

## Line 3 Delay Further Complicates Western Canadian Oil's Near-Term Takeaway Outlook

- On Friday evening Enbridge announced that it is revising the expected in-service date of its 370 kbpd Line 3 Replacement Pipeline to the second half of 2020, a delay of 6–12 months versus our prior expectation that the pipeline entered service at the end of 2019.
- Absent Line 3, some combination of yet-more oil-by-rail capacity and continued production discipline will be required to balance the Western Canadian oil market through 2020 and prevent discounts from experiencing a replay of last year's blowout sale on Canadian crude.
- Line 3's delay puts further pressure on the WCS differential to widen to at least oil-by-rail breakeven levels of \$15/bbl under WTI, with additional widening into the \$15–20/bbl range likely needed to incentivize the pace of oil-by-rail capacity growth in the private sector required to clear the market through mid-2020.

On Friday evening Enbridge announced that it is revising the expected in-service date of its 370 kbpd Line 3 Replacement (L3R) Pipeline to the second half of 2020, representing a 6–12-month delay from the end-2019 startup we had assumed prior to the company's announcement. The revised timeline comes after Minnesota regulators informed the company that necessary permitting will not be completed until November 2019 and follow-on Federal approvals are expected to require up to two additional months.

Absent the expanded replacement pipeline, some combination of yet-more oil-by-rail capacity and continued production discipline—whether voluntary, due to low pricing, or by government mandate—will be required to balance the Western Canadian oil market through 2020 (chart 1) and prevent discounts from experiencing a replay of last year's blowout sale on Canadian crude. And while a prolonging of the Alberta government's curtailment program (currently set to expire at the end of the year) could serve as a useful pressure value into mid-2020, challenges stemming from the policy's rollout have—paradoxically and temporarily—overtightened near-term discounts to a level that no longer supports profitable oil-by-rail transportation (chart 2).

In light of the L3R delay, it is more important than ever for Canadian oil differentials to begin sending the correct price signal—meaning a wider spread that supports rail economics—to would-be investors in fresh oil-by-rail capacity given that we're going to need many more oil trains than expected rolling down the track next year. Current heavy oil strength relative to lighter grades in the Gulf of Mexico could mean that rail theoretically breaks even at slightly less than \$15/bbl, but a discount level of \$15–20/bbl is still likely required to provide sufficient incentive for the private sector to grow additional oil-by-rail capacity. We expect that at full, uncurtailed production capacity the call on oil-by-rail services in Western Canada will surpass 500–600 kbpd by mid-2020 before L3R can enter service.

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Chart 1

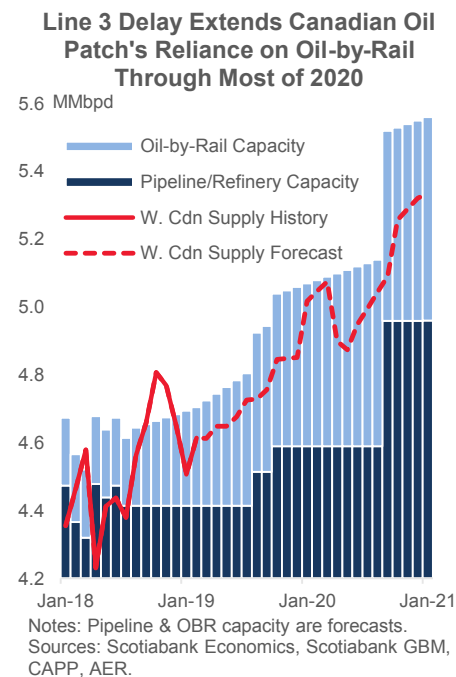
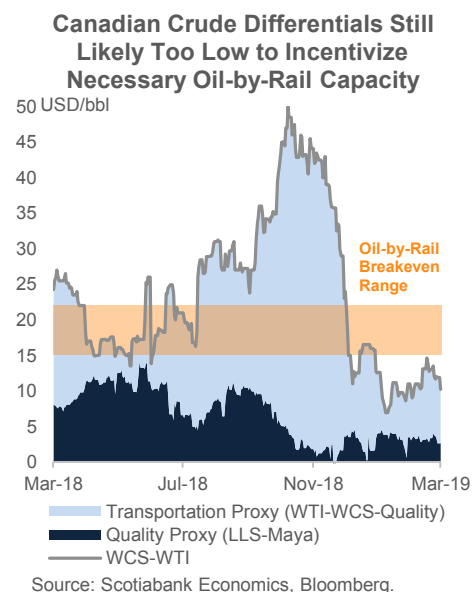


Chart 2



**Line 3's name is fitting given that it joins Keystone XL (KXL) and the Trans Mountain Expansion Project (TMEP) as the third such export pipeline currently caught in the limbo of regulatory/court-ordered delays**, though L3R's delay is particularly painful given that the project was previously seen as a relatively solid bet for the end of the year. While not as large as the other major projects on the drawing board—L3R's export capacity of 370 kbpd is less than TMEP's 590 kbpd and KXL's 830 kbpd—L3R was subject to what seemed to be a much firmer schedule, and it was conveniently meant to arrive at the midpoint between where we stand today and a future where either KXL or TMEP have solved the rest of Western Canada's takeaway bottleneck issue.

The Line 3 replacement pipeline is a 1,660 km line from Hardisty, Alberta (where WCS is priced) to Superior, Wisconsin and is part of Enbridge's massive Mainline system, which provides as much as two-thirds of the Canadian oil sector's export capacity. The project is a replacement of the existing Line 3 pipeline, which is currently operating at roughly half the aging pipe's nameplate capacity of 760 kbpd—the replacement will restore the pipeline to its full nameplate capacity, an effective increase of 370 kbpd.

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