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Alberta's New Oil and Gas Liability Management Framework

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08/06/2020

On July 30, 2020, the Government of Alberta announced the release of its new liability management framework (LMF) for oil and gas producers in Alberta. The LMF will replace the former Licensee Liability Rating system established by the Alberta Energy Regulator (AER). There are approximately 97,000 inactive wells in the province of Alberta with total liability estimates exceeding $30 billion.[1] Concerns regarding the growing inventory of orphaned and inactive wells caused the Government of Canada to commit $1.7 billion to the provinces of Alberta, British Columbia, and Saskatchewan to launch the Site Rehabilitation Program. Of this $1.7 billion, $1.2 billion went to the province of Alberta. Under the Site Rehabilitation Program, service companies can apply for grants to perform abandonment and reclamation work on oilfield sites.

The overhaul to the liability management regime has been highly anticipated since the *Redwater* decision[2] was rendered by the Supreme Court of Canada in January 2019. The trend toward an overhaul of the existing system continued when the AER made corporate Liability Management Ratings (LMRs) confidential in February 2020. A company's LMR is the ratio of a licensee's eligible deemed assets in the Licensee Liability Rating, Large Facility Liability Management, and Oilfield Waste Liability programs to its deemed liabilities in these programs, as set forth in AER Directive 006.[3] The LMF was due to be released earlier this year but was postponed due to the COVID-19 pandemic.[4]

Under the previous transfer system, the purchaser of well, facility or pipeline licenses in Alberta was required to maintain an LMR of 2.0 (and the seller was required to maintain an LMR of 1.0) in order to avoid having to a post a substantial security deposit or request special permission from the AER. Critics of the previous transfer system noted that it was too onerous and stalled many oil and gas asset deals. This prevented companies from receiving cash injections or offloading strategic assets at critical times. This problem was exacerbated by low commodity prices, which proved to be too much for many oil and gas companies to remain a going concern.

Overall, it is anticipated that the LMF will benefit oil and gas producers and potentially attract additional investment. The LMF also contains measures to reduce the number of inactive wells and to address well, facility and pipeline end-of-life obligations. The LMF is expected to be enacted and come into force and effect in the coming months.

In addition to the media release, the Government of Alberta released a fact sheet which outlines several key components of the new LMF. These key components are analyzed below.

Licensee Capability Assessment System

The Licensee Capability Assessment System is the new financial ability test under the LMF for assessing the financial health of oil and gas producers. It has been widely accepted that the corporate LMR was not an accurate reflection of the financial health of a company because of its narrow scope of tracking only deemed assets (production) and deemed liabilities (abandonment and reclamation liabilities).

Conversely, the Licensee Capability Assessment System will consider additional information such as a company's financial statements and other records, which will allow for a much broader and more fulsome assessment of a company's financial situation. The AER will also have more discretion and can work with companies to agree on mutually acceptable solutions to liability concerns. In some instances, this might preclude the licensee from having to post a security bond with the AER, which traditionally tied up capital and could be cumbersome to have returned.

It is also expected that the AER will collaborate with the Ministry of Environment and Parks to track payments to landowners and share compliance data. This will encourage companies to make rental payments in a timely manner and allow the AER to monitor the financial health of oil and gas producers.

Licensee Special Action

The Licensee Special Action under the LMF is a unique initiative that will empower the AER to proactively approach and provide guidance to high risk companies. The goal of the Licensee Special Action program is to assist struggling or distressed companies to prevent or limit the transfer of oil and gas assets to the Orphan Well Association (OWA). The OWA, which will now have an expanded scope as described below, is tasked with managing and covering the costs of inactive well liabilities in the absence of a solvent operator. Through the new framework, the AER will have the ability to support struggling or distressed companies by involving lending, insolvency and other industry experts. Together with the AER's flexibility to look more broadly at the financial health of companies in the Licensee Capability Assessment System, the Licensee Special Action program will provide additional regulatory tools for the AER to employ in order to minimize the transfer of assets to the OWA.

Inventory Reduction Program

The Inventory Reduction Program under the LMF will establish annual site closure spending targets designed to reduce inactive well inventories. Under the Inventory Reduction Program, companies can choose which sites to close in the order that works most efficiently. An area-based closure program will also be introduced as part of the Inventory Reduction Program whereby companies operating in the same area

can collaborate and cost-share on site closures, increasing the efficiency for multiple operators. The AER will require licensees to adhere to minimum annual spend targets over a five-year rolling period to clean up inactive wells, facilities and pipelines. The new annual site-closing spend threshold has not yet been determined but preliminary indications are that this could be at least 4% of the estimated cost of the company's inactive wells.[5]

Unlike in British Columbia and certain US states, the AER will not impose a mandatory timeline on operators to meet their abandonment and reclamation obligations for particular wells (i.e. the length of time in which a company must abandon its wells once they become inactive). The Inventory Reduction Program is instead designed to provide companies with additional flexibility to reduce inactive asset inventories, based on annual site-closing thresholds.

Landowner Opt-in

The LMF will include a new opt-in mechanism for landowners to nominate sites for clean-up on a priority basis to the AER. Landowners who want operators to attend to end-of-life obligations on their lands will formally request this from the AER. The AER will review the requested site and provide operators with the opportunity to oppose the request and convince the AER why abandonment and reclamation obligations do not need to be immediately attended to on the requested site. The AER will assume an active role in managing landowner nominations, assessing the landowner requests and making a formal determination as to whether the closure process needs to be immediately enacted on the requested site. With respect to Crown lands, the Alberta Government will receive requests directly from the citizens of Alberta and will forward such requests to the AER.

Legacy and Post-Closure Sites

The LMF will include a process to address legacy and post-closure sites. These are oil and gas sites that were abandoned and reclaimed prior to the current standards being implemented and for which reclamation certificates have already been issued, despite the fact that the procedures used to close these sites are outdated and not compliant with current environmental standards.

Orphan Well Association Mandate

The OWA, which is partially funded by both industry and the Government of Alberta, is responsible for abandoning the approximately 3,000 depleted orphan wells in Alberta and reclaiming sites when the operator becomes defunct.[6] Under the LMF, the OWA will have an expanded role as set forth in the *Liabilities Management Statutes Amendment Act* (Alberta), which came into force and effect on June 15,

2020. The OWA will have greater authority to manage orphaned oil and gas sites, including the authority to enter into agreements with oil and gas producers and services companies with respect to site closures, ensure oil and gas sites are not prematurely abandoned and exert more financial control to manage sites that may become orphaned or are already in their inventory. The OWA will contract with service companies under the Site Rehabilitation Program to abandon and reclaim existing orphaned sites in its inventory.

The authors of this article gratefully acknowledge the contributions of summer student Natalie Thompson.

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[1] "Oil and gas liabilities management" (last modified 30 July 2020), online: *Government of Alberta* <alberta.ca/oil-and-gas-liabilities-management.aspx/> ["Liabilities Management"].

[2] *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5.

[3] "Directive 006: Licensee Liability Rating (LLR) Program and Licence Transfer Process" (17 February 2016), online (pdf): *Alberta Energy Regulator* <aer.ca/documents/directives/Directive006.pdf>.

[4] Maureen McCall, "Alberta's new Liability Management Framework – A move in the right direction in unprecedented times" (31 July 2020), online: *BOE Report* <boereport.com/2020/07/31/albertas-new-liability-management-framework-a-move-in-the-right-direction-in-unprecedented-times/>.

[5] Kyle Bakx, "Alberta overhauls system to clean up old oil and gas wells, with 90,000 sitting idle" (last modified 30 July 2020), online: *CBC News* <cbc.ca/news/business/llr-savage-orphan-well-alberta-1.5668063>.

[6] Liabilities Management, *supra* note 1.

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