

McCULLOUGH RESEARCH

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PRINCIPAL

MEMORANDUM

Date: March 3, 2025

To: McCullough Research Clients

From: Robert McCullough

Subject: Deconstructing Trump's Energy Tariff

On February 1, 2025, the president issued an executive order imposing tariffs on Canadian energy. The actual tariff language was contained in a previous executive order entitled "Declaring A National Energy Emergency." As the world's largest oil producer and the world's largest natural gas exporter, the emergency may seem exaggerated. However, the significance of the emergency declaration lies in Section 8:

Sec. 8. Definitions. For purposes of this order, the following definitions shall apply:

- (a) The term "energy" or "energy resources" means crude oil, natural gas, lease condensates, natural gas liquids, refined petroleum products, uranium, coal, biofuels, geothermal heat, the kinetic movement of flowing water, and critical minerals, as defined by 30 U.S.C. 1606 (a)(3).
- (b) The term "production" means the extraction or creation of energy.
- (c) The term "transportation" means the physical movement of energy, including through, but not limited to, pipelines.
- (d) The term "refining" means the physical or chemical change of energy into a form that can be used by consumers or users, including, but not limited to, the creation of gasoline, diesel, ethanol, aviation fuel, or the beneficiation, enrichment, or purification of minerals.
- (e) The term "generation" means the use of energy to produce electricity or thermal power and the transmission of electricity from its site of generation.
- (f) The term "energy supply" means the production, transportation, refining, and generation of energy.

There is some reason to believe that an unsophisticated author may have relied upon an AI to write this section. There are two reasons for this surmise:

Deconstructing Trump's Energy Tariff

March 3, 2025

Page 2

1. Section 8(a) is strangely incomplete. The list excludes solar and wind generation. President Trump has been fiercely critical of wind, so it is strange that he would be exempting Canadian wind from tariffs.
2. The terminology of Section 8(a) is unusual. The term “kinetic movement of flowing water” is not used in the energy industry. An exhaustive search in Google, for example, came up with only two references before January: a blog on not using soap in the shower and the description of a painting.^{1,2}

It is reasonable to conclude that the author asked an AI to list fuels, not commodities suitable for the tariff. While many fuels are commodities – you can both consume natural gas and sell natural gas, for example.

The anomalous energy sources in Section 8(a) does not include solar and wind which have no fuel. In the case of “geothermal heat” and “kinetic movement of flowing water”, this is a strange construction of words that attempts to define the “fuel” for geothermal and hydroelectricity. However, they are not commodities since they are not traded, transportable, and relatively difficult to measure.

Press coverage has taken a number of approaches to handling the odd terminology. The most common has been to simply assume that the terms are simply meaningless and substitute logical alternatives. This is defensible given the president's lack of background in energy, but falls afoul of the standards of legal interpretation which argue against an interpretation that makes some of the text irrelevant.

The alternative is to simply take Section 8(a) at face value: “crude oil, natural gas, lease condensates, natural gas liquids, refined petroleum products, uranium, coal, biofuels” are commodities which can be bought and sold. These have a 10% tariff. The last two fuels, “geothermal heat” and “the kinetic movement of flowing water” are not traded and a tariff on these is simply irrelevant.

Interpreting “the kinetic movement of flowing water” as hydroelectricity has an additional flaw. The source of hydroelectricity is the Canadian grid. The origin of specific electrons can be identified only from filings made by Canadian utilities. In practice, the best source is the NERC eTag which lists the source, path, and destination. In Quebec, for example, an electron can come from wind, hydro, or thermal. The specific source is determined by the utility and difficult to debate unless the energy was a spot transaction north of the border. Given that in all but one province likely to export electricity to the

¹ <https://www.senseofsync.com/projects/bioluminescence>

² https://www.reddit.com/r/changemyview/comments/vqijxg/cm_v_shower_soap_is_almost_always_unnecessary/

Deconstructing Trump's Energy Tariff

March 3, 2025

Page 3

U.S. border, the province is dominated by a single crown corporation, such transactions are rare.³

If a Canadian utility volunteers to force its counterparties on the U.S. side of the border to pay the tariff, the problem is not readily solved. Sales through independent system operators leave purchasers with a portfolio of suppliers. Identification of hourly, daily, or even monthly purchases as to the supplying nationality and fuel is a major challenge. U.S. electricity transactions are approaching one billion per year. Auditing such a huge market is likely to eat up much of any possible tariff.

³ Alberta has a number of energy suppliers. Quebec, Ontario, Manitoba, and British Columbia are dominated by crown corporations.