The Straits of Mackinac Pipelines: A Market Perspective

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Presented by

Ken Winter
Dr. James Hill

Accompanied by:

Benjamin Barker
Macey Miller
Christopher Bonnen

Thank you for this opportunity to discuss an issue of concern to all of Michigan: the protection of our priceless Great Lakes.

We come here today with a proposal to address concerns about a potential oil spill from two Line 5 pipelines which run under the Straits of Mackinac. Proposals ranging from enhanced technology, maintenance and surveillance to shutting down the pipeline altogether have been proposed. However, what we present to you today is a different approach, which relies less on government intervention and controls and more on market forces, legal agreements, and shareholder interests to guide Great Lakes protection efforts.

Let me begin by saying our proposal has its origins in Central Michigan University student research on the issue of pipeline safety. Ken Winter, whom you may know was the Editor and Publisher of the Petoskey News-Review, chose as his CMU Master of Arts degree research to explore the Straits pipeline issue. His paper and the research he conducted led to further exploration of alternative options for pipeline safety that did not involve traditional command and control government intervention.

We later added to our team two undergraduate CMU students, Christopher Bonnen and Macey Miller, along with Ben Barker, a CMU graduate student, and developed a paper which we presented at the Michigan Political Science Association annual conference at Oakland University late last year. What followed from this paper was development of an article published in many news outlets including Dome Magazine, which you may have read, and a radio interview about our Straits pipeline proposal in December on Michigan Public Radio.

So our presentation is really a CMU student researched and generated proposal that we offer for your consideration. A copy of our conference proposal has been provided to you for more details, but let me highlight what we are proposing.

First, the problem. We have a 60+-year-old set of petroleum pipelines lying under the Straits of Mackinac which, if damaged or otherwise compromised, could create an environmental nightmare for the region.

The question then arises: should there be cause for concern since there have been no known leaks under the Straits for all of this time? The pipeline spill in Kalamazoo in 2010 involving a pipeline of the same age and owned by the same company is the canary in the mine that says the answer to that question is yes. Recent pipeline petroleum spills and leaks just in the last month are further evidence that the possibility of a Straits spill must be taken seriously.

If there were such a spill, could it be quickly and easily contained? Enbridge, the owner of the pipeline, says it could because of their sophisticated and state of the art detection and control systems, which I am sure they emphasized to you previously. However, Enbridge gave the same assurances to Congress not long before the Kalamazoo pipeline spill, which resulted in one of the worst inland oil spills in the nation's history.

Human error, technology failure, and extreme weather conditions complicate the ability of anyone to argue that a spill in the Straits could be quickly controlled. Add to the fact that the U.S. Coast Guard has indicated it does not have the capability in the Great Lakes to address a large-scale spill in the Straits area and the stage is set for a potential major environmental spill unless something changes. A status quo solution is not an option.

What we propose in this era of limited government resources and what Professors Viscusi and Zeckhauser (discussed in our conference paper) call the fat-tailed distributional losses associated with major environmental spills, is that we use market forces and the legally binding agreements to guide corporate decisions on the use, maintenance, and operation of pipelines in sensitive areas like the Straits of Mackinac.

Clearly the State of Michigan and the U.S. Coast Guard lack either the necessary resources or the technical and logistical expertise to comprehensively respond to a major oil spill in the Straits area, so we must concentrate our attention first and foremost on prevention.

The party in the best position to handle prevention and also ensure pipeline safety is the owner and operator of the pipeline, as it has the necessary information and expertise to make a wise and prudent decision about pipeline operation and control. What we believe is necessary to allow the market forces and incentives to operate effectively in addressing the Straits pipeline situation is to fill the information gap that exists at this time for this type of spill scenario.

Let us begin with this market information gap. The University of Michigan conducted a simulation of an oil spill along the lines of the Kalamazoo River spill of which I am sure you are aware. The simulation, because of the water currents and the sensitive areas around the Straits area, portrayed a spill that could span from northern Lake Michigan and Beaver Island to well beyond our beloved Mackinac Island in Lake Huron, with Mackinac Island being severely impacted no matter where the breach in the pipeline occurred.

We thus have an idea of the geographical breadth of a major oil spill. However, even this simulation may underestimate its size depending upon the weather conditions (winter?), the ability to detect and respond in a timely manner (technological failure or human error), and the size and cause of the breach (sabotage or marine accident). Human error played a big role in the Kalamazoo River spill and could also play a role here, despite assurances by Enbridge that a worse case scenario would be an 8-minute response time.

However, even assuming the simulation is a worse-case scenario, the problem also becomes determining the cost of such a spill both economically and environmentally. For unless a reasonable estimate of clean-up costs can be calculated, it is difficult for corporate decision-makers to make a risk benefit assessment for the maintenance or even the continuation of the pipeline operation.

If corporate pipeline owners underestimate the extent of a spill, they may unwittingly continue an economically inefficient activity based upon inadequate information, while at the same time putting the corporation and its shareholders in a precarious financial situation.

Thus our **first recommendation** that the state fund an economic and environmental assessment of the consequences of a major oil spill in the Straits area. This study should be conducted by natural resource economists and other social scientists with expertise in this assessment process and who have no ties to corporate pipeline owners or organizations with a vested interest in the outcome of the study.

With the creation of an expert and unbiased environmental and economic assessment report, pipeline owners such as Enbridge and their shareholders can more completely assess the value of Line 5 in order to calculate the financial advantage of continuing to operate and maintain this line.

If the assessment costs of a projected major spill are as high as some experts predict, even assuming that the risk is low, both corporate officials and shareholders will at least be able to make a more rational decision of whether or not to operate Line 5 without being blindsided by the costs of a potential future spill.

And we want to reiterate that despite the corporation using the best technology and maintenance strategies, it is still possible that human error, technology failure, the forces of nature, marine accidents, or even sabotage/terrorism could make such a remote possibility of a major spill a nightmare reality.

This state sponsored assessment could also be used to address our second concern: the need to negotiate a new and legally binding agreement with Enbridge about the insurance or surety requirements needed to protect the state's taxpayers from bearing the clean-up costs if Enbridge is unable or unwilling to foot all of the direct and indirect costs of such a spill. Since the initial easement the state granted Enbridge sets a minimum requirement of one million dollars in liability coverage, the state should negotiate a more realistic sum based on the projections of this assessment report.

Planning for a possible oil spill and ensuring that sufficient clean-up costs will be available leads to our **second recommendation**: that Enbridge sign a legally binding agreement to pay for all direct or indirect costs resulting from a spill from the pipelines and be solely responsible for all upfront payments. They are obligated already by virtue of the terms of their 1950's state-granted Straits easement and subsequent negotiations with the state, but past experiences ranging from EXXON Valdez to the BP spill in the Gulf indicate that long legal delays in seeking contributions from other potential defendants slow both the clean-up and the compensation processes.

Recognizing that such a spill should be characterized as an ultra-hazardous activity in a more contemporary legal agreement and having Enbridge agree to be the principal responsible for all upfront clean-up and compensation costs would ease the burden on the state as well as those exposed to the pollution. Such an agreement would not bar Enbridge from seeking contributions from other responsible parties, but rather would require Enbridge first to pay all claims and avoid lengthy litigation liability lawsuit delays.

If Enbridge balks at such an agreement, then the state would have to recognize that it too may have a financial threat on its hands and would be obligated to prepare for that contingency as well.

This leads to our **third recommendation** about ensuring Enbridge is financially able to pay for the costs of a major spill at the straits. Our concern comes on the heels of a November 3, 2014 statement by the President of Enbridge Energy Partners that it would not to be cost effective to maintain more than $700 million in aggregate environmental damage insurance. Since the Kalamazoo spill will exceed $1 billion, Enbridge will have to draw upon its corporate assets and profits to fill in that gap between its current insurance.

With the rise in the frequency of pipeline spills in its aging pipelines, Enbridge could be exposed to financial claims from other parts of its huge oil pipeline network that could, if another major spill occurred in close time proximity to a Straits spill, severely threaten its ability to handle both costs. Thus, Enbridge should be required to demonstrate its financial ability to handle more than just the projected costs of a single straits spill.

If they cannot so demonstrate this financial ability, Enbridge should be required to establish a surety or perhaps a contingency fund (funded by annual corporate payments) sufficient to handle the possibility of more than one major spill in a short time period.

We think that if a contribution fund is selected by Enbridge as the best way to address the potential financial liability issue, the funds should be held and administered by a state entity similar in structure to the Natural Resources Trust Fund, and thus be readily available to tap in case of an emergency and not subject to corporate delays or claimants from other spills.

The interest from the fund could be used by the state to supplement Enbridge efforts and fund local emergency preparedness activities aimed at protecting our wildlife and natural resources in the region from the consequences of a potential Straits spill.

In the end, a full assessment of the costs of a major spill and a legally binding agreement that the pipeline owner will be solely and strictly liable for any pipeline spill damages should give both Enbridge and it shareholders a realistic assessment of the costs and benefits of continued operation of Line 5.

Enbridge shareholders need only look at the recent $250 million write off that CMS Land Company shareholders took due to environmental contamination in nearby Petoskey to realize that environmental claims have severe consequences on corporate dividends and profitability.

If calculating the risk times the cost of a major spill changes the corporate determination of Line 5 from an asset to a liability, Enbridge can terminate the line to protect the interests of its shareholders, with the state and the public spared the risk of a future major spill and its economic and environmental consequences.

On the other hand, if Enbridge believes that Line 5 is still worth the risk that a potential spill may create, the legal and economic liability aspects of a clean-up program will be in place to ensure that state and the straits area residents will not be left bearing the financial burden that such a spill would create.

Whatever the final decision, we believe setting up this legal liability and financial compensation framework prior to any future spill makes good political sense as well.

Making such determinations now and not during the politically charged environment of an actual major spill will avoid an atmosphere of finger pointing where fear and anger will overpower rationality.

In short, we propose a non-regulatory solution to this threat which we believe will best serve the interests of both the people of Michigan and the shareholders of Enbridge.