) to

mandate specific types and amounts of financing that the company must keep on hand to cover its oil spill liability.

In March 2016, Enbridge filed its oil spill financial resource plan with NEB.¹⁵ That plan pledged four types of financial resources to pay for cleanup: liquid cash, available at a moment's notice; short-term "commercial paper" borrowings that the company could tap with one day's notice; draws on credit facilities provided by investment banks, which can be tapped within three days; and capital markets for debt and equity, which the company claims that it could access within two weeks.¹⁶

Just this past March, Enbridge updated its oil spill plan to reflect its finances as of the end of 2017.¹⁷ The plan reported only two sources that it could quickly tap in order to pay for cleanup costs: \$500 million in cash, and \$10 billion in liquidity provided by its revolving lines of credit, both directly and indirectly via commercial paper borrowings.¹⁸

Enbridge's cash on hand would cover at most half of the mandated \$1 billion cleanup liabilities—meaning that, in the event of a spill, the company would depend heavily on its lines of credit to provide short-term infusions of cash for cleanup. Although the NEB hasn't provided in-depth comments Enbridge's financial resource plan, it is virtually unthinkable that the agency would accept a plan that didn't guarantee the liquidity provided by the company's credit facilities. And if Enbridge lacked an acceptable financial resource plan, NEB would likely prohibit the company from building and operating Line 3.

CONCLUSION: INVESTMENT BANKS FUEL PIPELINE CONSTRUCTION

Enbridge's bankers are fueling the company's ambitions to build a tar sands pipeline. Banks give the company access to credit that the company relies on for liquidity for short-term capital outlays. Banks give Enbridge

access to capital, both by facilitating asset sales and by allowing the company to raise new money on both debt and equity markets. And banks give Enbridge the resources it needs to comply with financial mandates under Canada's oil spill liability statute. Without the direct financing and services provided by its bankers, Enbridge would have little choice but to abandon its plans to expand the Line 3 pipeline.

Endnotes:

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- ¹ Enbridge, Inc., “Line 3 Replacement Project Summary,” http://www.enbridge.com/~media/Enb/Documents/Projects/Line%203/ProjectHandouts/ENB_Line3_Public_Affairs_ProjectSummary.pdf.
- ² Enbridge, Inc., “Form 10-Q for the quarterly period ended June 30, 2018,” <https://www.enbridge.com/investment-center/reports-and-sec-filings/sec-filings/SEC%20Filing%20Details.aspx?filingId=12387834&docId=257297>.
- ³ Enbridge, Inc., “Q2 2018: Financial Results & Business Update,” http://www.enbridge.com/~media/Enb/Documents/Investor%20Relations/2018/2018_ENB_Q2_Presentation.pdf.
- ⁴ Enbridge, Inc., “Form 10-K for the fiscal year ended December 31, 2017”, <https://www.enbridge.com/investment-center/reports-and-sec-filings/sec-filings/SEC%20Filing%20Details.aspx?filingId=12065294&docId=255700> and “Form 10-Q for the quarterly period ended June 30, 2018”, <https://www.enbridge.com/investment-center/reports-and-sec-filings/sec-filings/SEC%20Filing%20Details.aspx?filingId=12387834&docId=257297>.
- ⁵ Enbridge, Inc., “Form 10-Q for the quarterly period ended June 30, 2018”, <https://www.enbridge.com/investment-center/reports-and-sec-filings/sec-filings/SEC%20Filing%20Details.aspx?filingId=12387834&docId=257297>
- ⁶ Enbridge, Inc., “Form 10-K for the fiscal year ended December 31, 2017”, <https://www.enbridge.com/investment-center/reports-and-sec-filings/sec-filings/SEC%20Filing%20Details.aspx?filingId=12065294&docId=255700>.
- ⁷ Enbridge, Inc., “Form 10-Q for the quarterly period ended June 30, 2018,” <https://www.enbridge.com/investment-center/reports-and-sec-filings/sec-filings/SEC%20Filing%20Details.aspx?filingId=12387834&docId=257297>.
- ⁸ Enbridge, Inc., “Form 10-K for the fiscal year ended December 31, 2017”, <https://www.enbridge.com/investment-center/reports-and-sec-filings/sec-filings/SEC%20Filing%20Details.aspx?filingId=12065294&docId=255700>.
- ⁹ See, e.g., Enbridge, Inc., “Corporate Finance,” https://www.enbridge.com/~media/Enb/Documents/Investor%20Relations/2017/2017_ENBDays_CorporateFinance.pdf.
- ¹⁰ Enbridge, Inc. “Our strategy,” <https://www.enbridge.com/about-us/our-strategy>.
- ¹¹ Enbridge, Inc., “Q2 2018: Financial Results & Business Update,” http://www.enbridge.com/~media/Enb/Documents/Investor%20Relations/2018/2018_ENB_Q2_Presentation.pdf. Note, however, that Enbridge recently sold its interest in the Hohe See wind farm off the German coast; see Enbridge, Inc., “NEWS RELEASE: Enbridge Completes Asset Sales for Approximately \$3.15 Billion in Cash Proceeds,” <https://www.enbridge.com/investment-center/reports-and-sec-filings/sec->

[filings/SEC%20Filing%20Details.aspx?filingId=12383948&docId=257227](https://www.enbridge.com/~media/Enb/Documents/Investor%20Relations/2017/2017_ENBDays_CorporateFinance.pdf). This sale could reduce the number and scale of 2019 capital projects to five projects totaling \$12 billion.

¹² See, e.g., Enbridge, Inc., “Corporate Finance,” https://www.enbridge.com/~media/Enb/Documents/Investor%20Relations/2017/2017_ENBDays_CorporateFinance.pdf.

¹³ Government of Canada, “Pipeline Safety Act, S.C. 2015, c. 21” http://laws-lois.justice.gc.ca/eng/annualstatutes/2015_21/page-1.html.

¹⁴ The Pipeline Safety Act also stipulates that pipeline companies face *unlimited liability* if they are found to be at fault for a spill, or if a spill results from the company’s negligence. Unlimited liability means that there is literally no cap on the amount of money the pipeline company would have to pay in the case of a serious spill. If courts find that a pipeline company has been at fault or negligent in a spill, the company could be on the hook for the full cost of cleanup, plus economic damages caused, plus any fines.

¹⁵ <https://apps.neb-one.gc.ca/REGDOCS/Item/View/2969861>

¹⁶ In the event of a catastrophic spill, it is not clear whether Enbridge could raise capital to pay for cleanup, as the company is already deeply indebted and produces minimal cash flow from operations.

¹⁷ Enbridge Pipelines Inc., “Update to Financial Resource Requirement Plan,” <https://apps.neb-one.gc.ca/REGDOCS/File/Download/3507981>.

¹⁸ In addition, the company pledged \$6.6 billion in accounts receivable and similar resources that the company could access within a few months. The updated plan did not pledge any insurance coverage to pay for oil spill cleanup on that grounds that proceeds from insurance claims—if they come at all—may take months or even years to secure.