Energy Transfer LP: Environmental Justice Risks in 2022

August 25, 2016, Dakota Access Pipeline.

Summary

In 2022, a client requested that Responsible Alpha develop 12 case studies and the underlying business, economic, and investment analysis used by 123 environmental, indigenous rights, and racial justice organizations in their letter to the Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission on the proposed rule "The Enhancement and Standardization of Climate-Related Disclosures for Investors."

Responsible Alpha's analysis suggests investors need companies to disclose their climate-related financial risks and strategies for managing them, their greenhouse gas (GHG) emissions, their plans to remain viable or thrive in a low-carbon future economy, and their financial resilience across these dimensions, as it relates to and is in support of the communities where these companies exist, and their impacts are often felt and underreported. To further buttress and support this analysis, Responsible Alpha wrote 12 business cases of which the case below on Energy Transfer LP is one.

Dakota Access Pipeline (DAPL) is a joint venture led by Energy Transfer LP, $36 billion market capitalization, $49 billion in fixed income across 70 corporate bonds, 9 loans, and 3 preferreds, 12,500 employees, with ownership stakes by MarEn Bakken Company (a joint venture between Enbridge and Marathon Petroleum Corporation), and Phillips. Energy Transfer was formed in 1996 and became a publicly traded partnership in 2004.

Ownership is:

- Energy Transfer LP: 36.40% (ET US Equity, FIGI BBG000BM2FL9, ISIN US29273V1008)
- Enbridge: 27.60% (ENB US Equity, FIGI BBG000K5M1S8, ISIN CA29250N1050)
- Phillips 66: 25.00% (PSX US Equity, FIGI BBG00286S4N9, ISIN US7185461040)
- Marathon Petroleum Corporation: 9.19% (MPC US Equity, FIGI BBG001DCCGR8, ISIN US56585A1025)

DAPL originates near Stanley, North Dakota, and traverses North Dakota, South Dakota and Iowa before terminating at the Patoka Oil Terminal near the towns of Patoka and Vernon in Illinois. The DAPL has a long history of resistance from communities impacted by the pipeline, including indigenous Native American nations and communities (see Timeline, Annex 1).

The Standing Rock Sioux First Nation communicated their opposition to DAPL for three years while Energy Transfer would not consult with them in any meaningful manner. The Standing Rock Sioux First Nation were concerned about impacts of DAPL on their indigenous lands and the company's failure to respect human rights. There also existing a lack of robust consultation and community between the Tribe and the U.S. Army Corps of Engineers (USACE). DAPL risks more than 800,000 acres of Standing Rock's entrusted land being negatively impacted by a leak or spill. If this were to occur, this would damage the waters the first nation relies up relies upon for both drinking and spiritual purposes.

Thousands of pipeline protesters protested the project, with the news about the ongoing protests frequently discussed by elite U.S. media. Despite the mass opposition to the Pipeline, as of August 2021, DAPL transports 750,000 barrels of oil daily, which is 180,000 more than previous limits. Energy Transfer is in the process of expanding the pipeline to so that 1.1 million barrels of oil will flow through the pipeline each day.

The expansion approval has been heavily litigated. It is now back in the hands of an administrative law judge – or ALJ – and will undergo a series of steps in 2022, with a proposed order from the ALJ due August 11, 2022, that may result in (re) approval of the expansion.

DAPL is 1,170 miles from North Dakota to Illinois, where joins with a second est. 774 mile pipeline to Texas.

Conservatively, assuming a 95% capacity utilization, 1.1 million barrels per day (under the expansion scenario), and including total lifecycle emissions from producing, transporting, processing, and burning the products derived from the oil would amount to 200+ million metric tons of CO_2e per year. These emissions are equivalent to 60 typical U.S. coal plants.

The Pipeline

"The Dakota Access and Energy Transfer Crude Oil pipelines are collectively referred to as the "Bakken Pipeline." The Bakken Pipeline is a 1,915-mile pipeline that transports domestically produced crude oil from the Bakken/Three Forks production areas in North Dakota to a storage and terminal hub outside of Patoka, Illinois, or to gulf coast connections including our crude terminal in Nederland, Texas. In the third quarter 2021, completed that Bakken Optimization project, which increased capacity from 570 MBbls/d to approximately 750 MBbls/d.

The pipeline transports light, sweet crude oil from North Dakota to major refining markets in the Midwest and Gulf Coast regions.

The Dakota Access Pipeline consists of approximately 1,170 miles of 12, 20, 24 and 30-inch diameter pipeline traversing North Dakota, South Dakota, Iowa and Illinois. Crude oil transported on the Dakota Access Pipeline originates at six terminal locations in the North Dakota counties of Mountrail, Williams and McKenzie. The pipeline delivers the crude oil to a hub outside of Patoka, Illinois where it can be delivered to the Energy Transfer Crude Oil Pipeline for delivery to the Gulf Coast or can be transported via other pipelines to refining markets throughout the Midwest.

The Energy Transfer Crude Oil Pipeline went into service on June 1, 2017 and consists of approximately 675 miles of mostly 30-inch converted natural gas pipeline and 70 miles of new 30-inch pipeline from Patoka, Illinois to Nederland, Texas, where the crude oil can be refined or further transported to additional refining markets."

Company Overview

Energy Transfer LP transfers natural gas and other energy resources through its massive network of US-based pipelines. The primary activities in which the company is engaged, which are in the US and Canada, and the operating subsidiaries through which it conducts those activities are natural gas midstream and intrastate transportation and storage, crude oil, NGL and refined products transportation, terminaling services and acquisition and marketing activities, as well as NGL storage and fractionation services. In addition, Energy Transfer own investments in other businesses, including Sunoco LP and USAC. Energy Transfer was formed in 1996 and became a publicly traded partnership in 2004.

Energy Transfer's revenue streams are its crude oil transportation and services; investment in Sunoco LP; the transportation of NGL and refined products; midstream services; interstate transportation and storage; intrastate transportation and storage; and its investment in USAC.

Energy Transfer's crude oil transportation and services provides transportation, terminaling and acquisition and marketing services to crude oil markets throughout the southwest, Midwest and northeastern US. The company owns and operates more than 10,850 miles of trunk and gathering pipelines in the southwest and Midwest in the US. The segment includes equity ownership interests in four crude oil pipelines, the Bakken Pipeline system, Bayou Bridge Pipeline, White Cliffs Pipeline and Maurepas Pipeline. The segment accounts for more than 25% of revenue.

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Energy Transfer's investment in Sunoco LP brings in nearly 25% of revenue.

The NGL and Refined Products Transportation and Services segment represents around 25% of revenue. It owns some 4,820 miles of NGL pipelines, fractionation facilities; a NGL storage facility in Mont Belvieu; and other NGL storage assets.

Energy Transfer's Midstream Segment generates about 10% of revenue. It owns natural gas gathering, compression, treating, processing, storage, and transportation assets.

The Interstate Transportation and Storage segment receive natural gas from supply sources including other transportation pipelines, storage facilities and gathering systems and deliver the natural gas to industrial end-users and other pipelines. It owns and operates approximately 12,340 miles of interstate natural gas pipelines and another approximately 6,780 miles through joint venture interests. The segment accounts for 10% of sales.

The Intrastate Transportation and Storage segment receive natural gas from other mainline transportation pipelines, storage facilities and gathering systems and deliver the natural gas to industrial end-users, storage facilities, utilities, power generators and other third-party pipelines. It owns and operates 9,400 miles of pipeline and three natural gas storage facilities.

The segment accounts for about 5% of sales. USAC provides compression services. This segment generates the remainder of the company's revenue.

Climate Risks

DAPL’s construction and full use locks in GhG emissions putting the U.S. commitment to the Paris Agreement at risk.

Conservatively, assuming a 95% capacity utilization, 1.1 million barrels per day (under the expansion scenario), and including total lifecycle emissions from producing, transporting, processing, and burning the products derived from the oil would amount to 200+ million metric tons of CO_2e per year. These emissions are equivalent to 60 typical U.S. coal plants.

Crude oil pipelines have Scope 2 emissions from the energy required to operate the pipeline. They are also associated with very significant Scope 3 emissions. Hazards associated with oil pipelines are primarily associated with leaks and ruptures.

Community Risks

Community impact from pipelines includes taking of land by eminent domain and risk of exposure to toxins. In the case of DAPL, community impact was underscored because the pipeline traversed sovereign Tribal lands without their consent of appropriate consultation, leading to vocal disapproval and resistance. Failure to constructively engage and consult with affected communities may have hastened the demise of DAPL

Hazards to public health are in exposure to oil because of spillage associated with leakage and rupture of pipeline infrastructure. Crude oil contains more than 1,000 chemicals, most of which are hazardous to human health. Exposure may be through direct contact, or through aerosols. There are no clear federal guidelines for chemical exposure at oil spills, nor are there long-term studies on the effects of exposure to human health.

Indirect hazards to the public are through contamination of ground and surface water resulting from spillage. In 2015, the Poplar Pipeline discharged 42,000 gallons of crude oil in the Yellowstone River, with adverse effects to wildlife and water resources. The spill resulted in the appearance of benzene, a known carcinogen, in the water supply of the town of Glendive Montana.

Environmental Risks

Pipelines are at risk from flooding and erosion, which can undermine pipelines, leading to rupture and pollution. The risk is exacerbated by extreme weather events associated with climate change. Vulnerabilities are especially high at underground river crossings where pipelines can be exposed to scouring during high waters, such as spring runoff. Petroleum is excluded from the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)'s definition of a hazardous substance.

Risks Facing Energy Transfer LP

- DAPL original cost was $3.8 billion, of which $2.5 billion was financed by loans from a group of 17 banks. The total cost is probably $7.5 billion or more.
- A study highlighted that "Energy Transfer's stock price significantly underperformed relative to market expectations during the event study period, and that it experienced a long-term decline in value that persisted after the project was completed. In fact, from August 2016 to September 2018, Energy Transfer's stock declined in value by almost 20% whereas the S&P 500 increased in value by nearly 35%."
- June 7, 2020, Moody's downgraded Midwest Connector Capital Company (Midwest Connector) outlook to negative from stable, while affirming its Baa2 senior unsecured ratings, due to ongoing litigation risks. Midwest Connector is a special purpose entity formed solely for the purpose of issuing notes. The notes are jointly and severally guaranteed by Dakota Access, LLC (DAPL) and Energy Transfer Crude Oil Company, LLC (ETCOC), the respective owners of the DAPL and ETCOC pipeline assets which together comprise the Dakota Access crude oil pipeline system (Dakota Access). Proceeds from the notes were used to repay a $2.5 billion project finance loan that financed in part the construction of the 570,000 barrel per day (bpd) crude oil pipeline system that extends 1,920 miles from North Dakota's Bakken Shale to Energy Transfer Operating, L.P.'s Nederland, Texas oil storage terminal. Ratings could be downgraded should there be an indefinite suspension of pipeline operations and/or cash flow, should contract shipper or sponsor ratings be downgraded or should there be a leveraging event that increases debt/EBITDA over 3x. The rating could be upgraded should leverage drop below 2x, if the weighted average rating of the pipeline's contract shippers increases above A3 or should the ratings of Dakota Access's sponsors be upgraded.

- The cost of pipeline construction is increasing, reflecting greater difficulty in regulatory review at FERC, which is expected to include climate change impacts and environmental justice considerations. Bloomberg analysis indicates that since the Social Cost of Carbon metric is back in play for federal agencies, climate change analysis will be a fulcrum for rejecting energy infrastructure projects. Regulatory risks include legal or regulatory actions related to the DAPL. In addition, the inability to continue to access land owned by third parties could adversely affect ability to operate and financial results." Liability, and the need to secure long-term insurance, for oil spills is a further regulatory impact on pipeline operators.

Risks Facing Energy Transfer's Investors and Lenders

- Energy Transfer, the company's investors, and the pipeline's financiers failed to account for the impacts of DAPL on Indigenous lands and human rights; as a result, the Standing Rock Sioux Tribe opposed the pipeline for three years - manifesting into a movement that resulted in long-term material losses, and reputational, operational, and legal risks to Energy Transfer and DAPL.
- In 2017, Lenders including ABN Amro, DNB, ING, Intesa Sanpaolo, and RBS stepped back from financing In DAPL. At the same time, Bank of Nova Scotia, CIBC, Fifth Third Bank, and TD Bank began to finance DAPL.
- Banks financing DAPL incurred $4.4 billion in losses from direct account closures of individuals and local governments (not including costs related to reputational damage). 90% of the lost accounts were held by Wells Fargo.
- June 7, 2020, Moody's downgraded Midwest Connector Capital Company (Midwest Connector) outlook to negative from stable, while affirming its Baa2 senior unsecured ratings, due to ongoing litigation risks. Midwest Connector is a special purpose entity formed solely for the purpose of issuing notes. The notes are jointly and severally guaranteed by Dakota Access, LLC (DAPL) and Energy Transfer Crude Oil Company, LLC (ETCOC), the respective owners of the DAPL and ETCOC pipeline assets which together comprise the Dakota Access crude oil pipeline system (Dakota Access). Proceeds from the notes were used to repay a $2.5 billion project finance loan that financed in part the construction of the 570,000 barrel per day (bpd) crude oil pipeline system that extends 1,920 miles from North Dakota's Bakken Shale to Energy Transfer Operating, L.P.'s Nederland, Texas oil storage terminal. Ratings could be downgraded should there be an indefinite suspension of pipeline operations and/or cash flow, should contract shipper or sponsor ratings be downgraded or should there be a leveraging event that increases debt/EBITDA over 3x. The rating could be upgraded should leverage drop below 2x, if the weighted average rating of the pipeline's contract shippers increases above A3 or should the ratings of Dakota Access's sponsors be upgraded.
- April 2022: An estimated $300 million to $400 million in EBITDA remains at risk related to DAPL regulatory review, expected to be complete in September 2022.

Societal expectations on companies to address climate change and other environmental and social impacts, investor and societal expectations regarding voluntary ESG disclosures, and consumer demand for alternative forms of energy may result in increased costs, reduced demand for fossil fuels and consequently demand for our midstream services, reduced profits, increased risk of investigations and litigation, and negative impacts on the value of our assets and access to capital. liability claims and litigation, or increased insurance costs including because of increased risks due to the potential adverse effects of changes in climate.

The SEC 10K filing adds that "we may receive pressure from investors, lenders, or other groups to adopt more aggressive climate or other ESG-related goals, but we cannot guarantee that we will be able to implement such goals because of potential costs or technical or operational obstacles."

Climate change legislation or regulation restricting emissions of greenhouse gasses, limiting oil and gas leases on federal lands, discouraging oil and gas development or otherwise increasing the company's and customers' costs, are also key risks. Operations govern air emissions, wastewater discharge, hazardous materials and wastes, and cleanup of contamination are noted. Noncompliance may incur substantial costs or curtailment or cancellation of operating permits.

Risks may also stem from the loss of access to lands owned by third parties, including tribal lands.

The identification of presently unidentified conditions may result in more rigorous enforcement action, with a material adverse effect on business. In particular, Energy Transfer's SEC filings noted that regulation may require new or modified facilities to reduce methane and volatile organic compound emissions.

The adoption of legislation or regulations that require reporting or restriction of emissions of GHGs could result in increased compliance costs or additional operating restrictions and make it more difficult to secure funding.

The 10K filing notes that "various investors are becoming increasingly concerned about the potential effects of climate change and may elect in the future to shift some or all their investments into other sectors. Institutional lenders who provide financing for fossil fuel energy companies also have become more attentive to sustainable lending practices that favor "clean" power sources such as wind and solar photovoltaic, making those sources more attractive for investment, and some of them may elect not to provide funding for fossil fuel energy companies."

In the SEC filings risks, including pollution risks with impacts to public health, the risks of spills, and the costs of countermeasures, and impacts to the environment are treated in generalities, whereas specific impacts are or should be documented through the regulatory processes. The specific risks of environmental and social harm that are a direct consequence of the transportation of crude oil and other fossil fuels should be disclosed in clear financial terms.

Annex: Timeline

July 2016: DAPL receives clearance from US Army Corps of Engineers (USACE)

December 2016: Energy Transfer Partners and Sunoco Logistic Partners, both subsidiaries of Energy Transfer Equity, announced their merger as Energy Transfer Partners

December 2016: The US government denies permits for the pipeline to cross the Missouri River and orders new EIA to analyze alternative routes.

January 2017: President Donald Trump issued an executive order to advance construction of the pipeline.

May 10, 2017: First spill happens at Spink county, ND.

June 2017: Construction completed and the pipeline is operational.

December 4, 2017: US District Court for DC imposes interim measures over ongoing operation of DAPL, citing the recent Keystone oil spill.

August 31, 2018: USACE affirms its original decision to issue a construction permit ("remand decision").

August 16, 2019: Standing Rock Sioux Tribe filed a motion for summary judgment in US District Court in Washington DC, arguing that the Tribe had been shut out of the review process in violation of environmental law. The Tribe asks the Court to vacate an easement granted to allow pipeline construction.

March 2020: Federal Court in District of Columbia overturns permits, and orders USACE to conduct a comprehensive environmental review citing violation of the National Environmental Protection Act in the USACE Environmental Impact Statement.

July 6, 2020: Federal court orders shutdown of DAPL until a full environmental impact statement is produced, on grounds that USACE had violated the National Environmental Policy Act (NEPA) and glossed over the devastating consequences of a potential oil spill when it affirmed its 2016 decision to permit the pipeline.

August 5, 2020: DC Circuit Court of Appeals issued an order that allows oil to continue flowing, while vacating the permit for the pipeline to cross beneath Lake Oahe. The order leaves the decision to shut down DAPL to the USACE.

September 10, 2020: US Army Corps of Engineers announced first phase of the environmental impact statement process. This phase reviews the scope of the EIS and alternatives to be considered.

October 16, 2020: The Standing Rock Sioux Tribe renews its request for an injunction.

January 26, 2021: US Court of Appeals for the DC Circuit issued a ruling upholding a lower court ruling that the US Army Corps of Engineers violated environmental laws and requiring a full environmental impact statement but leaving the decision to close DAPL immediately to the discretion of the USACE.

April 9, 2021: USACE declined to shut down DAPL, even though it is operating without a permit.

May 21, 2021: Federal district court denied Standing Rock Sioux Tribe's request for an injunction that would have forced the USACE to shut down DAPL while a federal environmental impact analysis was underway.

July 22, 2021: The Pipeline Hazardous Materials and Safety Administration fines DAPL and puts it on notice for safety violations.

September 20, 2021: DAPL filed a petition for *certiorari,* seeking Supreme Court review of the decision by the DC Circuit Court of Appeals.

September 22, 2021: The Standing Rocks Sioux Tribe calls for starting the EIS process over, calling it gravely off track.

Feb 22, 2022: US Supreme Court declines to hear case on DAPL, upholding the ruling of the DC Court, and leaving the future of the pipeline in jeopardy.

April, 2022: An estimated $300 million to $400 million in EBITDA remains at risk related to DAPL regulatory review, expected to be complete in September, 2022.