

# Globe Investor<sup>BETA</sup>

## A pipeline so big it'll move the markets

TransCanada's Keystone pipeline will take nine million barrels of oil to fill, and be kept filled – which takes that oil off the market, and creates a short-term squeeze that should boost heavy oil prices

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The opening of a 3,456-kilometre-long TransCanada TRP-T pipeline is set to boost demand for heavy oil, an added bonus for an industry already enjoying surging crude prices.

It will take about three months to fill the Keystone line with oil, long before any of it is refined into finished products.

That process could add enough demand to briefly strengthen prices for heavy oil, the thicker crude produced in and around the Alberta oil sands by companies like Canadian Natural Resources Ltd., Baytex Energy Trust, Nexen Inc., Husky Energy Inc. and Imperial Oil Ltd.

The pipeline, the largest to enter North American service in years, will need about nine million barrels to fill, and will take about 6 per cent of Canada's heavy oil production in that time. It's enough that energy traders believe it will lift prices.

**"The removal of that much heavy oil in one shot" means that "heavy oil differentials will likely tighten,"** said Jared Layton, a crude oil specialist with Phoenix Energy Marketing Consultants Inc.

Heavy oil is a thicker form of crude that must undergo more refining steps than light oil before it can be separated into end products like gasoline and jet fuel. As a result, it generally sells at a discount, which is known as the "light-heavy differential."

Already this year, declines in heavy production from Venezuela and Mexico have created enough demand to substantially shrink that differential.

The light-heavy differential has dropped from an average of 22 per cent last year to as low as 10 per cent this year.

Once Keystone starts taking oil, "it could tighten it up" even further, said Stephen Fekete, managing consultant with international energy consultants Purvin & Gertz Inc.

"If you fill it with heavy, then there's a shortage of supply, if you will, for heavy."

Every \$1 contraction in the differential adds about \$340-million to the Canadian industry's top-line revenues, meaning any positive lift from Keystone would come as a helpful counterbalance to the loonie, whose rise has hurt the northern oil patch.

Oil marketers believe the Keystone line-fill, which they expect to draw about 100,000 barrels per day, will begin in November. TransCanada has been tight-lipped on specifics.

"We expect to commence line fill in Q4 2009, and in-service Q1 2010," said company spokesman Terry Cunha.

He declined to comment on the mix of oil that will be used to fill Keystone, saying that's "up to the shippers to determine." But marketers believe about 70 per cent of the line-fill will be in the form of heavy crude. That represents about 6 per cent of Canada's heavy production, enough that it could drive prices to a point where heavy "will be closer in line with light sweet oil," Mr. Layton said.

The oil used to fill Keystone will flow to refineries in Wood River and Patoka, Ill., and Cushing, Okla., but the nine million barrels is considered "lost" since the pipeline will continue to keep that much oil out of the market until it is taken out of service decades from now.

The pipeline's effects on heavy pricing will, however, be determined in part by what happens to U.S. refiners.

"If they go into maintenance turnarounds" – which would decrease heavy oil demand – "it could balance itself out," Mr. Fekete said.

Still, the industry has undergone a dramatic shift in the past year, on the expectation that heavy oil differentials will remain slim for well into the future. Suncor Energy Inc. and EnCana Corp. have both discussed plans to go "bitumen long" – selling heavy oil rather than building expensive plants to refine, or "upgrade," it into light oil. Imperial Oil, similarly, plans to sell heavy oil, rather than refined or synthetic crude, from the first 110,000 barrel-per-day phase of its Kearl oil sands mine.

TransCanada has proposed an expansion to Keystone, called Keystone XL, which would carry oil to the U.S. Gulf Coast. Keystone XL would open up enough additional demand for Canadian heavy crude that TransCanada says it could boost revenues by \$3.4-billion in 2013, the year it's expected to be in full operation. Enbridge Inc. has disputed that number, and in recent weeks has attempted to persuade the National Energy Board to stop the Keystone XL project.

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