



**TransCanada**

*In business to deliver*

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February 27, 2012

William J. Burns  
Deputy Secretary of State  
United States Department of State  
2201 C Street, NW  
Washington, D.C. 20520

Dear Mr. Burns:

Re: TransCanada Keystone Pipeline, L.P.  
Advance Notice of Intent to Apply for Presidential Permit

TransCanada Keystone Pipeline, L.P. (Keystone) is in receipt of the Department of State's (the Department) letter of January 31, 2012 confirming the denial of Keystone's application filed on September 19, 2008 (the Application) for a Presidential Permit to construct a crude oil pipeline across the U.S./Canada international boundary as part of the proposed Keystone XL Pipeline Project. The purpose of this letter is to give the Department advance notice of Keystone's intentions in response to the denial of its Application.

As described in its Application, Keystone had proposed that the Keystone XL Pipeline would consist of 1,375 miles of new 36-inch diameter pipeline, to be built in three segments: the approximately 850-mile long "Steele City" segment from the U.S. border to Steele City, Nebraska; the approximately 478-mile long "Gulf Coast" segment from Cushing, Oklahoma to Nederland, Texas; and the approximately 47-mile long "Houston Lateral" segment from Liberty County, Texas, to the Moore Junction area in Harris County, Texas. Moreover, Keystone stated in its Application that Keystone XL would be built in phases, with the Gulf Coast segment intended to be built and placed in service by the second quarter of 2011, while the Steele City segment was not be planned to be in service until 2012.

In recommending denial of the border-crossing permit, the Department asserted that its recommendation "was predicated on the fact that the Department does not have sufficient time to obtain the information necessary to assess whether the project, in its current state, is in the national interest." Specifically, the Department found that it did not have time to adequately conduct an assessment of alternative pipeline routes that avoid the Sandhills region in Nebraska. The President's acceptance of the Department's recommendation to deny the Permit rested on the same reasoning. The Department's Report to Congress concerning the denial of the Presidential Permit expressly stated that the denial does not preclude any subsequent permit application or applications for similar projects.

Keystone has been working on developing alternative routing in Nebraska that avoids the Sandhills region since November 2011, following the Department's notice that it was delaying a decision on the application pending its review of additional alternative routing in Nebraska. Keystone is fully prepared to engage in a route selection process with the appropriate state and federal agencies as soon as possible once the applicable process is confirmed. Keystone hereby advises the Department that it intends to file a Presidential Permit application with the Department of State in the near future and subsequently to supplement that application with an alternative route in Nebraska, as soon as that route is selected. Keystone's application will incorporate the already reviewed route in Montana and South Dakota. Given the comprehensive three-year review of the Keystone XL Project that has already been conducted, the extensive existing record compiled under the National Environmental Policy Act, the Final Environmental Impact Statement that the Department issued on August 26, 2011, the incorporation of already reviewed route in Montana and South Dakota, and the National Interest comment period conducted last fall, it is Keystone's expectation that its border-crossing application can be processed expeditiously and a Presidential Permit decision made once a new route in Nebraska is determined.

When it files its application for a border crossing permit, Keystone will be including for consideration only the associated 36-inch pipeline and appurtenant facilities associated with the "Steele City" segment. Keystone has concluded that the portion of the previously proposed Keystone XL Project that will serve the Gulf Coast has its own independent utility as a stand-alone pipeline project.<sup>1</sup> Keystone hereby advises the Department that it intends to continue to seek any remaining required permits from federal, state, and local entities for the Gulf Coast Project, and that it will proceed to begin construction of that project as soon as any permits necessary to specific construction activities are in place. Moreover, Keystone advises the Department that it will move forward with construction of the Gulf Coast Project regardless of whether the Presidential Permit application discussed above is approved.

If you have any questions regarding its intentions, please contact the undersigned.

Very truly yours,



Kristine L. Delkus  
Deputy General Counsel  
Pipelines and Regulatory Affairs

cc: Assistant Secretary Kerri-Ann Jones  
Assistant Secretary Jose Fernandez  
Michael Stewart

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<sup>1</sup> Attached hereto is an appendix that sets forth the basis for the conclusion that the Keystone Gulf Coast Project has independent utility as a stand-alone project

## **Gulf Coast Project**

As demonstrated herein, the portion of the previously proposed Keystone XL Pipeline Project that will serve the Gulf Coast has independent utility as a stand-alone crude oil pipeline project (“Gulf Coast Project”). For that reason, TransCanada intends to develop the Gulf Coast Project independent of the Keystone XL Project.

The Gulf Coast Project would commence at the crude oil supply hub at Cushing, Oklahoma and terminate at existing crude oil storage terminal facilities near Nederland and Houston, Texas. The primary purpose of the Gulf Coast Project is to transport growing domestic crude oil production to serve Gulf Coast refinery demand which is currently being met through foreign imports of crude oil. Construction of the Gulf Coast Project will enable U.S. producers to reach a market with significantly lower transportation costs than through higher cost alternatives such as rail, trucking or barging. It will also enable Gulf Coast refineries to access lower cost domestic production and avoid paying a premium to foreign producers of crude oil.

The market need for the Gulf Coast Project is demonstrated in part by confirmed contractual shipper commitments. Shippers – producers, marketers or refiners – evaluate the merits of various pipeline proposals and ultimately decide which projects to support. Shippers have expressed material interest in the Gulf Coast Project and in securing additional pipeline capacity. Shippers have already committed to binding contracts in support of the Gulf Coast Project to transport crude oil from Cushing to Nederland and Houston. Importantly, these commitments are independent of a Presidential Permit for the Keystone XL Pipeline Project. These commitments and the market need for the Gulf Coast Project are sufficient to enable TransCanada to proceed with obtaining any remaining required permits from federal, state, and local entities and to proceed with construction of the Gulf Coast Project as soon as any permits necessary to specific construction activities are in place. These binding commitments

demonstrate a material endorsement of support for the Gulf Coast Project, its economics, and target markets, as well as the need for incremental pipeline capacity and market access for U.S. domestic crude oil producers. All of these factors demonstrate the independent utility of the Gulf Coast Project as a stand-alone pipeline project.

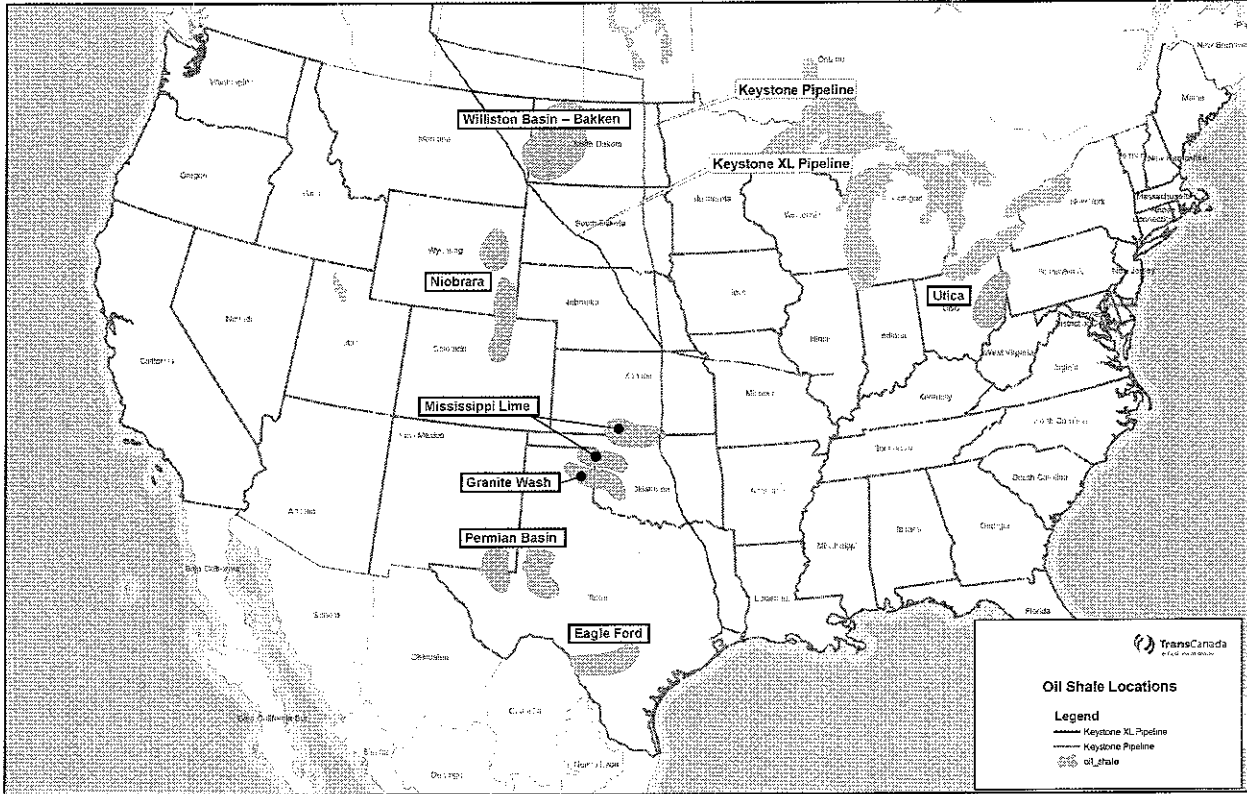
The market need for the Gulf Coast Project is also supported by a number of additional factors including:

- Increasing domestic crude oil supply in the Permian, Williston, Eagleford, Granite Wash, Niobrara, Mississippi Lime and Utica oil and gas producing basins;
- Decreasing demand for light domestic crude oil from U.S. Midwest refineries due to conversion projects which rely extensively on heavy crude oil supplies;
- Pipeline capacity limitations between Cushing and the U.S. Gulf Coast; and
- An opportunity to reduce U.S. dependence on foreign offshore oil supplies by increasing the availability of domestic production to Gulf Coast refineries.

#### **Increasing U.S. Domestic Crude Oil Supply**

Crude oil production in the U.S. has experienced significant growth over a short period of time, primarily due to increasing production from shale oil formations. Of the numerous growing production basins in the U.S., the Williston basin is the most advanced. According to aggregated U.S. State statistics, the Williston Basin's production averaged 138,000 barrels per day (bpd) from 1993 to 2004. Since 2005, production has grown on average 17% per year and reached an average of 514,000 bpd in 2011. Other producing basins are in various stages of development and many are also exhibiting similar growth rates. A key leading indicator of future production growth is the number of drilling permits filed within each region, which have increased significantly over the past number of years.

## Map of Growing U.S. Oil Producing Basins



**Growing U.S. Oil Producing Basins – Production and Permits Filed**

Basin	2005 Production (x1000 bpd)	2011 Production (x1000 bpd)	Permits Filed 2005	Permits Filed 2011	Forecast 2020 Production (x1000 bpd)
Williston	198	514	851	1,581	985
Permian	881	1017	5,022	11,117	1474
Eagleford	<1	149	3	2,176	955
Granite Wash	8	28	118	185	85
Niobrara	18	56	50	1,317	77
Mississippi Lime	1	3	44	131	118
Utica	-	<1	-	65	83
<b>Total</b>	<b>1,107</b>	<b>1,768</b>	<b>6,088</b>	<b>16,572</b>	<b>3,777</b>

Source: Various State agencies

Crude oil from these growing U.S. producing basins is primarily light, low sulphur crude oil with an API between 30 and 50. The majority of the production growth is expected to result in a surplus of light crude oil at the Cushing crude oil storage and pipeline hub. For the Permian, Eagleford, Granite Wash, Niobrara, and Mississippi Lime basins, the Cushing storage hub is the closest market of significance and in the cases of the Permian and Eagleford basins, pipeline access to Cushing already exists. Growing Utica and Williston basin production is likely to partially meet light crude oil demand in Mid-West markets which are currently served by pipelines from the Cushing area, and which will in turn displace light crude oil and further increase the supply at Cushing.

Between 2005 and 2011, growth in light crude oil production was close to 660,000 bpd, representing an annual growth rate of 110,000 bpd. TransCanada forecasts that the incremental growth between 2011 and 2020 will be approximately 2,000,000 bpd, representing an annual average growth rate of 220,000 bpd. While this forecast growth rate is substantially higher than the average between 2005 and 2011, these basins are in their early stages of development and greater growth rates are predicted as the basins mature. The growth rate of 220,000 bpd/year represents an average percentage growth rate of 9%, which is less than the percentage growth rate experienced in the Williston Basin between 2005 and 2011, which is the most mature of these emerging basins and therefore the best available predictor of how these future basins will grow.

#### **Decreasing Light Crude Oil Demand at U.S. Mid-West Refineries**

While the production of light crude oil is increasing in the lower 48 states, the demand for light crude is diminishing due to refinery conversion projects under construction or nearing completion in Whiting, Indiana, Detroit, Michigan, and Wood River, Illinois. These refinery conversions involve the addition of coker units that allow these refineries to run a larger amount of heavy crude oil. These refinery conversion projects do not significantly increase overall refining capacity, so as a result demand

for heavy crude increases with a corresponding and comparable decrease in demand for light crude oil on the order of 480,000 bpd.

Refinery	Expected Project Completion	Increase in Heavy Crude Oil Demand (x1000 bpd)	Decrease in Light Crude Oil Demand (x1000 bpd)
BP Whiting, Indiana	2013	260	(260)
Marathon Detroit, Michigan	Late 2012/Early 2013	60	(60)
WRB Wood River, Illinois	Early 2012	160	(160)
<b>Total</b>		<b>480</b>	<b>(480)</b>

The majority of the light crude oil that is currently transported to these refineries is sourced from Cushing and the Williston basin. The BP Whiting refinery is supplied with a significant amount of light crude oil through its wholly-owned BP1 pipeline which runs from Cushing to Whiting, while the remainder of BP Whiting's light crude oil supply is provided through the Enbridge system from light crude oil supplies in Alberta, Canada and North Dakota. The Wood River refinery received its light crude oil supply through the Ozark pipeline, which runs from Cushing to Wood River, as well as the Platte and Keystone pipelines which connect light crude supplies in Alberta, North Dakota and Montana. The Marathon Detroit refinery is supplied with light crude oil through the Enbridge system drawing on supplies from North Dakota and Alberta. The reduction in light crude oil demand resulting from these refinery conversions will primarily impact the Cushing area through reduction in flows through the Ozark and BP1 pipelines and, to a lesser extent, will reduce the available market for Bakken production.

#### **Foreign Light Crude Oil Imports to the Gulf Coast**

The U.S. Gulf Coast represents the largest amount of refining capacity in the U.S. at approximately 8,600,000 bpd. Of that total, 4,000,000 bpd of capacity is located along the Texas Gulf Coast in the vicinity of Nederland and Houston, Texas, while 3,500,000 bpd is located along the Louisiana Gulf Coast. The Gulf Coast refinery complex is capable of running a large volume of light crude

which is primarily imported into the Gulf Coast by tanker from foreign countries. On average, approximately 2,000,000 to 2,500,000 bpd of light crude oil is imported into the Gulf Coast from a variety of countries, primarily Saudi Arabia, Nigeria, Iraq and Mexico

<b>2011 USGC PADD III Light Imports*</b> <b>(x1000 BPD)</b>		
<b>Country</b>	<b>April</b>	<b>September</b>
ALGERIA	192	139
ANGOLA	97	121
AZERBAIJAN	15	-
BELIZE	4	2
CANADA	18	-
COLOMBIA	18	-
CONGO	30	30
EQUATORIAL GUINEA	17	18
GABON	17	18
IRAQ	342	210
KAZAKHSTAN	51	-
KUWAIT	60	72
MEXICO	257	246
NIGERIA	480	167
NORWAY	18	19
RUSSIA	130	19
SAUDI ARABIA	635	961
TRINIDAD & TOBAGO	21	51
UNITED KINGDOM	51	-
VENEZUELA	40	42
<b>TOTAL</b>	<b>2,493</b>	<b>2,115</b>

\* Light refers to any crude imported with an API gravity of 30+  
Source: Energy Information Administration

#### **Limited Pipeline Capacity between Cushing and the U.S. Gulf Coast**

Limited pipeline capacity exists to move incremental volumes of light crude oil from Cushing to the Gulf Coast. Aside from the proposed Seaway Crude pipeline reversal project, the Gulf Coast Project currently represents the only other alternative to directly link Cushing to the Gulf Coast market. The demand for crude oil transportation could alternatively be met by rail, trucking or barging crude oil to the Gulf Coast refineries. However, the cost of pipeline transportation between Cushing and the Gulf



Coast, using the Gulf Coast Project for example, is significantly less than the cost to rail light crude oil over a similar distance. Railing crude oil therefore results in U.S. domestic producers receiving a lower price for their crude oil as a result of higher transportation costs. There is also a significant safety consideration associated with the increased transport of crude oil by rail. According to the Pipeline Hazardous Material Safety Administration (PHMSA) and the Federal Railroad Administration, for every one pipeline safety incident, there are 50 railway safety incidents. Additionally, the practicality of using rail to move large volumes of crude oil is limited. Transportation of the equivalent of a 100,000 bpd pipeline would require 167 rail cars to be loaded per day, which creates significant logistical challenges.

### **Summary**

In summary, the need for, and independent utility of, the Gulf Coast Project is demonstrated by (i) confirmed shipper interest represented by binding contracts in support of the Gulf Coast Project to transport crude oil from Cushing to Nederland and Houston, Texas; (ii) the growth in domestic light crude oil production in the U.S.; (iii) diminishing demand for light crude oil at Midwest U.S. refineries; (iv) increasing oversupply of light crude at Cushing; (v) the large volume of light crude that is processed at Gulf Coast refineries, which is primarily imported to the Gulf Coast by tanker from foreign countries; (vi) the limited existing pipeline capacity that exists to move incremental volumes of light crude oil from Cushing to the U.S. Gulf Coast; and (vii) the impracticality of transporting domestic crude oil to the Gulf Coast by other modes of transportation.