

ExxonMobil stands to benefit from the U.S. State Department's approval of the Keystone XL pipeline, and consequently Secretary of State Rex Tillerson should recuse himself from the permitting decision.

### Summary Findings

- Secretary of State Rex Tillerson should recuse himself from the decision to approve or reject the Keystone XL pipeline.
- Tillerson's recent employer, ExxonMobil, is heavily invested in high-cost, environmentally destructive tar sands production that would be served by the pipeline.
- Canadian tar sands' production is projected to be limited by a lack of pipeline capacity. It trades at a significant discount relative to WTI crude when pipeline capacity is constrained -- a problem which Keystone XL was proposed to fix.
- Approval of Keystone XL would increase the value of tar sands oil sold on global markets, and hence the value of ExxonMobil's tar sands assets.
- As such, ExxonMobil stands to materially benefit from the approval of the pipeline granted by its former CEO Tillerson.
- By handing over U.S. foreign policy to an oil industry executive, Trump has created fertile ground for extensive conflicts of interest.
- Recusal in this case is keeping with the spirit of government ethics laws and Mr. Tillerson's own stated ethics commitments.

### Trump Order Calls For Rapid Approval of Keystone XL

Upon taking office one of President Trump's first actions was to revive the controversial Keystone XL pipeline, which would increase the connectivity between Canada's tar sands production and U.S. refineries.

In a January 24, 2017 Presidential Memorandum he directed the Secretary of State to "reach a final permitting determination" within 60 days of TransCanada's renewed application.<sup>1</sup> News reports indicated that TransCanada

<sup>1</sup> Presidential Memorandum Regarding Construction of the Keystone XL Pipeline. January 24, 2017. [\[link\]](#)

submitted a new application shortly thereafter,<sup>2</sup> notice of which was published in the Federal Register on February 10.<sup>3</sup> The 60 day period could expire as soon as March 27.

Former ExxonMobil CEO Rex Tillerson was narrowly approved by the Senate to serve as Secretary of State, giving him the task of approving TransCanada's permit consistent with "the national interest" and all applicable laws.



Figure 1: Keystone XL route map (Source: TransCanada)

### Canadian Tar Sands Are Environmentally Destructive and Economically Questionable

Canadian tar sands were widely touted as a major asset for international oil companies squeezed by declining production from existing oil fields and a lack of access to new discoveries. However, the tar sands have proven to be both highly controversial and economically questionable.

<sup>2</sup> Brady, J. 2017. TransCanada Submits New Application To Build Keystone XL Pipeline. *NPR*, January 26. [\[link\]](#)

<sup>3</sup> <https://keystonepipeline-xl.state.gov/>

The mining and processing of tar sands is environmentally destructive and highly carbon-intensive when compared to conventional crude oil. When first proposed in 2008, the Keystone XL pipeline provoked widespread opposition both in Canada and the U.S. eventually leading to President Obama's 2015 decision to reject TransCanada's permit application.

Over 120 First Nations and Tribes on both sides of the Canadian/U.S. border have signed a treaty stating their explicit opposition to tar sands pipelines, trains and tankers through their territorial lands and waters. The Treaty is an expression of Indigenous Law and opposes new, converted or expanded pipeline infrastructure projects in Canada and the U.S. that would facilitate the expansion of the tar sands -- including Kinder Morgan's Trans Mountain, TransCanada's Energy East and Keystone XL, and Enbridge's Northern Gateway and Line 3 pipelines.<sup>4</sup>

Analysts have criticized tar sands projects as highly capital-intensive but yielding low returns.<sup>5</sup> President Trump's proposed Border Adjustment Tax could further complicate the economics of these projects. A study published in the journal *Nature* found that expanded tar sands production was largely incompatible with limiting global warming to 2 degrees C. Under such scenarios, open-pit bitumen mining would end after 2020, and 85% of Canadian bitumen reserves would be "unburnable."<sup>6</sup>

All told, tar sands are among the oil assets most likely to be "stranded" by stagnant oil demand, persistent low prices, lack of infrastructure, or concerted global action to limit carbon emissions. Since 2014, 42 tar sands projects have been put on hold, delayed or cancelled.<sup>7</sup>

### **ExxonMobil Has Significant Production in the Canadian Tar Sands**

With its Canadian subsidiary Imperial Oil, ExxonMobil is heavily invested in Canadian tar sands, through its Syncrude, Kearn and Cold Lake projects in northern

Alberta.<sup>8</sup> The expansion of its Kearn Project was completed in 2015 and now has a production goal of 220,000 barrels of crude oil per day.

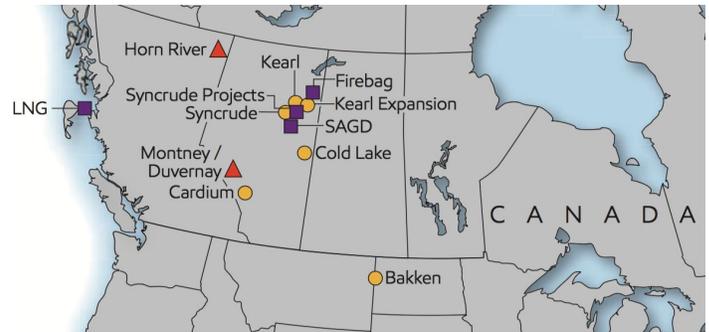


Figure 2: ExxonMobil's Canadian tar sands operations. (Source: ExxonMobil Financial & Operating Review 2015)

The question of whether ExxonMobil was properly valuing these assets drew attention from state attorneys general and the U.S. Securities and Exchange Commission. Just this month, ExxonMobil bowed to pressure and "de-booked" 3.5 billion barrels of previously proven oil reserves at the Kearn project, admitting that the oil was uneconomic to produce at today's prices.<sup>9</sup> Before the write-down, tar sands represented 35% of Exxon's liquids reserves.<sup>10</sup> ExxonMobil stated that production at Kearn will continue despite the reserve adjustment.

### **Canadian Oil Sands Production Is Limited By A Lack of Pipeline Capacity**

Over the past year Western Canadian Select (WCS, or tar sands) oil has traded about \$14/barrel lower than West Texas Intermediate (WTI) crude oil prices<sup>11</sup> and has traded by more than \$30/barrel lower in the past. This discount is evidence of competition from lighter U.S. crude oil, as well as an ongoing pipeline bottleneck which makes it difficult and more expensive for tar sands producers to transport their product to refineries and the global market.

A 2017 report by the Canadian Energy Research Institute (CERI) noted that "constraints in pipeline capacity and the lack of access to existing and new demand centers have deepened the discount between WTI and Western Canadian crudes" thereby giving "Canadian producers a financial incentive to expand market access in the United

<sup>4</sup> <http://www.treatyalliance.org/>

<sup>5</sup> CarbonTracker & Energy Transition Advisors. 2014. *Responding to Exxon-- A Strategic Perspective*. [\[link\]](#)

<sup>6</sup> McGlade & Ekins. 2015. *Nature*. [\[link\]](#)

<sup>7</sup> Greenpeace & Oil Change International. 2016. *Flawed Fundamentals: Shell's and BP's Stalled Tar Sands Ambitions*. [\[link\]](#)

<sup>8</sup> ExxonMobil. Canadian Oil Sands. [\[link\]](#)

<sup>9</sup> Kusnetz, N. 2017. Exxon Relents, Wipes Oil Sands Reserves From Its Books. *Inside Climate News*, February 23. [\[link\]](#)

<sup>10</sup> Kusnetz, N. 2016. Exxon's Big Bet on Oil Sands a Heavy Weight To Carry. *Inside Climate News*, September 30. [\[link\]](#)

<sup>11</sup> <http://economicdashboard.alberta.ca/OilPrice>

States, Canada, and beyond.”<sup>12</sup> The report also noted that refineries on the U.S. Gulf Coast were the “first target for market access” for Canadian producers due to their considerable heavy oil processing capacity.

The Canadian Chamber of Commerce estimated that this tar sands price discount was costing producers C\$50 million per day.<sup>13</sup> Future construction of more pipeline capacity would add value to the tar sands production and bring prices closer to WTI levels. This could create a windfall in revenue for all tar sands producers -- including ExxonMobil and Imperial Oil.

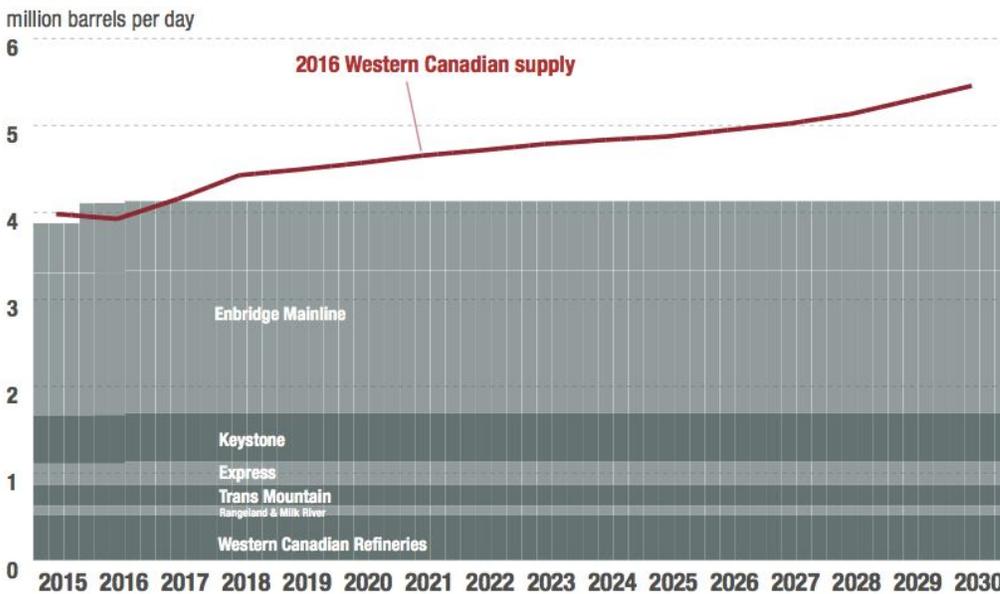


Figure 3: Western Canadian supply forecast and pipeline capacity. (Source: CAPP 2016)

A 2016 report by the Canadian Association of Petroleum Producers (CAPP) showed that pipeline capacity issues will only grow worse over time. Their report forecast a growth of 1.5 million barrels per day in Canadian crude oil production by 2030, and yet the existing pipeline system is already at capacity.<sup>14</sup>

Keystone XL would add a proposed 830,000 barrels per day of capacity to the system. Recently the Canadian government approved two additional pipeline projects that would similarly ease the tar sands bottleneck -- Kinder

<sup>12</sup> CERI. 2017. *Canadian Oil Sands Supply Costs and Development Projects (2016-2036)*. [\[link\]](#)

<sup>13</sup> Canadian Chamber of Commerce. *\$50 Million A Day*. [\[link\]](#)

<sup>14</sup> CAPP. 2016. *Crude Oil: Forecast, Markets and Transportation*. [\[link\]](#)

Morgan’s Trans Mountain line and Enbridge’s Line 3 expansion. If all three pipelines are built, the WCS discount could shrink to \$5-\$7 per barrel.<sup>15</sup>

### ExxonMobil Would Materially Benefit from Keystone XL Approval

Should the Keystone XL pipeline be completed, ExxonMobil’s tar sands production would be well-placed to take advantage. ExxonMobil states the Kearn project is “well connected to the substantial North American pipeline system.”<sup>16</sup>

It is not known if ExxonMobil or Imperial Oil have existing contracts or agreements with TransCanada to ship oil via Keystone XL. However, ExxonMobil would clearly benefit from any reduction in the WCS discount should Keystone XL be built, even if it does not directly contract with the pipeline for transportation services. If approved, the benefit to ExxonMobil could be measured in the tens to hundreds of millions of dollars each year.

The CAPP report also notes that two expansion phases for the Kearn project have been approved, but are

not yet currently operating. Kearn Phase 3 would bring 80,000 barrels per day online and Kearn Phase 4 Debottleneck would add 45,000 barrels per day.<sup>17</sup> Overall, Imperial plans to double their tar sands production to 600,000 b/d by 2020. ExxonMobil also has refineries in the U.S. Gulf Coast region that could benefit from the Keystone XL approval.

During the debate around the initial Keystone XL approval, Rex Tillerson and ExxonMobil both consistently advocated for the approval of the pipeline in speeches,<sup>18</sup> blog posts,<sup>19</sup> and reports.<sup>20</sup> Independent energy analysts

<sup>15</sup> Tuttle, R. 2017. *Canada Faces Era of Pipeline Abundance After Keystone Move*. *Bloomberg*, January 25. [\[link\]](#)

<sup>16</sup> ExxonMobil. *Kearn*. [\[link\]](#)

<sup>17</sup> CAPP 2016. Appendix A.2

<sup>18</sup> Tillerson, R. 2015. *Building Energy Policies Equal to the Technological Moment*. [\[link\]](#)

<sup>19</sup> Cohen, K. 2014. *Keystone XL and the national interest*. [\[link\]](#)

have also found that ExxonMobil would benefit from the Keystone XL approval.<sup>21</sup>

### **Trump's Ethics Rules Do Not Go Far Enough**

Upon accepting President Trump's nomination to serve as Secretary of State, Tillerson resigned as ExxonMobil CEO and negotiated a divestment of his pension and deferred stock compensation amounting to \$180 million.

Tillerson's ethics agreement states: "For a period of one year after my resignation from ExxonMobil, I will not participate personally and substantially in any particular matter involving specific parties in which I know that ExxonMobil is a party or represents a party."<sup>22</sup> Existing ethics guidelines put in place by President Obama<sup>23</sup> and continued by President Trump require appointees to recuse themselves from any decisions regarding their former employer for a period of two years.<sup>24</sup>

Tillerson further pledges to "recuse myself on a case-by-case basis" from any particular matter in which a "reasonable person" would question his impartiality. Tillerson also states that he will fully divest his stock in ExxonMobil within 90 days of his confirmation and will not participate in "any particular matter that to my knowledge has a direct and predictable effect on the financial interests of ExxonMobil" until he has divested or received a waiver. This raises the question of whether Tillerson will have divested himself within the 60 day timeframe given for the Keystone XL decision.

In sworn testimony before the Senate, Tillerson reiterated his commitment to recuse himself from "any matters that might come before the State Department that deal directly and specifically with ExxonMobil"<sup>25</sup> but also stated that he

"wouldn't expect to recuse himself from issues concerning the oil and gas industry generally."<sup>26</sup>

The phrase "particular matter involving specific parties" has been interpreted to refer to the "legal rights" of the parties.<sup>27</sup> In this case, ExxonMobil might not be considered a "specific party" to the Keystone XL decision because it would affect the legal rights of TransCanada, not ExxonMobil. Tillerson could choose to interpret this phrase in an artificially narrow manner that might allow his participation -- but any reasonable person would clearly question his impartiality in that situation.

A governmental decision that directly and predictably enriches a former employer is precisely the sort of situation that should warrant recusal. To ignore the close connection between ExxonMobil's tar sands operations and the Keystone XL pipeline would be a gross violation of the spirit of government ethics laws and would lend the strong appearance of impartiality. Recusal is the only possible course consistent with Rex Tillerson's ethics commitments.

The global scope of ExxonMobil's operations and the broad remit of the U.S. Department of State indicate that conflicts such as these will be the norm during Tillerson's tenure. Looming decisions regarding the Paris climate change accord and Russian sanctions were discussed during Tillerson's confirmation hearings and raise many of the same recusal questions.

These widespread and troubling conflicts only highlight the perils of appointing an oil industry executive to be the public face of U.S. diplomacy.

### **For Further Information**

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<sup>20</sup> Imperial Oil & ExxonMobil. 2012. *Canada's Oil Sands: Responsible Development, Innovation, and Opportunity*. [\[link\]](#)

<sup>21</sup> Eight Companies That Will Benefit from Keystone Pipeline Approval. *MarketWatch*. 2013. [\[link\]](#)

<sup>22</sup> Tillerson, R. 2017. Letter to Katherine D. McManus, Re: Ethics Undertakings. [\[link\]](#)

<sup>23</sup> CREW. 2017. The Trump Ethics Pledge: Explained. [\[link\]](#)

<sup>24</sup> Executive Order: Ethics Commitments By Executive Branch Appointees. January 28, 2017. [\[link\]](#)

<sup>25</sup> Shabad, R. 2017. Rex Tillerson grilled on ExxonMobil conflicts, Russia sanctions, climate change at confirmation. *CBS News*, January 11. [\[link\]](#)

<sup>26</sup> Wadhams, N. 2017. Tillerson Vow to Keep Away From Exxon Runs Into World of Oil. *Bloomberg*, February 1. [\[link\]](#)

<sup>27</sup> Cusick, R.I. Memorandum dated October 4, 2006. Office of Government Ethics. [\[link\]](#)