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Leading the Way?

**Liability Management
for the Alberta
Oil & Gas Industry**

**JASPER RESEARCH
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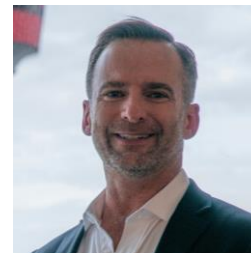
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Jeff Davidson is a Calgary energy lawyer with extensive experience in commercial, regulatory and Aboriginal law. For the past 14 years, Jeff has been Legal Counsel with Canadian Natural, providing advice to the Stakeholder and Regulatory, Mineral Land and Joint Venture groups.



Canadian Natural



Overview



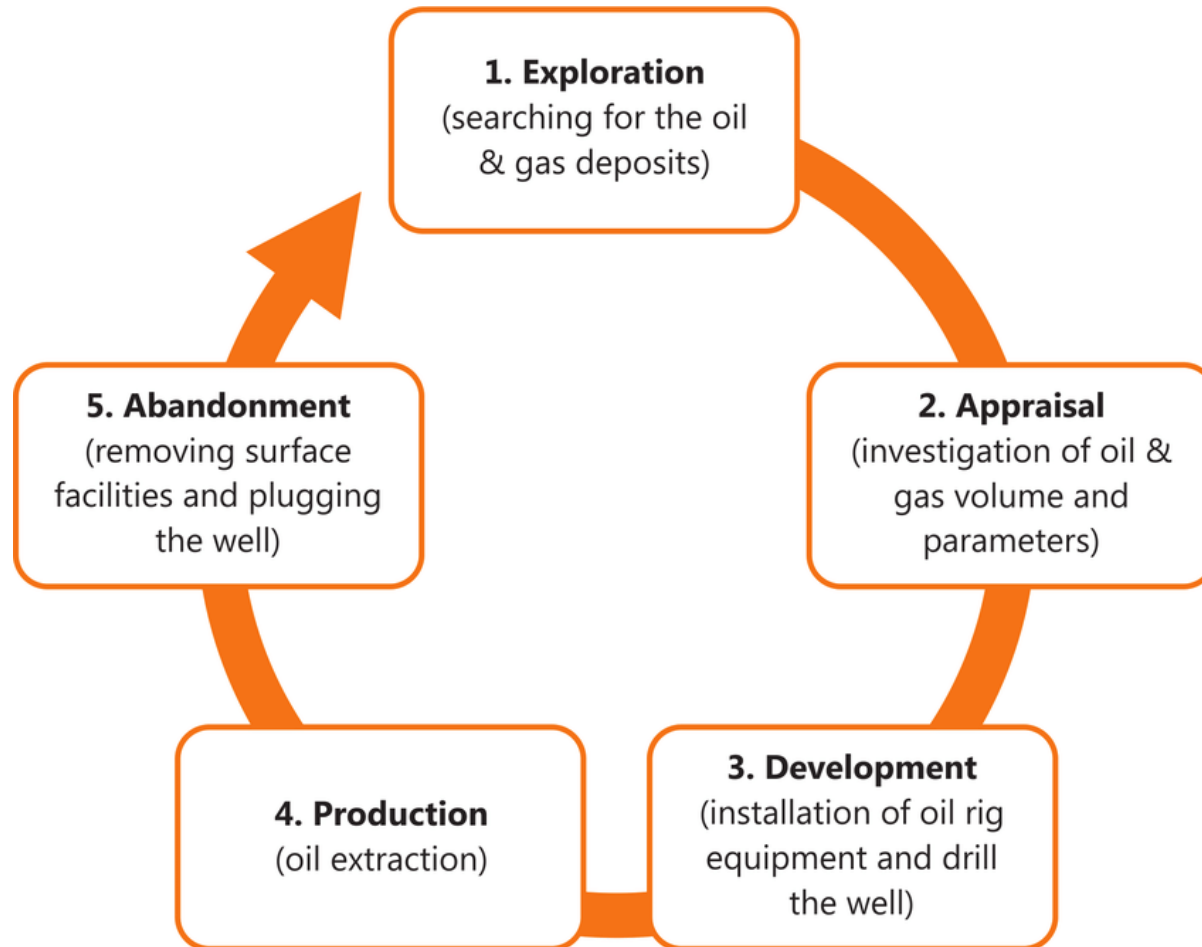
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PART 1:

Growth of Liability Management

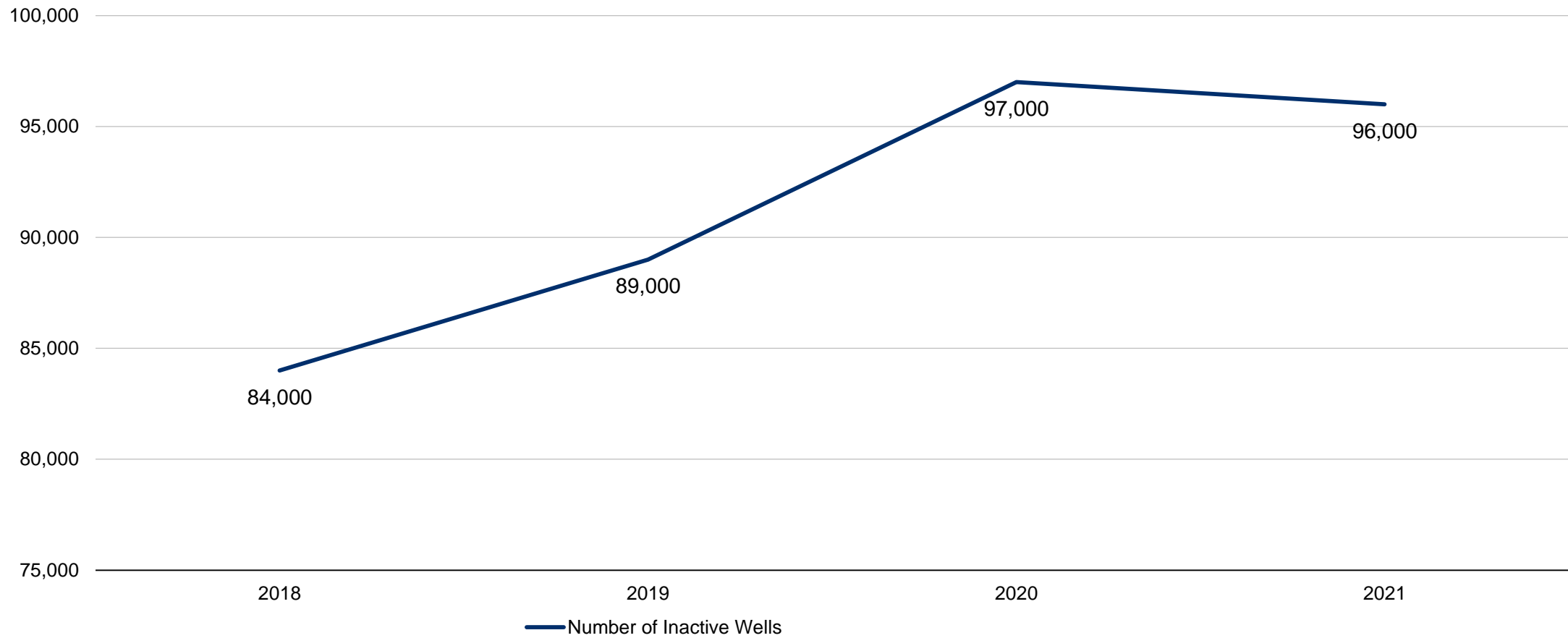


Life-Cycle of Oil & Gas Wells



- Growth of liability management in Alberta:
 - Rapid growth of the industry has made it difficult for regulatory policies to be proactive
 - Cyclical nature of the industry makes liability management challenging

Inactive Wells in Alberta



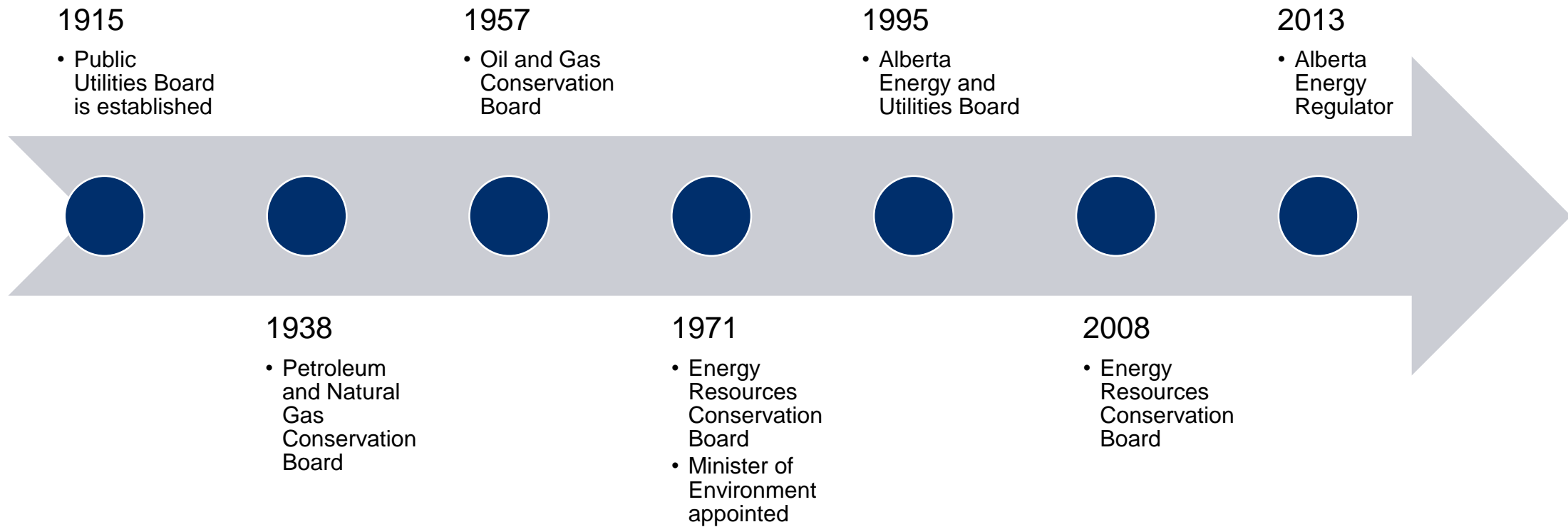
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PART 2:

Emergence of Regulatory Bodies



Evolution of Regulatory Bodies in Alberta



- Created through the introduction of the *Responsible Energy Development Act* in 2013
- Broad mandate and jurisdiction to provide a coordinated, forward-looking liability management system
- Role of the AER includes policy implementation and enforcement to ensure oil & gas producers are accountable to fund and complete their closure work



The Orphan Fund & Levy

The Orphan Fund

- Created pursuant to the *Oil and Gas Conservation Act* and *Oil and Gas Conservation Rules*
- Role is to, among other things, pay for the suspension, abandonment and reclamation costs of orphan wells, facilities, facility sites, and well sites where suspension, abandonment, or reclamation work is carried out by the AER
- Funded by the oil and gas industry to prevent closure costs being borne by the Government of Alberta and ultimately, Alberta taxpayers

The Orphan Fund Levy

- An amount prescribed by the AER based on:
 - Estimated costs for carrying out suspension, abandonment, remediation, and reclamation;
 - Anticipated claims from defaulting working interest participants (“**WIPs**”);
 - Payment of any debts for previous year’s operations; and
 - Any surplus for emergency and nonbudgeted expenditures the AER deems necessary
- Allocated amongst licensees included in the LLR and the oilfield waste liability programs and payable to the AER by licensee holders and approval holders of well, facility or unreclaimed sites



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PART 3:

Licensee Liability Rating System

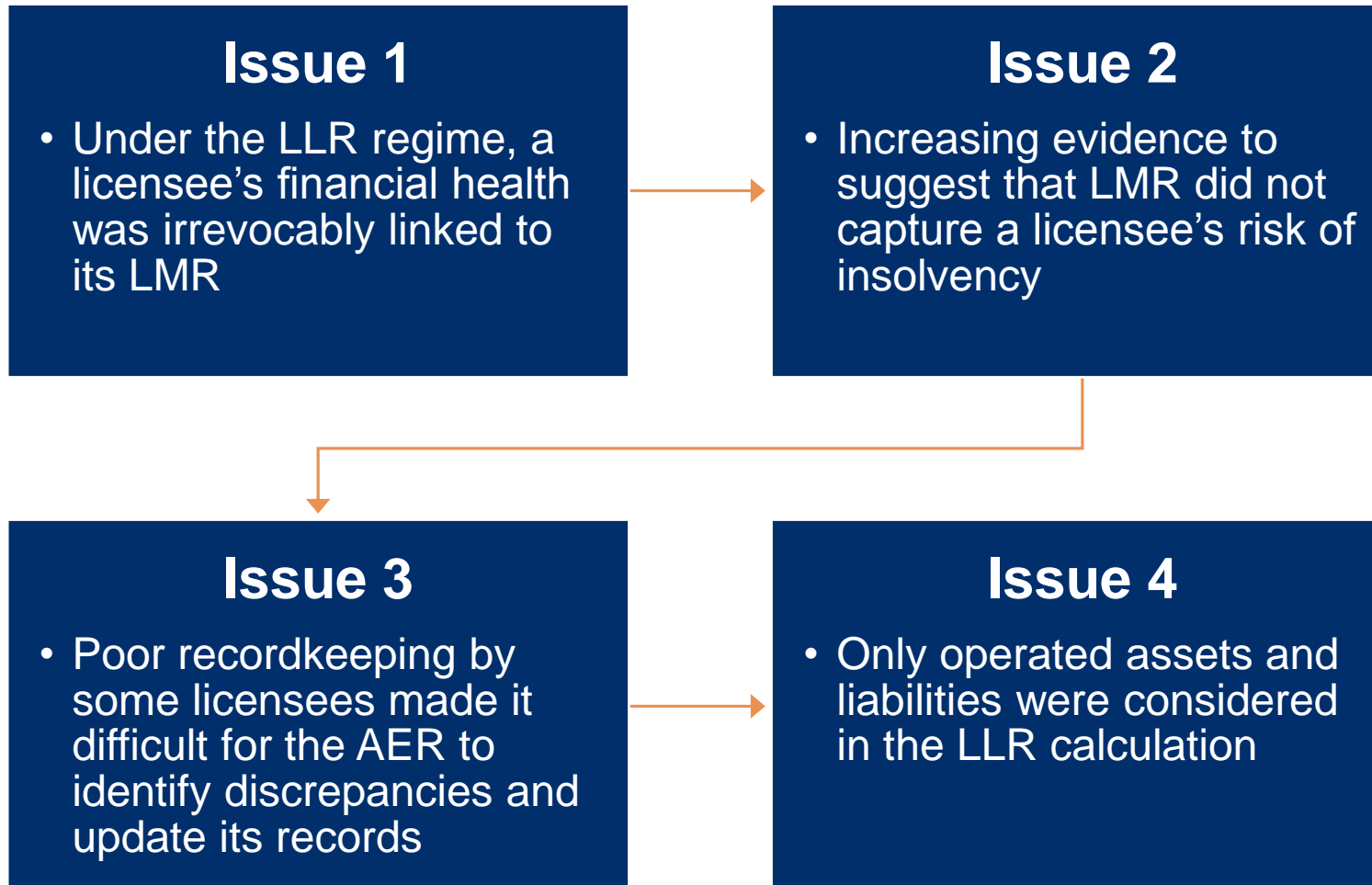


The Licensee Liability Rating (“LLR”) System

- The LLR system was re-vamped by the AER in 2013 through the release of *Directive 006 (Licensee Liability Rating Program)* to:
 - 1) Measure whether a company can address its regulatory liability obligations;
 - 2) Calculate a ratio of a company’s deemed assets and deemed liabilities; and
 - 3) Decide on licence transfers and security collections
- The LLR program utilized a licensee management rating (“**LMR**”) system to provide a real-time assessment of a company’s financial health
 - LMR is the ratio of a company’s assets to liabilities, calculated on a monthly basis
 - Companies with an $LMR < 1.0$ were required to provide a security deposit to the AER



Issues with the LLR System



Growing Need for a New Liability Management System

1. Under the LLR regime, compliant, low-risk and responsible oil and gas producers and taxpayers ended up funding the liabilities of irresponsible producers
2. In June 2016, the AER introduced Bulletin 2016-16 in response to the *Redwater* ABQB decision
3. As the price of oil dropped and the industry experienced economic upheaval, the orphan well count continued to grow
4. Alberta's orphan well problem was magnified in 2017 by the *Redwater* ABCA decision
5. In 2019 the SCC released its judgment on the *Redwater* case, paving the way for a new liability management system.



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PART 4:

The New Liability Management Framework



Emergence of The New Framework

- **July 30, 2020:** The Government of Alberta announced its new liability management framework designed to:
 - 1) Uphold the polluter-pays principle;
 - 2) Establish five-year rolling spending targets for reclamation; and
 - 3) Provide a process to address legacy and post-closure sites
- **December 17, 2020:**
 - The Government of Alberta amended the *Oil and Gas Conservation Rules* and *Pipeline Rules*
 - The AER released Bulletin 2020-26: Changes to *Oil and Gas Conservation Rules* and *Pipeline Rules*
- **December 1, 2021:** The AER released *Directive 088*, following consultation with stakeholders



Key Features of *Directive 088*

Holistic Licensee Assessment

- Assesses licensee capability and performance
- Multiple factors will be taken into account (i.e., financial statements, capabilities, unreasonable risk factors, and any other factors required in the circumstances)
- AER can use any information
- Licensees will only have access to their own information on file with the AER

Licensee Capability Assessment

- Designed to assess ability of licensees to meet their liability and regulatory obligations throughout the energy development life cycle
- It will consider the licensee's financial and liability risk, but it will also compare a licensee to its peers
- Risk factors determine, in part, whether security will be required by the AER, while the performance factors are used to determine the amount of such security

Licensee Management Program

- Licensees must provide the AER with all information requested and submit a site-specific liability assessment
- The Licensee Capability Assessment will assist the AER by identifying high risk licensees
- High risk licensees can be addressed through education, encouragement to follow industry best practices or, if necessary, specific regulatory action



Key Features of *Directive 088*

Inventory Reduction Program

- The Inventory Reduction Program sets closure spend targets for every licensee
- Each licensee must annually report its closure activities and spending
- Failure to meet the mandatory annual target or provide a security deposit triggers a Holistic Licensee Assessment to determine whether the AER should demand security and in what amount

Mandatory Closure Spend & Targets

- Licensees with inactive infrastructure are required to meet an individual annual AER-determined mandatory target, based on the licensee's liability, historical closure spending, and disclosed financial information
- Industry-wide closure spend targets are a five-year rolling target based on inactive liability and historical closure spending for previous years
- Voluntary closure spend

Reporting & Compliance

- Licensees may elect to report their closure spend either on an ongoing basis or upon completion of a closure milestone within a calendar year
- Licensees who do not meet their mandatory or voluntary spend targets are deemed to be noncompliant
- Enforcement mechanisms include request for security and loss of incentive eligibility



Key Features of *Directive 088*

License Transfers

- A license transfer application (“LTA”) may be submitted by the transferor, the transferee or any consultant or agent working on behalf of either party
- An LTA triggers an immediate Holistic Licensee Assessment of both the transferor and transferee
- Security may be required by either party

Security Deposits

- AER has broad and subjective authority to require a deposit
- AER will consider the Holistic Licensee Assessment, whether the licensee poses an unreasonable risk, or any other factor it considers appropriate
- Maximum amount of security that can be requested is the amount of the licensee’s total liabilities

Ceasing Operations

- Licensees who cease operations are expected to engage in an orderly wind-down of operations
- AER maintains first-priority lien over all other liens, charges, rights of set-off, mortgages and other security interests
- Licensees remain responsible for adhering to all other AER regulations

Initial Feedback, Issues, and Impact of *Directive 088*

- Impact on Due Diligence
 - AER will track, but not publicly produce, corporate LMRs
 - Licensees will have access to the following for their own company:
 - Liability Assessment Report;
 - Licensee Capability Assessment; and
 - Closure Activity and Spend
- Impact on Mineral Transactions
 - AER no longer offers feedback in consultation
 - Estimated timelines for decision – routine LTA 45 business days; non-routine LTA 60 business days



Initial Feedback, Issues, and Impact of *Directive 088*

- Working Interest Information
 - Under *Directive 088*, transacting parties will now update the AER on WIPs every time there is a license transfer
- The impact on the Orphan Fund Levy in the future could indicate the success of the new Liability Management Framework overall



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PART 5:

International Models of Liability Management



Australia

- Decommissioning liability has been one of the Australian government's biggest concerns since the Northern Oil & Gas Australia's ("**NOGA**") liquidation proceedings in 2020
- Decommissioning liabilities will cost AUD\$76 billion (approximately CAD\$76 billion) over the next 30 years to safely abandon oil and gas wells, pipelines and platforms in Australia
- Australia overhauled its liability regime effective March 3, 2022, with changes similar to the new Liability Management Framework (i.e., information gathering power and increased control over changes in titleholders)



The United Kingdom

- Former owners can only be liable for decommissioning offshore installations or pipelines in which they had an economic interest at the time they sold their interest
- Government can issue notice to certain persons to either submit a decommissioning program for the government's approval or, failing that, fund and complete the decommissioning program prepared by the government
- Sellers have a mechanism (typically letters of credit or guarantees) to achieve a clean break with the purchaser in an oil and gas asset transaction



Norway

- Ministry of Petroleum and Energy (the “**Ministry**”) requires licensees to provide an unlimited parent company guarantee for the benefit of the Norwegian State to secure all obligations in relation to the petroleum activities
- The licensee must submit a decommissioning plan to the Ministry two to five years before the license expires, is relinquished, or the use of a facility ceases
- All inter-company petroleum operations must be conducted through a single legal entity so that special-purpose entities cannot be created and then default
- A seller’s liability depends on the structure of the transaction (asset sale vs share sale)



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PART 6:

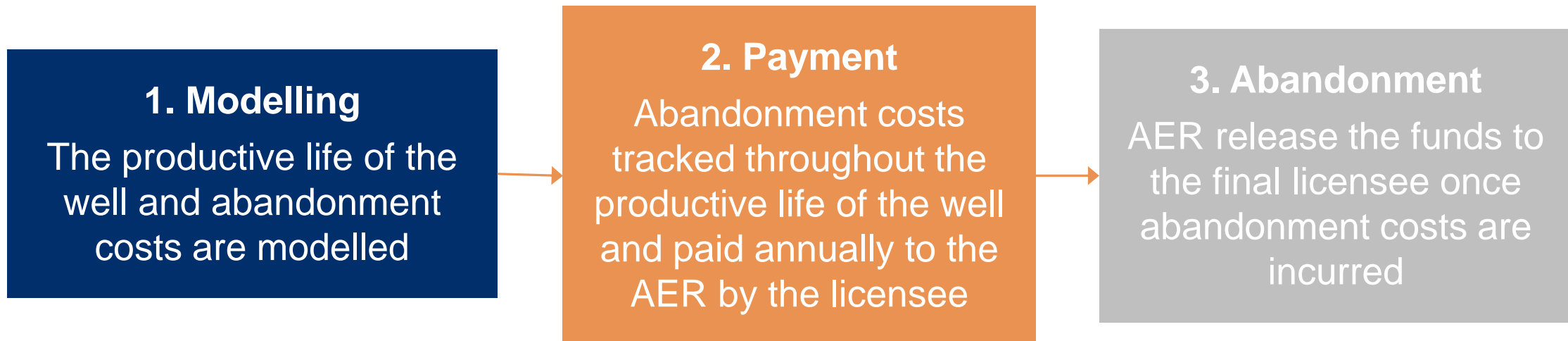
The Future of Liability Management in Alberta



Alberta's Liability Management Regime & Alternatives



An Alternative Model: Pay-As-You-Go



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