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# **A Made-in-Alberta Failure: Unfunded Oil and Gas Closure Liability**

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## EXECUTIVE SUMMARY

Alberta policy on inactive and orphan oil and gas wells is a massive regulatory failure characterized by a historical lack of transparency, excessive regulatory discretion, and regulatory capture — three deficiencies long since identified and understood in the scholarship as undermining the effectiveness of environmental laws and policies. The current policy to deal with the problem, the 2020 Liability Management Framework, fails to address these structural problems and is consequently unlikely to substantially reduce inventories of orphan and inactive assets. It is equally unlikely to uphold the polluter-pays principle, which states that the entity that pollutes the environment is responsible for cleaning it up. It is time for an independent and transparent public inquiry to examine Alberta’s mishandling of the inactive and orphan well problem and to recommend a regime that will effectively meet this challenge.

The inactive and orphan oil and gas well problem is an immense environmental and financial crisis that has been unsuccessfully dealt with by various policies over several decades. Approximately 230,000 drilled wells in the non-oil sands sector need to be abandoned and reclaimed, while 90,000 others that have been abandoned still await reclamation. The industry has continually delayed this closure work, resulting in a current liability estimate of at least \$60 billion—and quite possibly double that amount. This liability is largely unfunded as industry has not set aside enough (or any) money to pay for it, while successive governments over many decades have failed to require industry to post security in any meaningful amounts. In the absence of significant and immediate legal and policy reforms, the coming years and decades will see the enormous environmental, social, and economic costs of this regulatory failure fall on the province’s taxpayers.

The new Liability Management Framework’s components include mandatory spending to reduce the inactive inventory, assessment of licensee risk and capacity, and an orphan program. On their face, these are steps in the right direction. However, persisting high levels of secrecy, discretion, and nearly exclusive industry influence put the framework’s goals in doubt. Under the new framework, the Alberta Energy Regulator (AER) will not disclose financial information on licensees or even the general state of the oil and gas industry. The new framework also still relies heavily on AER discretion to trigger closure obligations and fails to legislate timelines or quotas for closure work. Provisions for external scrutiny are minimal, impeding meaningful democratic oversight. Finally, the framework perpetuates historic industry influence in its design and implementation, which to date has resulted in a singular focus on minimizing industry’s costs at the expense of reducing environmental risks and protecting the public purse.

Albertans have watched for decades as the problem of orphan and inactive assets has burgeoned into an environmental and financial crisis. They deserve a full accounting for the policies that have led to this state of affairs and they need unimpeded access to all of the relevant facts and information so that they can better understand the policy choices facing them as residents and taxpayers in the province.

## DEFINITIONS AND SPECIALIZED TERMS

Key terms referenced frequently in this paper have technical definitions set out in legislation and applicable policy. The paper is intended to be read by a wide range of interested persons who may or may not have access to specialized knowledge of Alberta's closure liability problem. Accordingly, we offer the following simplified description of key terms.

**Abandonment:** Abandonment is decommissioning, or the permanent dismantlement of a well or facility, so it is left in a safe and secure condition, or the permanent deactivation of a pipeline. An abandoned well has had the wellbore plugged and the wellhead removed at the surface.

**Closure work:** Closure work means abandonment, remediation (if needed) and reclamation.

**Inactive:** A well, pipeline or other facility is considered to be inactive if it has been shut in or not in use for a specified time period, typically 12 months, and closure work has not been started.

**Legacy site:** A legacy site is an oil and gas infrastructure site that was not reclaimed or not reclaimed to current standards and is not covered by the orphan fund system because the oil and gas site ceased operating before the orphan fund system took effect, so that no one accepts financial responsibility for the reclamation.

**Licensee:** A licensee is the holder of a licence for oil and gas infrastructure (usually a corporation). The term "licensee" is used throughout in this paper to reference the person(s) responsible for performance of closure work; however, readers should be aware that the person(s) responsible may be an entity other than the holder of a licence.

**Orphan:** A well, pipeline or other facility that the Regulator has designated as an orphan because there is no owner, licensee or other person having responsibility for closure work. A well, pipeline or other facility will normally become an orphan when it does not have a solvent owner or licensee.

**Reclamation:** Reclamation is returning the surface land disturbed by a well, pipeline or other facility to a state which is deemed to be equivalent to what existed prior to the development.

**Remediation:** Remediation is decontamination, or the removal of harmful substances from the site of a well, pipeline or other facility.

**Regulator:** The name, structure and responsibility of the regulatory agency governing Alberta's energy sector has changed many times over the years. Post-1986, the agency has been known as the Energy Resources Conservation Board (ERCB), Alberta Energy and Utilities Board (EUB) and the Alberta Energy Regulator (AER). The term "Regulator" is used throughout this paper to reference each of these iterations.

**Suspension:** The placement of an inactive oil and gas site into a safe condition, typically involving non-permanent sealing of a well to prevent leaks and locking surface equipment. While suspension is an important public and environmental safety measure, it is not part of closure work. Suspension obligations vary depending on the type of well, pipeline or facility.

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## PART 1: INTRODUCTION

Alberta is facing an environmental and financial crisis of immense magnitude, commonly known among industry observers as the inactive and orphan oil and gas well problem. Roughly 237,000 drilled wells in Alberta’s conventional (non-oil sands) sector need to be abandoned and reclaimed, 80,000 of which are currently inactive, while another 90,000 already abandoned wells still await reclamation.<sup>1</sup> Industry has postponed closure work for decades, causing it to grow into a massive long-term environmental liability. The exact size of this closure liability is unknown — official but unreliable estimates are at least \$60 billion, while other estimates suggest that the cost is likely to be at least double that amount. This enormous financial burden is exacerbated by the fact that almost all of this closure liability is currently unfunded. Industry has not set aside money to pay for this work and Alberta has not required oil and gas licensees to post security or used other financial assurance instruments in a meaningful way to ensure funding will be available. Worse still, this environmental and financial liability problem is not limited to oil and gas wells — it includes pipelines and related facilities — and its consequences extend beyond the closure of sites. Downstream from the inactive and orphan well problem are large unpaid property tax bills and lease payments from financially hollow oil and gas corporations with closure liabilities larger than the value of their remaining assets.

This problem is widely acknowledged to be the result of long-term policy and regulatory failure, having unfolded over several decades under the watchful eye of an established regulatory agency and a mature legal framework. It is also a clear failure to adhere to the polluter-pays principle which, in general terms, holds that the person who causes environmental pollution should be responsible for cleaning it up.<sup>2</sup> Moreover, it has become a classic tale of socializing what should be private losses, as public money is increasingly allocated to pay for closure work.

Our objective is to build on the growing body of literature describing the extent of the closure liability problem in Alberta’s conventional oil and gas sector.<sup>3</sup> Recognizing that past performance is one of the best predictors of the future, this paper offers a historically grounded law and policy evaluation of the Liability Management Framework announced in July 2020 — Alberta’s most recent attempt to tackle this problem (Government of Alberta 2020). Our evaluation is focused primarily on program design and its governing legislation. Drawing on lessons from Alberta’s approach to closure liabilities over the past 40 years, our primary goal is to assess whether the 2020 Liability Management Framework is designed to achieve its purported objectives of finally getting closure work done and ensuring the polluter — not Alberta taxpayers — pays for it. A secondary goal is to identify and explain the primary law and governance factors that in our view have contributed to Alberta’s historical failure to effectively manage closure liabilities and that appear bound to confound current efforts.

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<sup>1</sup> As of September 2023, see the Alberta Energy Regulator Data Hub “Well Status,” <https://www.aer.ca/providing-information/data-and-reports/data-hub/well-status>.

<sup>2</sup> For a detailed review of the literature on the polluter-pays principle, see Vlavianos 2000, 15–25.

<sup>3</sup> Several studies published recently have described the inactive and orphan oil and gas well problem in Alberta: (Barretto et al 2022; Shaffer, Dachis and Thivierge, 2017; Boychuk, Anielski, Snow and Stelfox 2021; Levin 2023). The auditor general recently issued his own deeply critical report on the implementation of the 2020 Liability Management Framework to date (Auditor General 2023).

In approaching these questions, we recognize that effectiveness is not a binary proposition but rather a matter of calibration. As Canada's Ecofiscal Commission (2018, 6) recently explained in its comparative assessment of several provincial mining liability regimes in Canada:

... policy-makers face multiple, competing goals. First, good policy should create incentives for the businesses involved to reduce the risk of environmental harm. Second, it should reduce the extent to which society bears the costs of any environmental damage that does occur. Third, good policy should consider the economic costs of achieving the first two goals.

As further set out in Part 3, which explores the history of liability management in Alberta's conventional oil and gas sector, Alberta's approach has been predominantly if not exclusively oriented towards the third goal of minimizing the sector's economic costs in order to promote continued investment, at the expense of reducing the risk to the environment (first goal) and endangering the polluter-pays principle (second goal). Going through this history, several factors – each well understood in the scholarship as a defect that undermines the effectiveness of environmental laws and policies – become apparent: a lack of transparency, excessive delegation of discretionary authority and regulatory capture by the industry.

The paper is organized as follows. Part 2 sets out a brief history of Alberta's inactive and orphan oil and gas well problem and describes how we assess Alberta's approach to addressing it. Part 3 sets out the general legal framework for liability management in Alberta and describes the four components of the Liability Management Framework, the problems that each is meant to address, their historical development and their current forms and explains their deficiencies. Part 4 summarizes our key findings and makes several recommendations, the most important of which is to call for an expert, independent and transparent public inquiry into the closure liability challenge.

Uniquely, our analysis in Part 3 relies extensively on records obtained using requests under the *Freedom of Information and Protection of Privacy Act*.<sup>4</sup> The portions of these records relied on in the paper are attached in the FOI Appendix. These requests were necessary because the Regulator and Alberta government have actively resisted disclosing the size and nature of the orphan and inactive asset problem. Records obtained through *Freedom of Information and Protection of Privacy Act* requests allow some insight into public body decision-making that occurred behind closed doors (Walby and Larsen 2011). Moreover, transparency has long been recognized by the environmental law and policy scholarship as critical to its success. Where a regulator works with regulated industry in secrecy, non-compliance with regulations leads to the renegotiation of the regulations instead of penalties (Rankin and Finkle 1983, 42–43). Part 3 is full of examples of the Regulator engaging in the secret renegotiation of regulations to the public's detriment.

These records also reveal how the Regulator has exercised its various and broadly discretionary (i.e., open-ended) powers in favour of industry, the potential for which has also long been recognized in environmental law scholarship. In matters of environmental and natural resources development, it is widely understood that the executive branch's exercise of discretion is "subject to the political, economic, and social winds of the time and place in which any particular decision occurs" and that "such winds usually favour business as usual," not environmental protection (Pardy 2005, 217; Boyd 2003, 233). Consequently, the most effective environmental laws impose constraints on the exercise of such discretion, e.g., by requiring public participation or adherence to certain principles, such as the precautionary principle and polluter pays (Bankes, Mascher and Olszynski 2014, 6044; Tarlock 2004). Part 3 provides selected illustrations of how the applicable legislative framework grants broad discretionary power to the Regulator.

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<sup>4</sup> Freedom of Information and Protection of Privacy Act, RSA 2000 c F-25. See also Yewchuk, 2023; Anderson. 2022a.

Part 3 also documents an exceedingly close relationship between the Regulator and industry associations (also known as lobby groups), who appear to have influenced the Regulator on key policy decisions regarding liability management.<sup>5</sup> While the relationship between a regulator and the regulated community need not be antagonistic, a regulator that prioritizes the interests of the regulated industry over the public and other stakeholders' interests is indicative of a phenomenon known as "regulatory capture": "the result or process by which regulation, in law or application, is consistently or repeatedly directed away from the public interest and toward the interests of the regulated industry, by the intent or action of the industry itself" (Carpenter and Moss 2014, 13; MacLean 2019). A consensual approach to regulation and a good working relationship with industry should not come at the exclusion and expense of public participation and the public interest (Fluker 2015).

Part 4 concludes by summarizing our key findings in relation to the 2020 Liability Management Framework and the law and governance factors (a lack of transparency, excessive discretion and regulatory capture) that have frustrated – and will very likely continue to frustrate – the effectiveness of Alberta's approach to closure liabilities. It also includes our recommendation for a public inquiry to address the concerns we identify here.

## **PART 2: A BRIEF HISTORY OF ALBERTA'S CLOSURE LIABILITY PROBLEM**

The problem of closure liability in Alberta's oil and gas industry became apparent in the 1980s with the onset of declines in oil and gas commodity prices and an increase in bankruptcies in the sector. In 1986, the Regulator announced the creation of a new fund to address closure liability for orphan wells (the first iteration of an orphan fund). The declining economic fortunes of Alberta's oil and gas industry was accompanied by an uptick in the transfer and divestiture of assets which increased the number of companies operating in the sector. The number of licensees operating in Alberta jumped from less than 80 in 1974 to over 700 in 1995 (Touchette 1995, 267).

It became apparent that more companies than initially expected were likely not going to properly abandon and reclaim their inactive sites. In 1989, the Regulator estimated that there were 25,000 inactive wells and 243 orphan wells in Alberta (ERCB 1989, i-ii).<sup>6</sup> In response, the Regulator considered shifting to a policy of scrutinizing well licence transfer applications and imposing closure obligations on previous licensees where an existing licensee was defunct, noting this would "ensure that those who sell low-productivity wells do so to viable, responsible operators who can be relied upon to abandon the wells properly as and when necessary" (ERCB 1989, 4). However, the Regulator backed away from this proposal and instead agreed to establish a joint task force with industry associations to develop a new proposal to address closure liability in the face of an increasingly complex oil and gas industry and a growing inventory of inactive and orphan wells (CPA, IPAC and EPAC 1990, 113-128). The joint task force rejected the notion of scrutinizing well licence transfers criteria (CPA, IPAC and EPAC 1990, 122). The Regulator believed industry was "prepared to accept the costs of any orphan wells that are generated because the Board has not been as thorough in the processing of well license transfers" (Nichol 1991, 3-5).

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<sup>5</sup> Some examples of consultation only with industry include EUB General Bulletin 2003-26: "Licensee Liability Rating (LLR) Program Scheduled Review," July 10, 2003; AER, "LLR Program Review Proposed Changes," April 26, 2004, question 6; J. R. Nichol, "Orphan Wells: Who is Responsible - For How Long and at What Cost?" AER Archive, 91-30.

<sup>6</sup> The Regulator noted that the actual number of orphans may have been as low as 17 or as high as 1,600 once all investigations were complete, as processes for identifying and tracking orphans were not well developed.

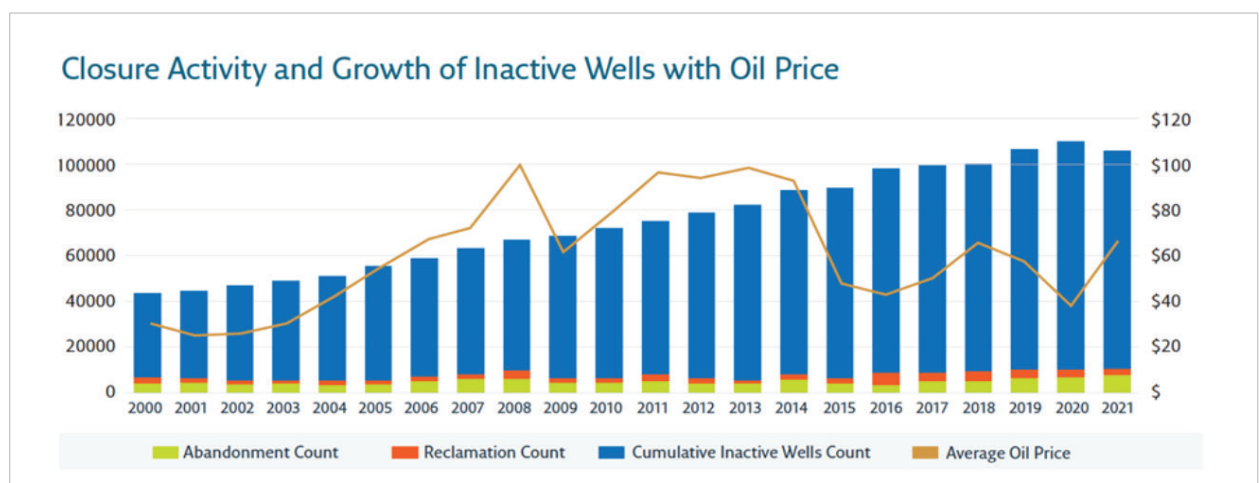
Despite a rising number of inactive and orphan sites with outstanding closure obligations, this “bargain” between industry and the Regulator remained intact, but with some alterations. In 1993, the Regulator began screening the number of active and inactive wells held by each company to avoid companies acquiring more closure liabilities than they could handle (EUB 1993; Brezina and Gilmour 2003, 41), but the orphan fund remained the primary regulatory focus to address closure liability. In 1994, the Regulator replaced the fund created in 1986 with a new fund approach consisting of fees collected from first-time companies applying for oil and gas licences and an annual levy imposed on the licensee for each inactive well. The fund was now explicitly capitalized by industry and it was soon given a larger mandate. Beginning in 1996, not only would the fund cover the costs for abandonment of orphan wells, but also the costs to abandon orphan facilities other than wells, as well as remediation and surface reclamation costs for all orphan sites.

Nevertheless, it was clear these measures were not halting the growth of inactive sites not being properly abandoned or reclaimed by industry in Alberta. In November 1997, the Regulator responded to this concern by implementing a requirement that all wells inactive for more than 10 years be abandoned, placed back into production or have financial security posted for their abandonment by December 2002. Unfortunately, the Regulator cancelled this program in October 2000.

The elimination of the closure requirements for inactive wells was one of three significant changes in policy direction between 2000 and 2002 implicating closure liability in Alberta’s conventional oil and gas sector. The second change was legislative amendments to transfer control over the administration and management of the abandonment fund to an industry-governed association. The third change was implementation of an assessment program using a ratio of a well licence holder’s deemed assets versus deemed liabilities as the basis for calculating solvency and closure liability risk. Industry significantly influenced the design of this program (as well as the cancellation of the closure requirements for inactive wells). All three of these policy changes did nothing to curb rising levels of inactive sites in Alberta’s conventional oil and gas sector.

Figure 1 shows the number of inactive well sites in Alberta consistently growing for two decades post-2000 in the context of both rising and falling commodity prices:

**Figure 1: Inactive Wells and Average Oil Price**



Source: Auditor General of Alberta, 2023.



In July 2014, the Regulator took a small step towards reducing the environmental risks associated with inactive wells by implementing a concerted compliance program to ensure proper suspension of inactive well sites. However, this program did not require actual closure work, and in any event, by 2014 the closure liability problem was well out of hand with more than 80,000 inactive wells needing abandonment and reclamation. A steep decline in commodity prices post-2014 (see Figure 1) led to insolvencies in the oil and gas sector, a sharp increase in orphan sites handed over to a severely under-resourced orphan fund (see Figure 2, below) and public acknowledgment that the amount of outstanding closure liability vastly exceeded security deposits held by the Regulator. The single greatest public policy failure in Alberta's history had resurfaced.

The bankruptcy sagas of Lexin Resources Ltd. and Redwater Energy Corporation are two well-known illustrations of the closure liability problem. In the Lexin case, Lexin stopped meeting various regulatory obligations, the Regulator petitioned Lexin into bankruptcy and by February 2017, the Regulator had designated 1,088 wells, 72 facilities and 1,165 pipelines from Lexin as orphans, transferring these sites to the Orphan Well Association (Resource 2017; OWA 2017, 25).<sup>7</sup> For some perspective on the magnitude of these numbers, between 1989 and 2012 the orphan fund had fewer than 100 wells for closure in its inventory, and the number of sites to close only gradually rose to approach 1,000 around 2012.<sup>8</sup>

After Redwater Energy entered bankruptcy, the Regulator refused to approve the transfer of licences for Redwater's producing wells in order to retain assets in the company to pay for its closure liabilities and prevent its assets from becoming orphans. The bankruptcy trustee successfully challenged this refusal in the Alberta courts, causing the Regulator to review its approach to the closure liability problem (AER 2016). However, in 2019 the Supreme Court of Canada confirmed the Regulator's authority to control the disposition of assets from insolvent corporations in order to lower the number of wells from becoming orphaned liabilities (*Orphan Well Association v. Grant Thornton Ltd.*, 2019 SCC 5). Notwithstanding this favourable outcome for the Regulator, a dissenting Supreme Court justice observed that Alberta's policy on addressing closure liability was largely to blame for the Regulator's predicament and astutely noted that other policy tools could be used to address the problem:

Whatever the merits of these competing positions, in matters of statutory interpretation this Court is one of law, not of policy. As the majority recognizes, at para. 30, "it is not the role of this Court to decide the best regulatory approach to the oil and gas industry"; decisions on these matters are made — indeed, they *have been made* — by legislators, not judges. And the law in this case supports only one outcome. But this does not mean that the AER is without options to protect the public from bearing the costs of abandoning oil wells. It could adjust its LMR requirements to prevent other oil companies from reaching the point of bankruptcy with unfunded abandonment obligations (as it has already done since this litigation began). *It could adopt strategies used in other jurisdictions, such as requiring the posting of security up-front so that abandonment costs are not borne entirely at the end of an oil well's life cycle.* One of the interveners, the Canadian Bankers' Association, noted that such *systems of up-front bonding are prevalent in American jurisdictions.* The AER could work with industry to *increase levies so that the orphan fund has sufficient resources to respond to the recent increase in the number of orphaned properties.* It could seek judicial intervention in cases where it suspects that a company is strategically using insolvency as a voluntary step to avoid its environmental

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<sup>7</sup> Resource was a website run by the Regulator.

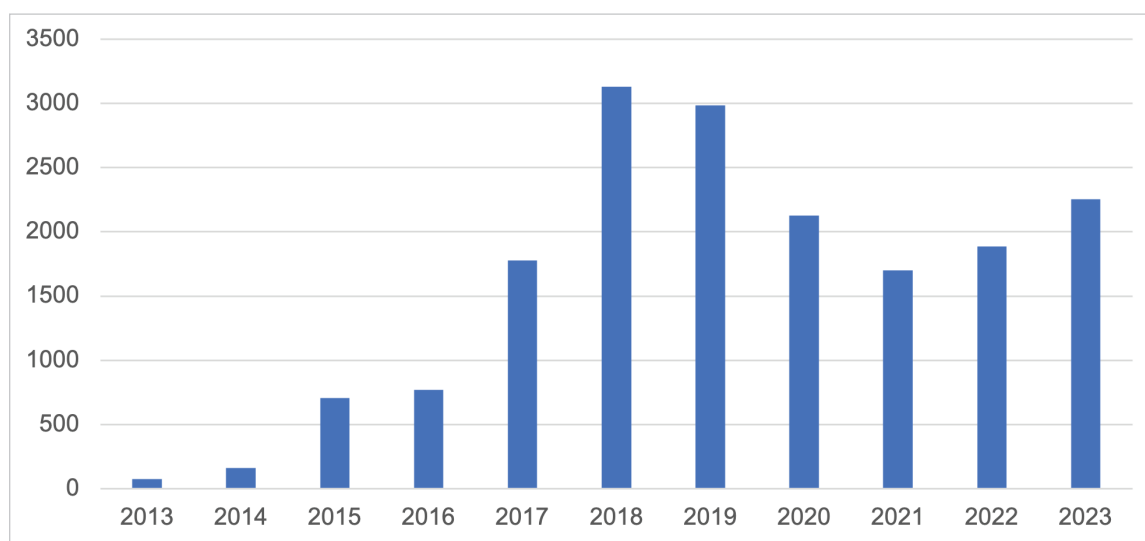
<sup>8</sup> This information is vague because of inconsistent reporting in the OWA annual reports from 1994/1995 to 2011/2012.

liabilities (*Sydco Energy Inc. (Re)*, 2018 ABQB 75, 64 Alta. L.R. (6th) 156, at para. 84). And, as I have noted, it can continue to apply the province’s statutory regime to all assets of an insolvent or bankrupt debtor that are retained by a receiver or trustee, including wells and facilities that the receiver or trustee seeks to operate rather than sell.

(*Orphan Well Association v. Grant Thornton Ltd.*, 2019 SCC 5 at para 290, dissenting opinion of Justice Suzanne Côté, emphasis added).

Although careful observers had been aware of the problem much earlier (for example, Robinson 2014), by 2019 it was clear to everyone that Alberta’s approach to addressing closure liability was woefully inadequate. The most apparent indicator of this problem was perhaps the new normal for inventory levels in the orphan fund.

**Figure 2: Wells for Abandonment with the Orphan Well Association**



Source: OWA annual reports: 2012/13–2022/23.

Figure 2 shows the inventory of orphan wells needing abandonment by the fund. However, these numbers underestimate the true extent of orphan sites. A more accurate inventory of orphan sites must include wells needing reclamation and remediation, as well as closure work for orphan sites other than wells. On July 1, 2023, the Orphan Well Association (OWA) inventory held a total of 3,134 orphan sites (wellbores and facilities) for abandonment, 7,796 orphan pipelines for abandonment and 6,800 orphan sites for reclamation (45 per cent of which are in or nearing final certification) (OWA n.d.).

It was also very apparent by 2019 that existing closure liabilities exceeded earlier estimates by huge amounts, dwarfing the amount of money the Regulator held in security for closure work. In 2018, the Regulator worked with industry to generate improved estimates that were subsequently leaked to the media that estimated existing closure liabilities for the conventional oil and gas sector alone had swelled to \$130 billion (De Souza, Jarvis, McIntosh and Bruser 2018; Bellefontaine 2018).<sup>9</sup> The Regulator responded with a public statement that the verified estimate of total liability for the entire sector (conventional and non-conventional) at the time was \$58.65 billion, with \$30 billion of that figure being in relation to conventional oil and gas assets (AER 2018).

<sup>9</sup> Note also that the total figure was \$260 billion, with oilsands mines accounting for the other \$130 billion.

In April 2020, the federal government announced a \$1 billion grant to Alberta, ostensibly to help offset the COVID-19 pandemic economic slowdown in the oil and gas sector by funding abandonment and reclamation work on inactive wells (Government of Alberta n.d.; Anderson 2023). This federal infusion of money was in exchange for a commitment by Alberta to make regulatory changes to reduce the future prospect of new orphan wells and ensure industry complies with the polluter-pays principle (Department of Finance 2020; ATI 2021, 2). In July 2020, the Alberta government, with the encouragement of industry associations,<sup>10</sup> announced a general outline of its new Liability Management Framework. The new framework has the stated objectives of reducing Alberta's large inventory of inactive wells, preventing wells from becoming orphans without a solvent owner, ensuring timely surface remediation and reclamation and addressing the closure of legacy sites (Government of Alberta 2020).

As of July 2023, Alberta has 80,871 inactive wells that have not been abandoned or reclaimed and 89,627 abandoned wells that have not been reclaimed (AER n.d.a). According to the auditor general, the Regulator estimates conventional oil and gas closure liabilities are now approximately \$60 billion – double their 2018 “official” estimate – while the Regulator holds less than \$295 million in security (as of July 2023) (Auditor General 2023, 23; AER 2023a).

Will the 2020 Liability Management Framework prevent the landslide of orphans that will almost certainly occur if major progress on closure is not undertaken soon? In other words, will this framework ensure industry complies with the polluter-pays principle? With these questions in mind, in Part 3 we undertake a critical examination of how Alberta's liability management framework evolved from 1986 to 2020, providing more specific details on programs mentioned briefly in this part, and we assess the design of the 2020 Liability Management Framework.

## **PART 3: THE LIABILITY MANAGEMENT FRAMEWORK**

### **THE STATUTORY FRAMEWORK FOR CLOSURE LIABILITY IN ALBERTA**

Closure liability is governed by an extensive collection of legislation (statutes, regulations and directives) and programs administered and implemented by the Regulator and formally under the oversight of the minister of energy. The *Responsible Energy Development Act*<sup>11</sup> establishes the Regulator's mandate to provide for the development of energy resources and tasks the Regulator with the oversight and regulation of abandonment, remediation and reclamation of wells, pipelines and other facilities. General structural matters like the establishment and governance of the orphan fund, as well as the basic legal obligations with respect to closure work are set out in the following statutes: the *Oil and Gas Conservation Act*;<sup>12</sup> the *Pipeline Act*;<sup>13</sup> and the *Environmental Protection and Enhancement Act*.<sup>14</sup> Figure 3 is a *simplified* representation of Alberta's legislative framework governing liability management and closure work.

As noted above and further discussed below, each of these laws and their associated regulations are broadly discretionary: they enable the Regulator to do things (e.g., to order a licensee to undertake closure work), without compelling or even constraining the exercise of such powers in any meaningful way. As one rough measure of the extent of this delegated discretion,

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<sup>10</sup> See the letter from the Canadian Association of Petroleum Producers to the Minister of Energy, dated June 24, 2019, released in FOIP 2020-G-0042, online at <https://thenarwhal.ca/wp-content/uploads/2023/05/AER-liability-narrative.pdf> attached to Anderson 2023.

<sup>11</sup> SA 2012, c R-17.3, s 2.

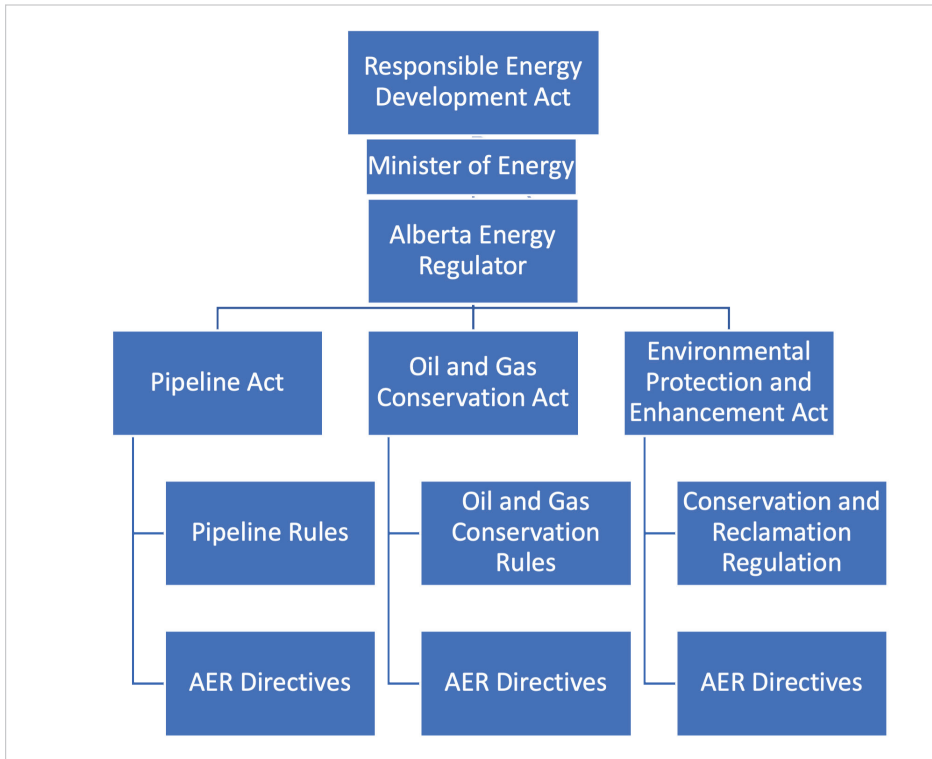
<sup>12</sup> RSA 2000, c O-6

<sup>13</sup> RSA 2000, c P-15

<sup>14</sup> RSA 2000, c E-12.

the term “may” (e.g., the Regulator *may* prescribe conditions) appears 190 times in the *Oil and Gas Conservation Act*, 84 times in the *Pipeline Act* and an astounding 437 times in the *Environmental Protection and Enhancement Act*.

**Figure 3: Legislative Framework Governing Liability Management and Closure Work**



The 2020 Liability Management Framework has four components:

- 1) Inactive Inventory Reduction;
- 2) Licensee Risk and Capacity Assessment;
- 3) Orphan Program; and
- 4) Legacy and Post-closure Site Clean-up.

Below, we describe the purpose, history and details of each component as it currently exists (including the applicable legislative provisions). The discussion on legacy and post-closure sites is cursory and does not follow the format of the other three components because at the time of writing, Alberta had not yet created a legacy and post-closure site program, despite committing to one in 2020.

## 1) INACTIVE INVENTORY REDUCTION

### Purpose

The purpose of an inactive inventory reduction program is to ensure the conduct of closure work on inactive sites within a specified period. In many jurisdictions, this requirement includes a prescribed timeframe within which the work must be started or completed, and the amount of allocated time is typically calculated as a number of years after a site becomes inactive (Muehlenbachs 2017, 3). As an alternative approach, an inventory reduction program may establish a minimum amount of closure work that a licensee must perform within a prescribed timeframe without assigning the obligation to any particular site.

### Program History

Alberta did not have an inventory reduction program until 1997, when the Regulator implemented the Long Term Inactive Well Program (LTIWP) in an effort to reduce the rising number of inactive wells that had not been properly closed (EUB 1997).<sup>15</sup> The LTIWP required all wells inactive for more than 10 years to be abandoned, placed back into production or to have financial security posted for their abandonment by December 2002. By the end of 1999, 1,200 wells that had been inactive for more than 10 years were abandoned and financial security was collected for another 1,500 (EUB 2000a). The LTIWP was intended to increase the abandonment rate to 5,000 wells per year (EUB 1997, 41).

Despite some success at achieving closure work on long-term inactive wells, the Regulator abruptly cancelled the program in October 2000. Internal records suggest the Regulator moved away from the LTIWP because industry was choosing to pay security deposits (around \$10,000-\$15,000 per well) rather than perform closure work. Industry had also expressed concerns the LTIWP was hampering its ability to “selectively administer wells” by limiting its ability to decide which wells to prioritize for closure (e.g., based on location, complexity, etc.) (EUB 2000a). In announcing the end of the LTIWP, the Regulator also indicated the program would be made redundant by the new Licensee Liability Rating program (described below under the “licensee risk and capacity assessment” component) (EUB 2000b).

The number of inactive sites continued to grow. In 2014, the Regulator implemented the Inactive Well Compliance Program, which as noted above did not aim to reduce the number of inactive wells but rather to ensure inactive wells had been properly suspended as the Regulator required.<sup>16</sup> Even this tepid goal, however, was not achieved. The Regulator indefinitely paused compliance assurance relating to suspension in 2019.<sup>17</sup> In March 2021, there were more than 15,000 inactive wells not properly suspended (AER 2021a).

In 2018, the Regulator, in conjunction with industry associations, developed the Area-Based Closure (ABC) program, whereby multiple licensees would complete closure work in one geographic area in order to reduce overall costs (as opposed to closure work based on the age of inactive wells) (AER 2020). Participation in the ABC program was voluntary and incentive-based, with the Regulator granting amnesty on other regulatory obligations for participants that completed prescribed amounts of closure work.

<sup>15</sup> See also John Nichol, 1995. “Alberta’s Orphan Well Prevention Program Support Processes,” October 18, 1995, FOI Appendix (C) 2023-G-0015, vol. 5, 242-244.

<sup>16</sup> For a detailed discussion of the problem with improperly suspended wells and the Inactive Well Compliance Program, see Robinson 2014, 7-10.

<sup>17</sup> The Regulator did not report the pause to the public. The public was informed of the pause by the auditor general, at which point the compliance assurance program had been paused for four years. (Auditor General 2023, 34).

## Inactive Inventory Reduction in 2023

The statutory obligation to abandon a well is set out in section 27 of the *Oil and Gas Conservation Act*,<sup>18</sup> and for a pipeline the obligation is set out in section 23 of the *Pipeline Act*. The statutory obligation to remediate lands affected by the release of harmful substances from a well, pipeline or facility is set out in section 112 of the *Environmental Protection and Enhancement Act*. The statutory obligation to reclaim lands upon which a well, pipeline or facility is constructed is set out in section 137 of the *Environmental Protection and Enhancement Act*. These statutes also set out who must fulfil the obligation, when the work must be conducted, who pays for the work and where liability flows in cases where the work is not conducted, was left incomplete or otherwise not done properly.<sup>19</sup>

It is crucial to observe that these obligations are triggered almost entirely at the Regulator's discretion. For example, the obligation to abandon a well almost always requires a direction from the Regulator: "[A] licensee or approval holder shall suspend or abandon a well or facility when directed by the Regulator or required by the regulations or rules."<sup>20</sup> There is no statutory rule establishing a timeframe for when abandonment must occur. Similarly, the statutory obligation to reclaim a site does not set out when reclamation must be done.<sup>21</sup> The absence of legislated timeframes for closure work means that, in almost all cases, the work is only conducted either voluntarily by the licensee or when the Regulator issues an order.

The abandonment, remediation and reclamation work is also governed by applicable subordinate legislation: rules, regulations and AER directives. Abandonment for wells must be conducted in accordance with the requirements of AER Directive O20.<sup>22</sup> Abandonment for pipelines must be conducted in accordance with section 82 of the *Pipeline Regulation*.<sup>23</sup> Remediation and reclamation must be conducted in accordance with requirements established by Alberta Environment and Protected Areas (AEPA)<sup>24</sup> under authority provided by the *Remediation Regulation*<sup>25</sup> and the *Conservation and Reclamation Regulation*.<sup>26</sup> Remediation and reclamation work is not completed until the Regulator certifies it under the *Environmental Protection and Enhancement Act*.<sup>27</sup> This certification is issued at the Regulator's discretion.<sup>28</sup>

The Liability Management Framework announced in July 2020 includes closure spending targets (see below). To facilitate this, provisions were added to the *Oil and Gas Conservation Rules* and the *Pipeline Regulation* to authorize the Regulator to implement an inventory reduction program by imposing a closure work quota on a licensee.<sup>29</sup> There are no legal rules to prescribe the actual

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<sup>18</sup> The terms "well" and "facility" are defined in section 1 of the *Oil and Gas Conservation Act*.

<sup>19</sup> For a discussion of these requirements (in particular to whom liability attaches), see Vlavianos, 2002. The legislative framework has changed significantly since 2002, and a more recent discussion is set out Lilles, 2017.

<sup>20</sup> *Oil and Gas Conservation Act*, s 27(1). Section 3.012 of the *Oil and Gas Conservation Rules*, Alta Reg 151/1971, sets out specific instances for when the abandonment obligation is triggered but generally so long as the licensee remains in operation and current with applicable legal requirements the obligation will not be triggered without an order by the Regulator.

<sup>21</sup> *Environmental Protection and Enhancement Act*, s 137.

<sup>22</sup> *Oil and Gas Conservation Rules*, Alta Reg 151/1971, s 3.013. The specific requirements are set out in AER Directive O20: "Well Abandonment," October 19, 2022, <https://www.aer.ca/regulating-development/rules-and-directives/directives/directive-O20>.

<sup>23</sup> *Pipeline Regulation*, Alta Reg 91/2005. See also AER Directive O56: "Energy Development Applications and Schedules," <https://www.aer.ca/regulating-development/rules-and-directives/directives/directive-O56>.

<sup>24</sup> See Land Reclamation and Remediation Forms,

<https://www.alberta.ca/land-reclamation-and-remediation-forms.aspx>.

<sup>25</sup> *Remediation Regulation*, Alta Reg 154/2009.

<sup>26</sup> *Conservation and Reclamation Regulation*, Alta Reg 115/1993.

<sup>27</sup> Sections 117 and 138 govern the issuance of a remediation and reclamation certificate, respectively.

<sup>28</sup> Notably, it was reported in 2019 that the Regulator issued certification for reclamation work without a site visit in approximately 97 per cent of instances (Riley 2020). Moreover, the Alberta auditor general (2023, 36, 37) recently reported that inaccuracies were found in the Regulator's automated certification process.

<sup>29</sup> *Oil and Gas Conservation Rules*, Alta Reg 151/1971, s 3.014; *Pipeline Regulation*, Alta Reg 91/2005, s 82.1.

amounts. Accordingly, and like the provisions noted above, closure amounts are established based solely on the Regulator’s absolute discretion under the *Oil and Gas Conservation Rules*:

3.014(1) The Regulator *may* establish closure quotas that are applicable *to some or all* licensees with respect to the required amount of work or the amount to be spent, or both, *as directed by the Regulator and for the period determined by the Regulator*, with respect to the closure of the licensee’s wells and facilities.

(2) *A licensee shall* comply with any closure quota applicable to it, *unless otherwise directed by the Regulator*.

[Emphasis added to demonstrate the discretionary nature of these provisions.]

The Regulator commenced the program in 2022, and it is summarily described in Directive 088: “Licensee Life-Cycle Management” as follows:

... the AER has the authority to establish “closure quotas,” meaning set minimum required amounts of closure work, money to be spent on closure activities, or both. The AER will set the following closure quotas for each licensee annually: mandatory closure spend and supplemental closure spend for each licensee. The AER will annually publish industry-wide closure spend requirements. Licensee-specific mandatory and supplemental spends will be calculated and released through OneStop each year. (AER 2023b)<sup>30</sup>

This is essentially a mandatory version of the 2018 voluntary ABC program (mentioned above under Program History) that sets closure spend quotas for each licensee with inactive liability. However, the Regulator still establishes closure amounts at its absolute discretion and without explanation.

In 2022, the industry-wide closure spend quota was forecast to increase by nine per cent annually (AER 2022):

2023 (set)	\$700 million
2024 (forecast)	\$764 million
2025 (forecast)	\$833 million
2026 (forecast)	\$909 million
2027 (forecast)	\$992 million

However, further illustrating the Regulator’s broad discretion, in August 2023 the AER abandoned that pattern for increases and set the 2024 industry-wide closure spend quota at \$700 million (AER 2023e). The closure quota for each licensee is calculated as a percentage of their deemed inactive liability (AER 2022; n.d.b).<sup>31</sup> Most licensees receive a quota based on a standard percentage of their deemed inactive liability, but licensees the Regulator considers to be in financial distress (who hold around 10 per cent of industry’s total inactive liability) receive a quota set at a lower percentage. For 2023, the standard percentage was 6.7 per cent and the financial distress percentage is 3.6 per cent.

<sup>30</sup> OneStop is the Regulator’s online application and information submission system.

<sup>31</sup> The format of the information has been changed to improve clarity. The liability estimates derive from EUB Directive 011: “Licensee Liability Rating (LLR) Program: Updated Industry Parameters and Liability Costs,” (revised April 1, 2005), which is described in the next section.

In addition to mandatory closure work, the 2020 Liability Management Framework also announced the creation of a process whereby sites could be nominated for closure. Section 3.016 was added to the *Oil and Gas Conservation Rules* to provide legislative authority for the nomination of a well or facility for closure. Where a well or facility has been inactive for five or more years, the person who owns the surface land on which the well or facility is located (depending on the surface title, this person can be a landowner, the minister of energy, band council or reserve government, Métis settlement government or a municipal government) can request that the licensee prepare and submit a closure plan which documents how abandonment and reclamation will be completed within a prescribed time (normally between 10 and 13 years, depending on the site's condition). The closure nomination program began in April 2023, but published specifics on the nomination process and other details remain sparse.<sup>32</sup> For example, the Regulator has stated that exceptions from normal closure timelines may be granted where a large number of sites held by a single licensee are nominated for closure, but it has not provided details (AER 2023c).

## Critique

Without any form of timeline, yearly quota or penalties for non-compliance, closure obligations became a mirage constantly receding into the distance. The last 50 years have shown that, in the absence of mandatory requirements, licensees will continually push most or all of their closure work into the future. A liability management framework without some form of mandatory and enforceable closure timeline or quota does nothing to change this behaviour; this missing piece is one reason Alberta's liability management framework failed until 1997, and again from 2000 to 2021. The inactive inventory reduction program in the 2020 Liability Management Framework is only a partial step towards remedying this huge policy gap because it still relies far too much on the Regulator's exercise of discretion.

There are no legislated rules establishing timelines for closure work or for setting the annual closure quota amounts, and accordingly, the Regulator still establishes the overall amount of closure work at its discretion. The absence of any transparency or public participation in setting the annual closure quotas means that industry almost certainly influences this discretion. This is a longstanding and continuing deficiency in how the Regulator has administered the liability management framework, with landowners and the public generally excluded from the process. The site closure nomination process could alleviate this to some extent, but the Regulator's practices on landowner and public participation gives reason to question this (see Fluker 2015).

The closure spending quotas were partially modelled on historic closure spending patterns (AER 2021b), which were clearly insufficient. This is yet another instance of the Regulator's failure to set goals and report on their progress and to omit context to obscure growing problems (Auditor General 2023, 22-23). It is also important to note that the total deemed inactive liabilities (\$11.3 billion in June 2022) are based on the calculation method of the prior LLR program (described below) that are now known to be unrealistically low — often less than half what they ought to be.<sup>33</sup> Given these serious underestimates of actual inactive liability and the fact that roughly a third of Alberta's conventional oil and gas assets are inactive, the closure spend quota numbers the Regulator has established thus far only require industry to address less than two per cent of its total closure liabilities per year.

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<sup>32</sup> Details of the nomination process are set out in section 4.2 of Directive 088: "Licensee Life-Cycle Management," <https://www.aer.ca/regulating-development/rules-and-directives/directives/directive-088>, with supplementary information also set out in AER, "Manual 23: Licensee Life-Cycle Management," February 2023.

<sup>33</sup> The LLR liability figures are established by the AER, Directive 011: "Licensee Liability Rating (LLR) Program: Updated Industry Parameters and Liability Costs," (revised March 31, 2015).



The lower spend requirement for licensees in financial distress also seems contrary to the overall policy objective of reducing the number of orphan sites. Keeping failing licensees afloat leads to their accumulating closure liabilities far exceeding the value of their assets, and thus more likely to end up falling on the orphan fund. This problem appears to have its origins in the directions the Alberta government gave the Regulator for the new framework, which said the inventory reduction program would provide “flexibility to account for operator-specific circumstances.” (Government of Alberta 2020).

## 2) LICENSEE RISK AND CAPACITY ASSESSMENT

### Purpose

A risk and capacity assessment in a liability management framework is a form of credit check used to determine if licensees are creditworthy enough to fulfil their closure liabilities. These measures serve two major roles. First, they are used when assets are being transferred from one licensee to another or when licensees are reorganized in order to block a strategy known as liability dumping or value stripper operators. The initial operator, usually a large corporation, drills and operates assets through their most productive and valuable years, then sells the assets to either a licensee that fails to plan for the cost of closure or a licensee that deliberately plans to never perform required closure. After draining as much value as possible from the wells, the second licensee either goes bankrupt or simply ceases operations, leaving no solvent licensee to handle closure. The Regulator and industry have long been aware of the risk of this closure liability avoidance strategy. Regulator documents from 1989, 1991 and 1993 all describe the problem (ERCB 1989, 4; Nichol 1991, 3)<sup>34</sup> and the Regulator has identified specific cases (OWA 1997, case study no 1; Ellis 2018; Yewchuk 2022). An effective licensee credit check system would identify licensees that will be unable to fulfil closure liabilities and block the licences from being transferred to prevent liability dumping.

Second, licensee credit checks are used to periodically check if licensees remain solvent enough to complete their closure obligations, to ensure the licensee does not become defunct without completing closure. As oil and gas licensees approach the point where their closure obligations exceed the value of their remaining reserves,<sup>35</sup> licensee credit checks should help to ensure that the liability management framework compels the licensee to accelerate closure or post security.

### Program History

Alberta initially had a legal requirement that each applicant for a new well licence must provide a monetary deposit as security for closure work on that well, but this requirement was rescinded in 1986 when the Regulator shifted to a fund approach to address closure liability for orphan wells (ERCB 1986). The Regulator’s explanation at the time was that the amount of security deposits it had been collecting were insufficient in the face of large expenditures to close orphan sites, increasing the amount of deposits was not feasible and the deposit system itself was too costly to administer.

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<sup>34</sup> The Alberta Court of Appeal has noted this use of the corporate structure to evade regulatory scrutiny has similarities to the strategies used to reduce tax liabilities. See *PricewaterhouseCoopers Inc v Perpetual Energy Inc*, 2021 ABCA 16 at 147.

<sup>35</sup> This point is the economic limit, described by the regulator in ERCB Interim Directive 93-2: “Requirements for the Issuance of a Well License or Approval of Well Licence Transfers,” July 2, 1993, and discussed in detail in Boychuk et al 2021, 13-14.

# Informational Letter

IL 86-1

To: All Oil and Gas Operators

21 February 1986

## WELL LICENCE DEPOSITS

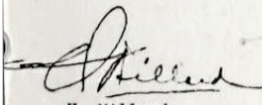
The requirement that each applicant for a well licence provide a deposit to guarantee the proper drilling, control, completion, suspension, or abandonment of the well has been dropped. In its place the Board has established a special well fund to be used to finance abandonment or other operations which might be necessary in the few instances where a licensee cannot be found or is unable to carry out proper operations. The establishment of the fund has been agreed to by the Alberta Government and representatives of the petroleum industry associations.

The deposit amounts were so small that little protection was afforded against large expenditures where a licensee did not exist or was not able to meet his responsibilities, and increasing the deposit to a meaningful amount was not considered feasible. In addition, the administration of the deposit system was costly.

The special well fund will be established from existing deposits that cannot be returned because the depositor cannot be traced, and a transfer of funds from the Board's surplus account. It will be maintained through interest earnings and annual budget contributions as required.

Sections 2.060, 2.070, and 2.080 of the Oil and Gas Conservation Regulations have been repealed. Deposits held by the Board or the Provincial Treasurer will be returned without application. There will be a few exceptions to this, such as where a Board order to abandon a well is outstanding because the licensee is experiencing serious financial problems. In these instances, the deposit will not be returned until the wells in question are properly abandoned. If any operators believe they have a deposit and do not have it fully returned by 31 May 1986, they should contact the Controller for the Energy Resources Conservation Board at 297-8329 in Calgary.

It should also be noted that, in accordance with section 92 of the Oil and Gas Conservation Act, the absence of a well licence deposit does not relieve the licensee of a well of liability for any costs of or incidental to the control, completion, suspension or abandonment of a well, and does not reduce his liability for those costs.



In 1993, the Regulator established the well screening ratio that required a licensee to have at least half as many active wells as inactive wells on a monthly basis, and to have at least as many active wells as inactive wells in order to transfer licences or receive new licences (EUB 1993; Funk 1999, 5-7).<sup>36</sup> However, licensees could ask for the Regulator to make exceptions and consider specific evidence of sufficient cash flow or resource reserves to pay for closure (EUB 1993; Brezina and Gilmour 2003, 41-43). The well screening ratio used a simple back-of-the-envelope calculation, with no consideration of the production levels, remaining reserves or specific closure costs of the wells, but allowed more nuanced calculation options that licensees could use.<sup>37</sup>

<sup>36</sup> See the 1996/1997 Abandonment Fund Annual Report, 5.

<sup>37</sup> Notably, it included an early version of an economic limit test to check if a well or other asset had greater remaining value than liability.

In October 2000, the Regulator, in consultation with industry, designed an economic limit-based licensee liability rating (LLR) program to replace the well screening ratio (EUB 2000c). Key to the new program was a formula designed for determining if an asset still possessed sufficient value to pay for its own closure — what the Regulator called an asset’s “economic limit.” This formula was to be used to determine when a licensee would need to post security for a well or facility.<sup>38</sup>

What happened next is a critical demonstration of industry’s significant influence on the Regulator’s approach to managing liabilities. In January 2001, the program was softened to require less security (EUB 2001a), but the Canadian Association of Petroleum Producers (CAPP) and the Explorers and Producers Association of Canada (EPAC) continued to oppose the amount of security that the proposed formula would require (Knox 2001; CAPP 2001), and in April 2001 it was scrapped for an interim approach using the old well screening ratio while a joint industry-government committee reconsidered the proposed LLR (EUB 2000d). Committee meeting records indicate an agreement among the representatives of the Regulator and industry that because the orphan program was funded by industry, industry was entitled (the committee uses the term “right”) to participate in the development of the liability management programs designed to reduce the number of orphans (AER 2001a).

The joint industry-government committee held 31 meetings from January to October 2001, and this process resulted in the Regulator replacing the economic limit-based LLR (designed in October 2000) with a fundamentally different asset-to-liability-based LLR program. The revised new program was expressly designed to collect less security, from fewer oil and gas licensees, at the request of industry members of the committee seeking to have the bar for requiring security as low as possible (AER 2001b). It set a much lower bar in terms of when licensees would be required to post security and significantly — and unrealistically — lowered the estimates of closure liabilities compared to the estimates the Regulator initially proposed. With this version of the new LLR program, the balance had shifted heavily in favour of industry’s desire to minimize the requirement to post security deposits. On May 1, 2002, the Regulator began implementing the new LLR system.

If the LLR system were to be effective, the deemed asset and liability values had to be reasonably accurate estimates of actual asset and liability values. However, already by 2003, the Regulator was aware the LLR was significantly understating closure costs (Weedon 2003). Under the LLR program, the Regulator had required only \$11 million in security compared to \$41.7 million a few years earlier and the number of licensees required to provide a security deposit had declined from 355 to 251 (AER 2003). The Regulator initially planned to review and update the LLR’s system for calculating liability estimates annually<sup>39</sup> and in 2004, the Regulator was forming a plan for five years of annual increases to the liability calculations and a system for gathering information on actual closure costs. Crucially, however, this information gathering would rely on voluntary submissions from industry, presumably because of expected opposition from industry to such measures (AER n.d.c., 44).<sup>40</sup> The estimates used for liability and asset value calculation numbers were updated in 2004 and 2005 (EUB 2005)<sup>41</sup> but then not updated again until 2013 (ERCB 2013a), when the Regulator started a three-year program to update the estimates of liability for closure (with new information produced by 2012). Most liability estimates had to be

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<sup>38</sup> The full calculation was highly involved. For full details, see EUB Interim Directive 2000-11.

<sup>39</sup> The Regulator knew from the beginning that liability estimates were set too low and based on poor information. By 2002, the Regulator knew liabilities for pipeline closure would need to be added (FOI Appendix (J) 2023-G-0015, vol. 4, 325-326, (2001) LLR ID Issues).

<sup>40</sup> Note the document also implies this information would not be shared outside the Fund Advisory Committee.

<sup>41</sup> Some of the changes increased deemed assets to accommodate the interests of seasonal producers, meaning that total security collected did not go up.

doubled and a rule that had arbitrarily lowered the estimated closure cost of active assets was removed since it was clearly underestimating liabilities (ERCB 2013b). At this time, the Regulator also implemented a special program to attempt to ease financially troubled companies into the now-increasing security deposit requirements (AER 2014; Robinson 2014, 7-10).

Over time, the LLR also created parallel systems for large facilities (AER n.d.d.) and oilfield waste management facilities (AER n.d.e.). These programs were collectively known as the Liability Management Rating (LMR) program.<sup>42</sup>

An internal presentation within the Regulator confirms it knew the LMR was a flawed system by 2019 (AER 2019a):

### D006 Problem Summary

#### » Liability Management Ratio (LMR)

- LMR ratio is limited to 2 parameters
- Companies' focus is on achieving LMR, not closure
- Does not reduce inactive liability
- Security demand occurs when company is not financially able to pay
- Poor predictor to assess capability to address end of life obligations
- Companies operate at a loss to maintain an LMR of 1.0

AER 2

## Licensee Risk and Capacity Assessment in 2023

The legal framework governing licensee risk and capacity assessment<sup>43</sup> is enabled by the Regulator's statutory authority to approve or refuse the issuance and transfer of a licence for a well, pipeline or other facility under Part 6 of the *Oil and Gas Conservation Act* and Part 4 of the *Pipeline Act*. For example, section 24 of the *Oil and Gas Conservation Act* provides that no licence may be transferred without the Regulator's consent and that "[t]he Regulator may consent to the transfer of a licence subject to any conditions, restrictions and stipulations that the Regulator may prescribe, or the Regulator may refuse to consent to the transfer of a licence." These statutory powers are further enhanced by requirements in the *Oil and Gas Conservation Rules*. For example, section 1.300 of the Rules provides that an applicant for a licence must meet the Regulator's eligibility requirements set out in Directive 067 (AER 2023d).<sup>44</sup>

<sup>42</sup> The broader LMR program has similar problems to the LLR since it all operates on a similar basis.

<sup>43</sup> The details of the LLR program and its calculations are set out in AER Directive 006: "Licensee Liability Rating (LLR) Program," <https://www.aer.ca/regulating-development/rules-and-directives/directives/directive-006>, and AER Directive 011: "Licensee Liability Rating (LLR) Program: Updated Industry Parameters and Liability Costs," <https://www.aer.ca/regulating-development/rules-and-directives/directives/directive-011>. The Regulator started to replace the LLR with a new Licensee Capability Assessment (LCA) in December 2021, but the LLR is still used for calculating the closure spend quotas and reporting liability estimates to the public. The Regulator has not updated Directive 011 since 2015, when it was raised to meet estimates from in 2012: see AER Bulletin 2015-13: "Licensee Liability Rating (LLR) Program Changes - Phase 3," March 31, 2015.

<sup>44</sup> The Regulator also employs these requirements to undertake what it calls a holistic assessment of licensees; see AER Directive 88: "Licensee Life-Cycle Management," <https://www.aer.ca/regulating-development/rules-and-directives/directives/directive-088>.

Specifically in relation to security deposit requirements and closure work, section 1.100(2)(c) of the *Oil and Gas Conservation Rules* provides that the Regulator *may* demand security from a licensee “at any time where the Regulator considers it appropriate to do so to offset the estimated costs of suspending, abandoning or reclaiming a well, facility, well site or facility site.”

Directives 067 and 088 set out numerous factors for assessment of licensee performance, including:

- Financial health;
- Estimated abandonment, remediation and reclamation liability;
- Remaining lifespan of mineral resources;
- Whether infrastructure is operated in compliance with regulatory requirements;
- The pace of closure spending and inactive liability growth; and
- The timely payment of fees and levies from the Regulator.

The licensee’s performance in these factors is compared to a performance group of licensees with a similar business type, production type and production level. Each licensee is deemed to be high or low risk compared to peer comparators.

As with the inactive inventory reduction program, all of these licensee risk and capacity assessment tools are implemented entirely at the Regulator’s discretion. The legislative framework provides no constraints on how the assessment factors will be applied and what actions the Regulator must take. The law makes no explicit connection between a high-risk assessment on a licensee and a security deposit for closure work. Perhaps the following statement in Directive 088 sums it up best:

The AER will specifically engage and use appropriate regulatory tools or conduct compliance assurance activities with the licensee to address the risk. This may involve providing education or recommendations to follow industry best practices and, where appropriate, initiating specific regulatory actions (AER 2023b).

Moreover, the Regulator does not publish the results of a licensee risk and capacity assessment and the decision-making process is fully non-transparent in determining what regulatory actions to take based on the assessment.

## Critique

The LLR program is widely acknowledged to have been a major policy failure as a credit check system. It failed to prevent liability dumping, it failed to compel the payment of adequate security for closure work and it failed to require an acceleration of closure work by a licensee approaching insolvency. The Alberta government acknowledged and admitted these shortcomings. In announcing the creation of the 2020 Liability Management Framework, the minister of energy not only acknowledged that the LLR program “hasn’t been working,” but also admitted that the Regulator and successive governments had long been aware of the problem: “we’re looking at *decades where no government has been willing to move on this file*” (Morgan 2020).<sup>45</sup> And in the Regulator’s own words: “... the AER will not perpetuate the false sense of security offered by this flawed system” (Morgan 2020). However, the licensee risk and capacity assessment program

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<sup>45</sup> Geoffrey Morgan is quoting then-minister of energy Sonya Savage.

under the 2020 Liability Management Framework remains highly problematic because it is still almost fully non-transparent and relies far too much on the Regulator’s exercise of discretion.

The LLR relied on simplifying assumptions that created distorted incentives and produced wildly inaccurate estimates of corporate solvency. The LLR only considered which licensee held the licence and did not consider ownership percentage. This opened a loophole in the LLR that allowed for liability dumping. A licensee could sell nearly all the value of the assets and remain the licensee for the purpose of LLR calculations so long as it retained a one-per-cent interest in every asset. It also estimated the closure liability of wells based on large geographic areas, encouraging licensees to selectively close only well sites that were particularly cheap to clean to maximize the benefit to their LLR scores. While the licensee assessment under Directives O67 and O88 should capture these scenarios and trigger regulatory action, nothing in the legal framework actually obligates the Regulator to act on such findings.

The LLR program’s complexity concealed its ineffectiveness, as it consistently overestimated the financial viability of oil and gas licensees. The LLR program’s deemed liabilities were never close to an accurate prediction of actual closure liabilities, particularly for reclamation costs. As one example, after a 2019 bankruptcy, the trustee working with the OWA obtained a third-party assessment of liability that estimated actual closure costs to be almost double the LMR’s estimate.<sup>46</sup>

Although the LLR program was highly ineffective as a corporate credit check, its defects were compounded further by the absence of any timelines or quotas for annual closure. As discussed in the previous section, no licensee credit check program (even a well-designed one) was likely to be effective at controlling closure liability without timelines or annual quotas for closure.

The Regulator collects more information under the new licensee risk and capacity assessment program than it did under the LLR, but the new program still fails to explicitly require security deposits in high-risk assessments. The Regulator has provided only a table showing the range of security it may request, retaining “discretion to determine the appropriate amount considering the specific risks and circumstances of the application” (AER 2023b). Moreover, the program still uses risk assessments to determine when to require security, so that the demands for security will occur after the licensee is unable to pay.

The legislative framework does not define objectives for the program. Indeed, the licensee risk and capacity assessment program lacks sufficient clarity to evaluate because it is not yet a program; it is a plan to collect more information and handle each situation on a discretionary basis with no transparency or explicit objectives. Indeed, the auditor general recently noted the lack of a defined approach for financial security (Auditor General 2023, 29–31). Simply put, whether and when the Regulator is demanding security, and what amounts, is currently not known.

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<sup>46</sup> Affidavit of Lars De Pauw, sworn on June 6, 2022, relating to the bankruptcy of the Trident Group, court file 1901-06244, at para 13, [https://www.pwc.com/ca/en/car/trident/assets/trident-100\\_060822.pdf](https://www.pwc.com/ca/en/car/trident/assets/trident-100_060822.pdf).

## The Failure of Transparency in the Liability Management Framework

When the LLR was being designed in 2001, the information to be made public included the “number of licensees having only abandoned wells facilities, or pipelines,” “producing LLR and total LLR (producing LLR plus deposits) by individual licensee,” the “provincial reserves/life index” and the “LLR summary of licensees that have gone into receivership/bankruptcy” (EUB 2001b, 6–7). As the Regulator became aware the liability management system was failing, the Regulator became increasingly secretive about the size of the problem and its causes.

The Regulator initially posted LLR program performance summaries but appears to have stopped by the end of 2005.<sup>47</sup> In 2007, the monthly LLR reports still showed how much security each company had posted and the company’s security-adjusted LLR score, but by 2010 the monthly reports no longer showed the amount of security posted by each licensee, only whether or not they had security posted and their LLR score. In December 2019, the LLR scores of individual licensees were no longer included and instead the LLR report only contained general information about the overall industry. The Regulator had shut off the supply of information needed to detect and understand the problem. Landowners, municipalities and the public were deprived of the ability to assess closure liability problems and the solvency of individual licensees.

The AER gave no public explanation for the December 2019 decision to reduce the information provided to the public. However, the results of a FOIP request relating to the decision do shed some light on its motivation. The Regulator had drafted a bulletin explaining why the LMR scores of individual licensees would no longer be made public, but this bulletin was never posted. One reason set out in the draft was that the LLR system was not a good indicator of licensee capability and was potentially having unintended consequences for commercial (lending) decisions (AER 2019b). The AER redacted most of the information relating to the reasons for withholding individual licensees’ LMR scores, meaning the LMR caused problems that are still being kept from the public.

In short, the Regulator was concerned LMR scores were so poor an indicator of financial health that they were harmfully misleading. We note licensees continue to have access to their own LMR scores and can still provide the scores to financial institutions. Although the LMR score was a poor indicator of financial health, instead of providing more or better information to the public the Regulator chose to stop providing any information.

This high level of secrecy has been carried forward and expanded for the new licensee risk and capacity assessment program: each licensee will receive its assessment report, but those reports will not be made public. The Regulator will not publicly disclose information on particular licensees, peer groups of licensees or even the overall state of the oil and gas industry. The secrecy that allowed the Regulator to minimize external scrutiny of the LMR as it failed continues under the new program. Without reliable information on the oil and gas industry, meaningful democratic oversight of the 2020 Liability Management Framework is impossible.

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<sup>47</sup> The last version created that the authors were able to find was the LLR Program Performance Summary for September 5, 2005.

### 3) ORPHAN PROGRAM

#### Purpose

As a type of financial assurance instrument, a sectoral fund like the orphan program is “similar to bonds, insurance, and letters of credit in that firms pay regular premiums in exchange for coverage. However, firms within the sector collectively provide the coverage rather than a third party such as a bank or an insurer” (Canada’s Ecofiscal Commission 2018, 27). Sectoral funds are relatively common, coming in various forms. An industry-based sectoral fund has been described as:

a dedicated fund that provides compensation to government or other affected parties (either directly or via the responsible firm) in the event of a qualifying environmental harm. Funds might be built up over time, funded with an initial endowment, or a combination. Firms might pay into the fund on the basis of their production volume, revenues, or profits (Canada’s Ecofiscal Commission 2018, 27).

Assuming no public funds are added, an orphan program shifts from the standard version of the polluter-pays rule that requires the particular polluter to pay, to an industry-level version of the polluter-pays rule. This is a second-best approach to polluter pays, where the polluting industry pays for closure even though the particular polluter failed to do so. This approach fulfils the goal of keeping the pollution costs from being pushed onto the public, but instead of keeping liability with the particular person who benefited from the activity that caused the pollution, it keeps liability for the pollution with the industry.

#### History

The Alberta oil and gas industry agreed to fund the orphan program as an industry-pays system in exchange for the Regulator accepting industry’s preferred approaches of minimizing scrutiny on licence transfers and taking very low amounts of security (Nichol 1991; CADE/CAODC 1990; CPA, IPAC and EPAC 1990, 113–128).

The first levy for the purpose of orphan abandonment was charged to industry in the 1993/1994 fiscal year. The levy went to an abandonment fund held by the Regulator and monitored by industry via an advisory committee. From 1993 to 1999, the abandonment fund was funded by a fee on first-time licence holders and an annual levy on each inactive well that ranged from \$55 to \$100 over the years (AER 1994–2000). Initially, the levy was used only to fund well abandonment, the first step in well closure. The scope of funded closure was expanded in 1996 to cover the decommissioning of pipelines and facilities in addition to wells, and to include remediation and reclamation.

In 2000 and 2001, the OWA was set up to replace the joint industry-government fund advisory committee, and for those two years no orphan levy was charged. The OWA was, and remains, controlled by industry associations.<sup>48</sup>

Since 2002, the orphan levy has been set annually or biannually as a fixed amount and then charged to all licensees in Alberta based on their percentage of the province’s total estimated liability.

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<sup>48</sup> The 2002/2003 annual report for the OWA lists its membership as CAPP, EPAC and the Alberta Energy and Utilities Board. See Orphan Well Association Annual Report 2002/2003, 3. From 2002 to 2009, the chairperson of the OWA rotated between CAPP members and EPAC members, and since 2009 has typically been a vice-president of CAPP. The Alberta Oil and Gas Orphan Abandonment and Reclamation Association bylaws, amended and restated (as of February 26, 2021) provide in section 2.1(b) that at “any given time, CAPP shall be entitled to three (3) votes, EPAC shall be entitled to two (2) votes, and the AER shall be entitled to one (1) vote on each motion put to a vote at any meeting of the Members.”



## Orphan Program in 2023

Part 11 of the *Oil and Gas Conservation Act* establishes the Regulator's powers to operate the orphan program, section 70 sets out what the orphan fund can be used for and section 73 enables the Regulator to prescribe and allocate an annual levy. These provisions are all broadly enabling. Of particular relevance to this paper, section 73(2) provides the Regulator full discretion to set the annual levy amount based on the costs that the Regulator estimates the fund will incur. The annual orphan levy is set by annual updates to Part 16.5 of the *Oil and Gas Conservation Rules*.<sup>49</sup> The levy for the last four fiscal years has been \$65 million, \$70 million, \$72 million and \$135 million.<sup>50</sup>

The OWA was established under the *Societies Act*,<sup>51</sup> and sections 2 and 3 of the *Orphan Fund Delegated Administration Regulation*<sup>52</sup> delegate authority from the Regulator to the OWA to spend money from the orphan fund to perform closure work and other functions set out in section 70 of the *Oil and Gas Conservation Act*. Changes to legislation in 2020 expanded the OWA's scope of authority, allowing it to spend orphan fund money on "reasonable care and measures" to maintain orphaned assets in safe condition and to apply to court to appoint a receiver or trustee for bankrupt oil and gas licensees.<sup>53</sup> After the Lexin bankruptcy in 2017, the Regulator stopped petitioning licensees into bankruptcy, leaving the OWA to decide when to petition licensees into bankruptcy (OWA 2023, 7).<sup>54</sup>

## Critique

The most significant problem with the orphan program is the high volume of closure work in the orphan inventory and inactive sites waiting to be designated as orphans. The fund was originally intended as a backstop to cover exceptional circumstances where a licensee failed to meet its closure obligations (CPA, IPA and EPAC 1990, 119), but the policy shortcomings with inactive inventory reduction and licensee risk and capacity assessment, along with a downturn in the economics of the conventional oil and gas sector, have led to high demand on the OWA to undertake closure work. This, in turn, has revealed flaws in how the Regulator sets the orphan fund levy. In short, the OWA is severely under-capitalized.

As is the case throughout the liability management program, the key decision-making functions are at the Regulator's absolute discretion with no meaningful transparency. The law does not establish any relationship between the amount of the levy and the amount of closure work in the orphan inventory. The annual orphan levy has never been set at an amount sufficient to pay for any fixed percentage of the orphan inventory. The orphan fund levy went from \$12 million in 2013 to \$70 million in 2022 (an increase of 583 per cent), while the orphan inventory rose from 74 in 2013 to 1,700 in 2022 (an increase of 2,297 per cent). Moreover, it is apparent that industry has significantly influenced the Regulator in setting the annual levy amount. The OWA explicitly consults with CAPP and EPAC to propose a levy to the AER that will cover the work planned by the OWA each year, and there is no public disclosure on how the levy is set or an explanation for why the determined amount is adequate.

<sup>49</sup> Alta Reg 151/1971.

<sup>50</sup> Fiscal years 2020/21, 2021/22, 2022/23 and 2023/24. The OWA anticipates a \$135 million orphan levy for the next several years (OWA 2023, 4).

<sup>51</sup> RSA 2000, c S-14.

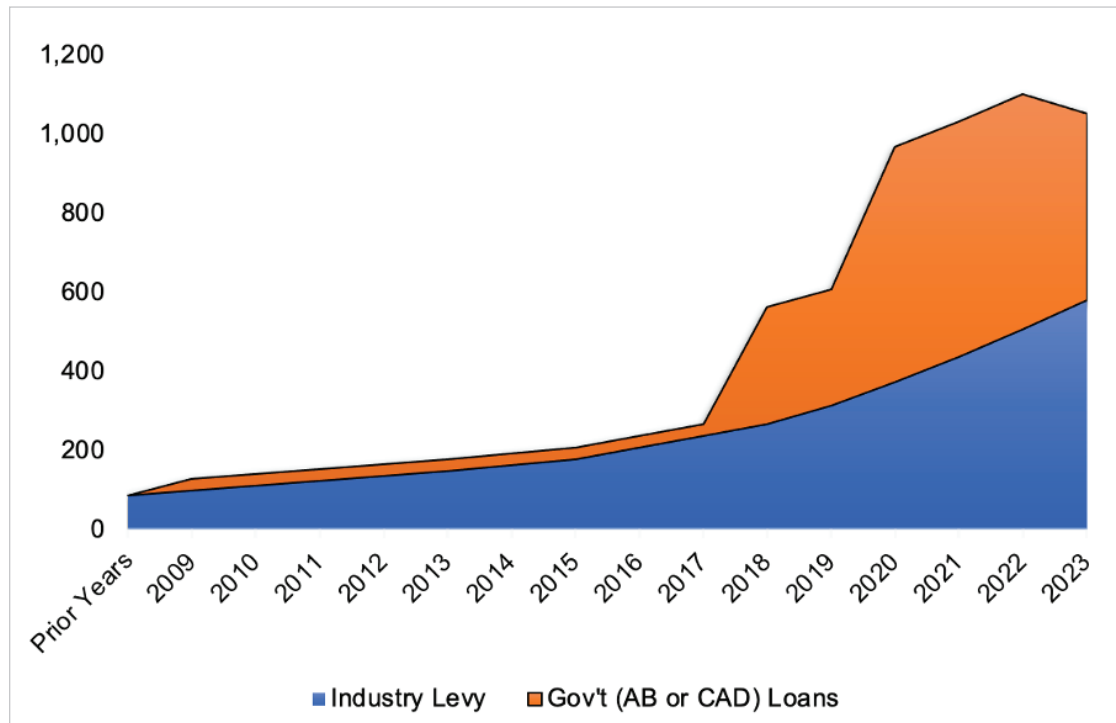
<sup>52</sup> Alta Reg 45/2001.

<sup>53</sup> Bill 12, *Liabilities Management Statutes Amendment Act, 2020*, 30th Leg., 2nd Sess, 2020.

<sup>54</sup> The annual report notes the OWA's role applying to appoint receivers for bankrupt oil and gas companies. For an example, see the Supplemental Affidavit of Lars De Pauw, sworn on April 3, 2023 for the receivership of Everest Canadian Resources Corp., [https://www.pwc.com/ca/en/car/everest-canadian-resources/assets/everest-005\\_060423.pdf](https://www.pwc.com/ca/en/car/everest-canadian-resources/assets/everest-005_060423.pdf). Accessed July 11, 2023.

Aggravating this problem was the fact that until 2022, the Regulator was not making any attempt to even assess the adequacy of the orphan levy (Auditor General 2023, 26). The only steps the Regulator took to confirm the levy was appropriate was to require letters of support from CAPP and EPAC. The Regulator even knew that far more assets were likely to be orphaned in coming years but did not seek a higher levy, instead withholding that information from the public (Yewchuk 2023).

**Figure 4: Industry and Government Funding for the OWA (Cumulative in C\$ Million, 2008-2023)**



Source: OWA annual reports: 2009 - 2023

From 2018 to 2022, the OWA continuously underestimated the forthcoming scale of the orphan problem and recommended insufficient levies by using seemingly optimistic forecasting that predicted Alberta would turn the corner on the orphan problem in the following year (OWA 2018).

Figure 4 shows a rapidly increasing amount of public money being directed into the orphan program beginning in 2017. What started as a relative trickle of public funds with a \$30 million grant from the provincial government in 2009 and a \$50,000 contribution from Alberta Energy in 2012, has ballooned into hundreds of millions of interest-free government loans to the OWA, with loan repayment scheduled to run until 2035 (OWA 2010, 1; 2023, 38-39).

In sum, the OWA is a closely held, industry-controlled organization. Its membership is dominated by industry with very limited government representation and no representation by the public whatsoever. This structure was perhaps appropriate when the orphan fund was exclusively funded by industry but that is clearly no longer the case. Furthermore, while hundreds of millions in public funds being made available to the OWA in recent years have largely been characterized as loans, there is a significant risk that these loans will never be repaid. This is because the OWA

has no retained earnings and no ability to generate revenue beyond what it receives from industry via the annual levy (or from a further injection of public funds).

Moreover, while the Regulator has some oversight on the OWA through the *Orphan Fund Delegated Administration Regulation*, as a society under the *Societies Act* the OWA is not subject to the usual accountabilities of government agencies, boards and commissions, even though it is exercising delegated governmental powers and spending public monies. For example, the OWA is not subject to the Alberta government's public agency governance policies or the terms of the *Alberta Public Agencies Governance Act*.<sup>55</sup> Nor is it subject to review by the auditor general under the *Auditor General Act*<sup>56</sup> (a supervision that has proven to be an important discipline for the Regulator). Neither is the OWA subject to the *Freedom of Information and Protection of Privacy Act*. The OWA's structure places it outside the definition of a "public body" in section 1(p) of that act and it has not been deemed a public body under Schedule 1 of the *Freedom of Information and Protection of Privacy Regulation*.<sup>57</sup>

#### 4) LEGACY AND POST-CLOSURE SITE CLEAN-UP: THE MISSING PART

Legacy and post-closure sites are those sites with closure obligations but for which no apparent responsible party exists. A regulatory program on legacy and post-closure sites assigns legal responsibility for (further) closure work on these sites to a person. The 2020 Liability Management Framework acknowledges the problem of legacy and post-closure sites that were abandoned before current standards were put in place and contaminated sites that improperly received reclamation certificates with the operator's liability period having lapsed. The framework indicates that a panel would be established to develop a solution for bringing these sites up to date with the current environmental requirements (Government of Alberta 2020). As of the date of writing, no steps have been taken under the 2020 Liability Management Framework to address these sites.

In Alberta, it appears most legacy and post-closure sites are produced by the operation of section 142(2)(b) of the *Environmental Protection and Enhancement Act*<sup>58</sup> and section 15(2) of the *Conservation and Reclamation Regulation*.<sup>59</sup> For reclamation certificates issued prior to October 1, 2003, the responsibility of former operators ended five years after the reclamation certificate was issued. For reclamation certificates issued after October 1, 2003, the responsibility of former operators ends 25 years after the reclamation certificate was issued. Other legacy sites may be produced by section 144(2)(b) of the *Environmental Protection and Enhancement Act*, which requires reclamation certificates only for right-of-entry orders in effect on or after 1963. Alberta does not have a dedicated regulatory program to address legacy and post-closure clean-up (De Beer 2016), and the OWA does not consider these sites to fall within its mandate (Auditor General 2023, 23). The Regulator has had difficulty tracking which sites are within its responsibility and authority (Auditor General 2021, 12-13) but believes these sites represented approximately \$215 million in liabilities as of November 2019 (Auditor General 2023, 21).

Section 113 of the *Environmental Protection and Enhancement Act* provides the Regulator with authority to require a person to remediate a legacy or post-closure site if pollution from a substance release is still occurring. Moreover, sections 125 and 129 of that act authorize the Regulator to designate a legacy or post-closure site as contaminated and order clean-up.

<sup>55</sup> SA 2009, c A-31.5.

<sup>56</sup> RSA 2000, c A-46.

<sup>57</sup> Alta Reg 186/2008.

<sup>58</sup> RSA 2000, c E-12.

<sup>59</sup> Alta Reg 115/1993.

However, these powers have rarely been exercised, and when relied upon, they have led to lengthy administrative and judicial proceedings (Lilles 2017). These powers have been applied to the clean-up of legacy gas stations and refineries (Anderson 2022b) but their application to legacy and post-closure upstream oil and gas sites remains uncertain.

A program is needed to address legacy and post-closure site closure liability in a systematic and transparent way. To begin with, there needs to be clarity and more certainty on the size of the legacy and post-closure site problem. While there is currently a suite of legal powers to require closure work on some of these sites, the law needs to be far more precise in defining what a legacy or post-closure site is, who is responsible and liable for the closure work and when it needs to be conducted.

## PART 4: CONCLUSION

Drawing on over 40 years of regulatory history, our primary goal in this paper was to assess the design and likely effectiveness of Alberta's most recent attempt to tackle its escalating orphan and inactive asset problem, the 2020 Liability Management Framework. A secondary objective was to identify some of the factors that have contributed to what is widely accepted as a massive policy failure to date; namely, a lack of transparency, excessive discretion and regulatory capture. In light of the continuing presence of these factors in the new program, the 2020 Liability Management Framework is unlikely to meaningfully reduce orphan and inactive asset inventories, nor to uphold the polluter-pays principle.

**Lack of transparency:** To avoid scrutiny of both its own actions and the actions of the industry it regulates, the Regulator has been and continues to be intensely non-transparent. The culture of secrecy and confidentiality at the Regulator allowed the inactive and orphan site problem to grow without sufficient public scrutiny. The LLR program designed in 2001–2002 was highly flawed and the Regulator was far too slow in responding, allowing known problems with the LLR to persist for decades and keeping information on the scale of the problem quiet. A major source of public attention and democratic pressure to take regulatory action only occurred after a number of high-profile bankruptcies in the oil and gas sector and a leak of closure liability estimates revealed a more accurate picture of the magnitude of the inactive and orphan site problem.

**Excessive discretion:** The legislative framework remains far too reliant on the Regulator's exercise of discretion to trigger legal obligations on closure work. There remains a troubling absence of legislated timelines or quota amounts for closure work. Moreover, neither the Legislature nor the Regulator has set binding and measurable public targets for the liability management system, such that the performance of the system cannot be easily assessed. As the auditor general noted in his 2023 report, there is a need for long-term planning, including setting goals for closure rates and total inactive asset levels for both industry and the orphan program.

**Regulatory capture:** The Regulator has prioritized its relationship with the oil and gas industry over accountability to the public, and continues to do so, thereby allowing industry to have excessive influence on the design and administration of the liability management regime. Some illustrations of this influence documented in this paper are: (1) the Regulator's reluctance to demand adequate security deposits from industry for closure work; (2) the design of the flawed LLR program which grossly underestimated actual closure liabilities; and (3) a severely under-capitalized orphan fund. These errors were made in close consultation with industry, generally at industry's urging, and industry was given voting positions on key decision-making committees. Because industry's overall goal is to minimize its costs, it is not surprising that a liability management framework designed in close consultation with it appears to have been created

around that goal. However, the Regulator is also responsible for the oversight and regulation of closure and is accountable to the public for ensuring the polluter-pays principle is upheld in Alberta's oil and gas sector. An effective framework needs to balance industry influence with accountability to the public. The 2020 Liability Management Framework demonstrates some shift towards more balance; for example, the site nomination process for closure work, but far too much industry influence remains in areas such as the orphan program.

The history and developments detailed in this paper point strongly towards the need for a public inquiry into Alberta's approach to liability management in the conventional oil and gas sector. Such an inquiry should be both backward and forward looking. There are unanswered questions about past events that are not yet understood. Questions remain about why certain asset transfers were approved when it was clear the transfer would exacerbate the closure liability problem, why LLR reforms were so slow in occurring and why the Regulator has still not yet approved a new system for estimating closure liabilities. A critical and public evaluation is needed with respect to the significant amount of regulatory discretion in key decision-making aspects of the liability management framework. There are obvious places where legislation can and should be enacted to direct outcomes on closure work, such as prescribed timelines for when the work must be undertaken and circumstances when a licensee must provide financial security. Finally, a public inquiry would bolster recent efforts to enhance transparency on Alberta's oil and gas closure liability problem. Albertans deserve a full accounting for the decisions and policies adopted over the past several decades, but they also need significantly more access to accurate and tested information to better understand the policy choices going forward.

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- (C) 2023-G-0015, v5, 239-252 (18 October 1995) John Nichol, Alberta's orphan Well Prevention Program Support Processes
- (D) 2023-G-0001 (27 September 2000) Alberta Energy and Utilities Board Memorandum, Proposal for the Cancellation of the Long Term Inactive Well Program
- (E) 2023-G-0015, v1, 38-40 (9 May 2001) Hal Knox, Process Forward Expanded Orphan Program
- (F) 2023-G-0015, v4, 270-271 (12 January 2001) Letter from the Chairman of the Canadian Association of Petroleum Producers to the Chairman of the Alberta Energy and Utilities Board, Re- Liability Management Plan Implementation
- (G) 2023-G-0015, v4, 35-36, 56-58 (19 April 2001) LLR Review Subcommittee, Meeting No 3 and 12
- (H) 2023-G-0015, v4, 187-189 (5 July 2001) LLR Review Subcommittee, Meeting No 23
- (I) 2023-G-0015, v4, 241-242 (February 2003) Licensee Liability Rating (LLR) Program
- (J) 2023-G-0015, v4, 325-326 (2001) LLR ID Issues
- (K) 2023-G-0015, v4, 15-16 (23 September 2003) Terry Weedon of EUB Letter to ConocoPhillips Stakeholder Consultation on LLR
- (L) 2023-G-0015, v5, 44 (2003) License Cost Processor Draft Document
- (M) 2022-G-0035 (6 Sep 2019) Closure and Liability Branch Update Slides
- (N) 2022-G-0035 (November 2019) Bulletin 20XX-XX, Licensee-Specific Liability Management Ratings no Longer Published on Website

**(A)**

## **5.0**

# **NEW EUB ENFORCEMENT APPROACH**

**BY**

**Leo Touchette**

**Provincial Coordinator**

**Production Inspection**

**Alberta Energy and Utilities Board**

### **ABSTRACT**

Regulators and other energy industry players must face together the new challenges associated with a maturing industry. These new challenges require that regulatory processes and philosophies used in the past must be adjusted to remain effective. The open communication policy which distinguished the ERCB from many other regulators is one which will not be compromised. However, today the Alberta Energy and Utilities Board (EUB) must combine that open communication with more effective enforcement. This paper outlines the reasons more effective enforcement is required, as well as the Enforcement Policy and Philosophy the EUB intends to use to ensure that industry is treated in a firm but fair manner.



## NEW EUB ENFORCEMENT APPROACH

### Background

The former ERCB, energy industry, and the public have worked together over many years to create a climate that allows companies to explore for and produce energy while minimizing impacts on the public and the environment. This working relationship has benefitted both the companies and the people of Alberta. However, that working relationship has gradually evolved such that Alberta Energy and Utilities Board (EUB) staff have become increasingly involved in all phases of an energy development. Perhaps one of the best illustrations of this would be our organization's reaction to a very serious problem which occurred during the early 1970's in the Swan Hills area. Two or three companies were found to be operating wells and facilities in a very poor manner. Numerous spills had occurred because of this shoddy operation and virtually none were being cleaned up.

This problem received significant media publicity. Our organization's response was to implement a lease inspection program. This involved our staff inspecting thousands and thousands of leases and advising companies of spills and improper operating practices and to clean up those spills. Thousands of spills, large and small, have been prevented, or found and cleaned up due to this program. However, to my knowledge, no enforcement action was ever taken against the offending companies and remnants of our lease inspection program are still in place today. Over the past many years, that has been the ERCB response to



## NEW EUB ENFORCEMENT APPROACH

non-compliance – increase our involvement in terms of inspections, paper reviews, etc. It is only today that we ask the underlying question our example poses. Who's responsibility is it to: prevent where possible, find, report, and clean up spills? The answer is obviously that it is the responsibility of the company operating the facility. The more difficult question for EUB staff today, and indeed of companies meeting their obligations, is ~~how do we force all companies to accept that and other equally important responsibilities?~~

### Today's Realities

~~Regulators and energy industry players are facing a working environment that includes a maturing industry. We are and will be dealing with the many challenges related to that. Increasing numbers of companies are not meeting our requirements and our customer surveys indicate that most representatives of companies, the public, and other government agencies, do not believe our enforcement actions are capable of achieving that compliance. We, and some industry representatives, are very concerned that regulators are not providing a level playing field and enforcing requirements equally. If this continues the intense competition for investment dollars will create an unnatural selection process which will favour those companies with substandard operations.~~

We, as regulators, once worked under the assumption that one company would drill wells, construct facilities, and produce and abandon these wells and facilities.

### NEW EUB ENFORCEMENT APPROACH

It followed, therefore, that rigid and immediate compliance to our requirements was not critically important as we knew the company would ultimately have to abandon and reclaim the site, thereby having to absorb any costs associated with non-compliance. Over the past several years this assumption has been proven very wrong with most major operators divesting themselves of older projects which are on the downward slope of profitability. This divestiture of properties is one of the factors which has contributed to a rapid increase in the number of energy companies active in Alberta (70-80 in 1974 vs. over 700 in 1995). Further, the actual number of facilities in the province has also increased dramatically (3,000 oil facilities in 1976 vs. 14,000 oil facilities in 1995). Some companies have already proven not to have the financial ability to address the liabilities associated with the facilities they own. It is our duty as a regulator to prevent this from occurring and to ensure the Alberta public does not have to deal with that liability.

The companies our organization dealt with in the seventies had comparatively large incomes, many support staff, and entrenched bureaucracies. The companies of today have responded to lower oil and gas prices and intense competition for investment capital by becoming ever more streamlined. These companies have limited funds, few support staff, and live with an uncertain future due to potential takeovers, etc. These types of companies are valuable parts of Alberta's economy but the aggressive, wildcatter, risk-taking attitude which enables them to survive and flourish in difficult times presents a whole new challenge to us as the

### NEW EUB ENFORCEMENT APPROACH

regulator. This is at a time when the public is increasingly concerned about the environmental effects of oilfield activities. We are also realizing that some operating practices considered acceptable in the past are having to be discontinued as environmental problems they have caused are just now showing up.

#### Conclusion & Philosophy

When we review all these changes in light of government downsizing it is obvious that we need an approach which requires less involvement by our staff and more responsibility for compliance by energy companies. The approach we have arrived at and intend to follow is:

~~Education & Awareness~~

~~Effective Enforcement~~

~~Voluntary Compliance~~

↓

Potential to Reduce

Inspection Activity

**NEW EUB ENFORCEMENT APPROACH**Education

The EUB must do a better job of communicating exactly what our expectations are of the energy industry. Industry must work much harder to improve their knowledge of our requirements. It remains part of our philosophy to include industry involvement in forming all regulatory policy and requirements. However, all participants in this process must be more aware of the necessity to reduce requirements whenever possible.

Awareness

The staff of our organization must ensure that companies are aware of the enforcement action which will be taken in the case of non-compliance.

Our staff have the responsibility to outline the expectations and consequences of not meeting those expectations. We will, however, continue our open communication policy with industry by considering immediate submissions by companies indicating the reasons they feel that the expectations or consequences are not reasonable in a particular case. We will be prepared to discuss alternatives as long as it is evident that our goal of "lasting improvement" by the company is met. We will not, however, become involved in the same negotiation process after the deadline for compliance has passed.

## **NEW EUB ENFORCEMENT APPROACH**

### **Effective Enforcement**

The enforcement action must be such that it results in "lasting improvement" by the company. If the lasting improvement is not achieved, another escalating enforcement action must be taken. EUB staff are not asked to judge whether a company or their personnel are good or bad. They are asked to decide what enforcement action is required to ensure that non-compliance is rectified and not repeated. It is also very important that the enforcement actions taken are efficient and do not involve large amounts of time and effort by Board staff.

### **Voluntary Compliance**

This is a company putting in place a process such that their staff are kept aware of requirements and the company's policy to ensure these requirements are met.

### **Potential To Reduce Inspection Activity**

Our staff will be able to reduce the hands-on involvement in each step of a project's life.

## NEW EUB ENFORCEMENT APPROACH

### EUB ENFORCEMENT PHILOSOPHY AND POLICY STATEMENT

The EUB believes that enforcement is one part of a total program of regulation, information, distribution, and enforcement; all of which is designed to enable the achievement of regulation of the energy industry in Alberta.

*"An energy industry that understands, respects and meets or exceeds regulations and standards often through the implementation of self-imposed guidelines."*

This vision states very clearly that compliance is the responsibility of the energy industry. The EUB expects that all industry players will understand our requirements and have an infrastructure in place to ensure compliance. At the same time, the EUB believes that on occasion enforcement of regulations will also be required to ensure compliance and to meet our vision.

## **NEW EUB ENFORCEMENT APPROACH**

The following pages outline details of the EUB's "firm but fair" enforcement approach, designed to ensure each company accepts its responsibility for compliance.

### **EUB ENFORCEMENT PHILOSOPHY**

EUB enforcement action dealing with non-compliance must accomplish several goals. We will strive to achieve the following goals in a balanced manner.

1. The enforcement process used will achieve compliance and lasting improvement (without continuous EUB involvement) in industry operations.
2. The enforcement action will be appropriate for the severity of the situation (firm but fair). This will ensure that all industry operations are conducted in a responsible manner (level playing field).
3. Industry will clearly recognize the enforcement actions and be motivated to prevent similar events from occurring again.
4. Our customers will be made aware of enforcement actions and accept that effective enforcement actions were taken.
5. All enforcement actions will be consistent with comparable situations of similar severity and be confidently initiated by staff.
6. Enforcement actions will be fully communicated to industry in advance.



## Today's Realities

- very significant EUB involvement in all stages of energy development
- large increase in number of companies
- increasing number of companies not meeting basic requirements
- public, company and other government agency representatives not confident in our enforcement



STANLEY STEEL INDUSTRIES



## Today's Realities (Cont'd)

- companies with substandard operations could be favoured by investment community
- property divestiture
- aggressive, wildcatter, risk-taking companies, present regulator with new challenges



STANLEY STEEL INDUSTRIES



## EUB Enforcement Philosophy/Policy

- will apply to all EUB operations
- not limited to Field Operations or Facilities Division
- front-line services - primarily in Facilities Division will be first to interpret and implement
- collective EUB experience will be documented and shared to achieve confidence and consistency



STANLEY STEEL INDUSTRIES



**Education & Awareness  
+ Effective Enforcement  
Voluntary Compliance**



**Potential to Reduce  
Inspection Activity**



STANLEY STEEL INDUSTRIES



## Enforcement Goals

- compliance and lasting operations improvement
- enforcement actions appropriate to situation
- consistent EUB enforcement actions regardless of location or operator (level playing field)
- industry recognition of enforcement actions creating effective deterrence
- advance operator notification of enforcement action



STANLEY STEEL INDUSTRIES



## Policy Statement

- enforcement action must be timely, effective and appropriate to the severity of the situation
- repeated or similar non-compliance by one operator will result in escalating enforcement consequences



STANLEY STEEL INDUSTRIES



**NEW EUB ENFORCEMENT APPROACH**

**BIOGRAPHICAL SKETCH - LEO TOUCHETTE**

Leo Touchette graduated in 1974 from the University of Alberta with a Bachelor of Science degree. He has worked for the Alberta Energy and Utilities Board (EUB) since that time and been posted in the Red Deer and Wainwright offices. He has been involved in the inspection of rigs and oil and gas facilities for many years, author of the Oil Facility Inspection Manual, and is presently the Provincial Coordinator for Production Inspection. He is also Acting Chairman of a committee charged with designing and implementing modified enforcement approaches for the EUB.

**NEW EUB ENFORCEMENT APPROACH**

**EUB ENFORCEMENT POLICY STATEMENT**

This policy, along with the preceding philosophy should guide any EUB enforcement action.

- All enforcement action for non-compliance must be timely, effective, and appropriate to the severity of the situation.
- Any repeated or similar non-compliance will result in escalating enforcement consequences.



## EUB Expectations

### Examples:

- Identify source of H<sub>2</sub>S and start repair immediately.
- Identify and immediately begin clean-up of any spills.
- Put in place procedures and/or equipment to prevent reoccurrence of H<sub>2</sub>S emissions or spills.
- Act upon EUB requests.



STANDARD OPERATING PROCEDURES



## Events/Enforcement Actions

**EVENT:** - major deficiency public/  
environment not affected

**ACTION:** - meeting with senior staff  
- plan outlined to resolve problem  
- consequences if dates not met



STANDARD OPERATING PROCEDURES



## Events/Enforcement Actions

**EVENT:** - lack of due diligence at large facility  
- no impacts on public/environment or  
- repeated minor problems

**ACTION:** - self inspection required  
- third-party monitoring  
- improvement expectations set  
- consequences outlined

STANDARD OPERATING PROCEDURES



## Events/Enforcement Actions

**EVENT:** - documented repeat of major deficiency  
- prevention inadequate  
- negligent re "due diligence"  
- continuing minor infractions which operator  
refuses to address

**ACTION:** - long-term shut down  
- written prevention plan  
- possible EUB inquiry

STANDARD OPERATING PROCEDURES



## Events/Enforcement Actions

**EVENT:** - numerous situations of non-compliance  
- spill clean up or site reclamation not  
performed according to EUB  
expectations

**ACTION:** - withhold new approvals  
- possibly cancel existing approvals

STANDARD OPERATING PROCEDURES



## EUB Enforcement Philosophy/Policy

**EUB will** Deal firmly with companies  
when there is an obvious  
disregard for EUB requirements.

**EUB will not** Allow companies to gain  
competitive advantage by  
waiting for the EUB to  
identify problems before  
addressing them.

STANDARD OPERATING PROCEDURES

**(B)**



December 13, 1990

Energy Resources Conservation Board  
640 - Fifth Avenue S.W.  
Calgary, Alberta  
T2P 3G4

Attention: Dr. J.P. Prince  
Board Member


Dear Sir:

RE: Joint Industry Task Force  
Recommendations to Limit the Public Risk  
from Corporate Insolvencies Involving  
Inactive Wells

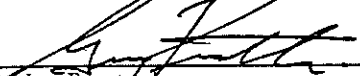
In December 1989, the Energy Resources Conservation Board (ERCB) released a position paper titled "Recommendations to Limit the Public Risk from Corporate Insolvencies Involving Inactive Wells". Subsequent meetings between representatives of industry, the ERCB and the Alberta government were held to discuss the issue of abandoning "orphan wells". Agreement was reached to establish a joint industry task force comprised of representatives from CPA, IPAC and SEPAC to develop an industry proposal in regard to this issue. We can advise you that over the course of the past several months, the three Associations have spent considerable time and resources addressing this matter. On behalf of the Associations, we submit the attached Recommendations for consideration.

We wish to note that the Recommendations have been approved by the respective governing boards of the three Associations. Additionally, we trust that consideration of the Recommendations will be viewed in the same cooperative spirit as that which led to the development of the Suspension Guidelines for Inactive Wells. Finally, we would welcome an opportunity to meet and discuss these Recommendations in detail with the Board's representatives. We understand that such a meeting has been scheduled for Thursday, December 20, 1990 at 8:30am in the Board's office. We look forward to meeting with ERCB to discuss this issue.

CANADIAN PETROLEUM ASSOCIATION

  
\_\_\_\_\_  
Hans Maciej  
Vice President

INDEPENDENT PETROLEUM ASSOCIATION

  
\_\_\_\_\_  
G.J. Protti  
Executive Director

SMALL EXPLORERS AND PRODUCERS  
ASSOCIATION OF CANADA

  
\_\_\_\_\_  
Ken King  
Chairman

Joint Industry Task Force (CPA, IPAC, SEPAC)  
Recommendations to Limit the Public Risk  
Involving Inactive ("Orphan") Wells

The Joint Industry Task Force ("the Task Force") recommends that the proposal outlined in this position paper be implemented for a two year trial period. We believe that this would provide a reasonable opportunity to implement the programme as set-out and to determine its effectiveness in reducing the number of orphan wells.

I. Parties Responsible for Abandonment (see attached outline)  
As a preliminary matter, for purposes of this proposal, the Task Force has defined a Working Interest Participant as being a party who is voluntarily burdened with the risk and costs of drilling, developing and operating an oil and gas producing property. As well, this definition is intended by the Task Force to be broad enough to encompass a receiver-manager in those situations where one is appointed to oversee the business affairs of an insolvent working interest participant.

1. As a starting point, the Task Force recommends that ERCB's proposal of a descending order of responsibility be set aside. We feel that the descending order is unfair and unworkable in that it may lead to ongoing contingent liabilities to parties who have legitimately transferred their interests. Instead, the Task Force proposes that responsibility for abandoning a well be limited to the Licensee of a well as indicated by ERCB's records, and ascertainable working interest participants.

2. We believe that in many instances the Licensee of a well is also the Operator of the property on behalf of the

*current licensee  
+ current WIO*

working interest participants. Therefore, in those situations where a well requires abandonment, it should be the responsibility of the Operator/Licensee to enforce the contractual obligations of each of the working interest participants under the operating agreement. In situations where any of the working interest participants were "reluctant" to participate in the abandonment, the Operator/Licensee would resort to the remedies available under the operating agreement. In cases of an insolvent or non-existent working interest participant, the Abandonment Fund (the make-up and mechanics of which are detailed later on in Part II of this paper) would assume the share of the insolvent/non-existent participant.

*-any well that is abandoned for the province where there is an interest in it?*

3. The Task Force believes that in situations where it is the Operator/Licensee who is insolvent or non-existent, the operating agreement should prevail insofar as it is the responsibility of the working interest participants to select a new Operator from amongst themselves. Once appointed, the new Operator would have the responsibility of ensuring that a well was properly abandoned.

*Why not the happening now?*

*Does this currently happen in insurances? I think not.*

In the event that none of the existing working interest participants assumed or accepted the position of Operator, the Task Force proposes that ERCB assume the responsibility for abandoning the well. Upon abandonment, the Board would be empowered to charge the viable, working interest participants their proportionate share of the abandonment costs. Additionally, the Task Force recommends that ERCB be entitled to charge each working interest participant in this situation a 25% surcharge over and above their respective share of the abandonment costs. We feel that this would have the effect of discouraging the working interest participants from

*We believe that we already have this authority*

*"We don't want to get into the abandonment Board should transfer all remaining WIC joint business"*

defaulting on their responsibility in selecting an Operator with the attendant obligation to abandon. The 25% surcharge would be for the account of the Abandonment Fund.

In instances where ERCB assumed the abandonment obligation as a result of a new Operator not being appointed and where one of the working interest participants was "reluctant" to pay its proportionate share of the abandonment costs, the Task Force advocates that the Board be empowered to exercise a number of remedies including the following:

- i) the right to be subrogated to the remedies of the Operator under the Operating Agreement;
- ii) the right to refuse issuance or transfer of well licenses on the application of a reluctant working interest participant, and
- iii) possible amendments to the Mines and Minerals Act permitting ERCB to attach a reluctant participant's interests in any Crown leases.

We believe that these powers, taken either separately or collectively, would have the effect of compelling a reluctant working interest participant to meet its obligations regarding the abandonment of a well.

In cases where one of the working interest participants was insolvent or non-existent, the Task Force would advocate that the Abandonment Fund assume that party's share of the abandonment expense.

*- why not power to  
go after revenues  
of reluctant parties?  
directly?*



4. The Task Force recognises that situations may arise where an Operator/Licensee may refuse to comply with an abandonment order. The Task Force recommends that, in these situations, ERCB be empowered to order an Operator/Licensee to abandon the well. In the event that the Operator still refused to comply, on application, ERCB could have its order affirmed as an order of the Court of Queen's Bench of Alberta. We believe that ERCB already has this power under the existing legislation. Additionally, we would propose that ERCB be given the right to refuse well license issuances and transfers to such a "reluctant" Operator/Licensee. Although the Task Force appreciates that ERCB is of the opinion that it already has these powers, nevertheless the legislation should be amended to clarify the situation.

*What about reluctant w/o should ERCB have the same power?*

Finally, we believe that consideration should be given to amending the Mines and Minerals Act to provide for ERCB attaching a reluctant Operator's interests in any Crown leases where the Operator refuses to comply with an abandonment order.

*By doing so does the Bid get his share of any revenues accruing to those parties*

5. A key element of the process outlined above is the formulation by ERCB and industry of specific criteria for identifying wells requiring abandonment.
6. The Task Force further proposes that ERCB be given the responsibility on behalf of the industry to maintain records of those parties who have defaulted on their abandonment responsibilities and for whom the Abandonment Fund has had to contribute to the abandonment costs of a well.

*administrative task.*

The Task Force believes that the outline, as set-out above of parties responsible for abandonment in the situations noted, has merit for a number of reasons. First of all, it allows the oil and gas industry to continue business on terms agreed upon by the parties to an agreement. Additionally, the proposal retains the relationship of the parties to an agreement as being one that is of a "several and not joint or collective" relationship, i.e., as tenants in common. Finally, and perhaps most importantly from ERCB's point of view, it provides a programme for resolving the orphan well problem without putting the public at risk. Under the mechanics of the scheme proposed, the Abandonment Fund would act as a measure of last resort insofar as there would be funds available to ensure that all true "orphan wells" were properly abandoned.

*Would not cover all true orphans if industry is relieved of responsibility after well is first abandoned.*

## II. Abandonment Fund

As noted above, the Task Force proposes the establishment of an Abandonment Fund to act as a "backstop" or a measure of "last resort" to ensure that all wells within Alberta are properly abandoned when required. Access to the Abandonment Fund would be available in those situations as described under Part I where contractual remedies between working interest participants and ERCB orders had failed to produce the necessary result. In this regard, it is important to emphasize that the Task Force proposes that the Fund not be characterized as an insurance fund: rather, that it be available as a remedy to ensure that public funds are not expended for abandonments.

1. The Task Force proposes that the existing "Abandonment Fund" administered by ERCB be retained. It is our understanding that this fund currently stands at +\$3 million, derived from the defunct well deposit programme. This existing Abandonment Fund would thus fulfill the role of remedy of last resort as described above.

The Task Force proposes that a joint industry/ERCB management committee be established to review, audit and administer the Abandonment Fund. The committee would meet on a regular basis to consider all matters related to abandonment of wells and administration of the Abandonment Fund, including the following:

- i) Fund expenditures for well abandonment for the preceding period;
- ii) financial reporting for the fund;
- iii) review of designation and determination of all existing wells in Alberta as either "active" or "inactive" (see Paragraph 2 below for further

*suspended well  
review - industry  
issue in development  
of review criteria but  
ERCB alone make  
decision on abandonment*

- details on this point);
- iv) identification, planning and orderly scheduling of orphan wells requiring abandonment for up-coming period;
  - v) review of ERCB records as compiled by the Board under Part I, Paragraph 6 above with a view to dissemination of this information, and
  - vi) establishment of an Abandonment Fund levy for the up-coming period (see Paragraph 2 below for details on this point).

The Task Force is of the view that the establishment of such a committee would ensure that the Abandonment Fund was meeting its objectives. Furthermore, it would continue the cooperative spirit between industry and ERCB in promoting a successful resolution of this problem. Finally, we propose that the ERCB be given the responsibility of overseeing the daily, administrative functions of the Fund as well the research, identification and enforcement duties described earlier in this Report, functions we believe ERCB is uniquely suited to perform.

2. The Task Force submits that the Abandonment Fund be replenished when required as determined by the joint industry/ERCB committee within the following parameters:

- i) ERCB would determine and designate all existing wells in Alberta as either "active" or "inactive". Broadly speaking, this would be a function of reviewing whether a well had or had not produced during the preceding period; *12 months*

*set min.  
fund level  
\$500,000*

- ii) upon designation of wells as being "active" or "inactive", all inactive wells would be subject to a special "inactive well" levy. The levy so collected would be used to replenish the Abandonment Fund for the previous period's actual expenditures and to maintain funding at an appropriate level;
- iii) funding required for ERCB administrative expenditures related to their functions identified under Paragraph 1 would be covered by the existing ERCB annual levy on industry.

disagree!

We believe that the proposal as described for financing the Fund has many attributes which make it acceptable to both industry and ERCB. First of all, it accepts the rationale that inactive wells represent the highest risk category for future, potential orphans. Additionally, the Task Force is the opinion that a levy as described on an inactive well would, at the very least, focus a company's attention on the status of its wells and provide an incentive for a company to take steps either to abandon a well or to place it on production. Furthermore, by providing for a regular assessment of wells requiring abandonment, industry would be allowed to undertake abandonments in an orderly fashion with little fear of an "accumulated" problem several years hence. By assessing risk versus expenditures on current orphans, the joint industry/ERCB management committee would be ensuring that adequate funds would be available to abandon current orphans, but without allowing the Fund to accumulate into an unnecessary "super-fund".

*What about shrinking population of inactive wells - system is designed to accomplish this*

### III. Well License Transfers

As a starting point, the Task Force rejects any proposal for development or implementation of well license transfer criteria. We believe that requiring transferors and transferees to provide corporate or financial information at the time of a proposed transfer is unworkable and unreliable. The Task Force is of the opinion that such a policy would only serve to slow down the orderly processing and approval of transfers while at the same time, failing to provide the necessary assurance that a well would ultimately be properly abandoned.

Instead the Task Force proposes the following approaches to transferring well licenses:

1. As a matter of policy, it is proposed that well licenses be issued or transferred automatically by the Board if the Transferor and Transferee (and related affiliates of both) are not in violation of an abandonment order or other orders or penalties of ERCB. This would promote continued industry efficiency.
2. In the case of an inactive well proposed for transfer (inactive in the sense as designated by the Board under Part II), the Task Force proposes that ERCB have the power to refuse such a transfer until the Transferor or Transferee undertakes to bring or actually brings the inactive well into compliance with the recently adopted Suspension Guidelines. Upon such compliance, ERCB would then approve the transfer. Concurrent with this, the Task Force favours ERCB having the power to refuse a transfer where the well proposed for transfer is one for which there is outstanding abandonment order. The Board would also have the ability to refuse transfers or issuances of

well licenses where a party to a transfer had defaulted on payments to ERCB for its share of abandonment costs in those situations identified in Part I of this paper.

OK.

3. Finally, the Task Force proposes that a licensee/transferee be required to file with the Board, at the time of the license issuance or transfer application, a list of all of its working interest participants. This would be of assistance to ERCB in tracing the parties responsible for abandonment in accordance with the scheme outlined under Part I.

and any time this we change

The Task Force submits that the above proposals for well license issuances/transfers are workable for a number of reasons. At the outset, by requiring that an inactive well meet the Suspension Guidelines before a transfer is approved, future abandonment costs in the event the well becomes "orphaned" will be minimized. Additionally, the proposal utilizes the existing mechanism for suspended wells which has been accepted by both industry and ERCB, thereby enhancing the effectiveness of the Guidelines.

are you proposing that no action be taken with suspended wells until a transfer application is filed

Other advantages to this procedure include the discouragement of irresponsible divestiture schemes involving inactive wells, thereby reducing the potential for future orphan wells resulting from such transactions. Furthermore, the process, as proposed, would allow companies that are involved in "stripper" wells to pursue their operations without undue interference. As noted earlier in this Part, these measures would eliminate lengthy and unwieldy "means tests" being administered by the Board when a transfer application was submitted, tests which do not give any assurances that a well will be properly abandoned when required. Lastly, the proposed approval procedure would

how does it do this

-11-

enhance ERCB's powers to assist the industry in reducing the number of potential orphans.



IV Re-abandonments

The Task Force believes that the issue of wells which have been abandoned but, due to the passage of time, may require further work or "re-abandonment", is one which requires further dialogue between industry and ERCB. We have assumed when discussing wells requiring "re-abandonment" that the reference is to wells which were initially abandoned in accordance with then existing regulatory requirements, but for which remedial work is required.

We are of the view that, for any well which was abandoned in accordance with existing standards of the day, any future work should be borne by the provincial government. This would apply also to those wells whose initial abandonment required funding from the Abandonment Fund. Subsequent costs would be the responsibility of the government. We would also propose that industry and ERCB work towards the development of an "Abandonment Certificate" which would be conclusive proof that a well had been abandoned in accordance with the standards and regulations of the day.

The Task Force believes that this issue poses a problem which represents a shared responsibility on the part of industry and government. Borrowing a concept from another current debate, the Task Force believes that the notion of "sustainable development" implies, at some time, a limitation of industry responsibility. We are not proposing excusing gross negligence or wanton recklessness in the abandonment of a well: such cases should continue to attract responsibility or liability. However, once a party has properly abandoned a well and has conformed with all existing regulatory guidelines employing available technology, then that party's responsibility should be limited. The Task Force believes that the adoption of an

*what about  
sitac trans  
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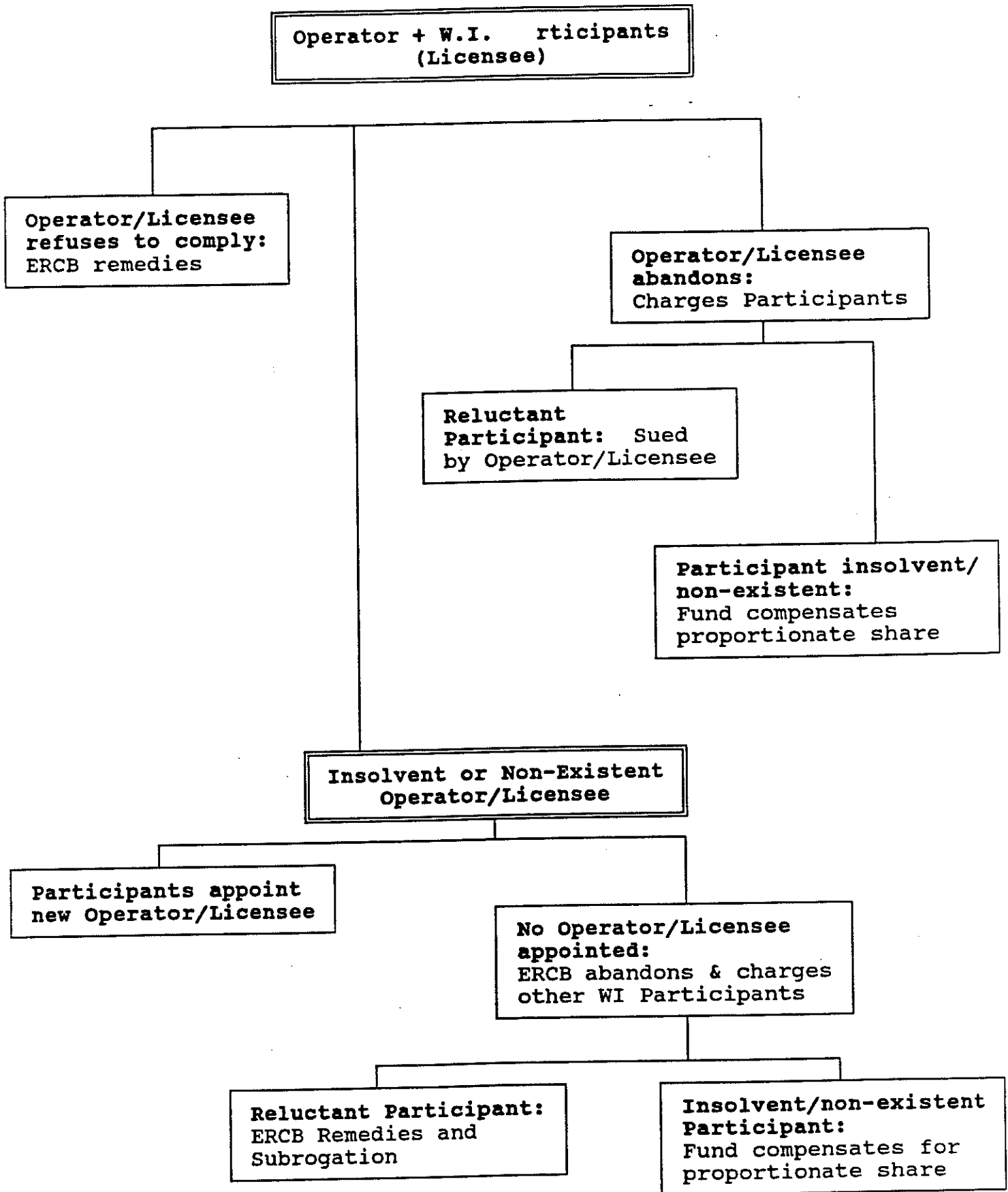
*We do not  
scrutinize  
all abandonments  
close enough  
at the present  
time we  
would have  
to increase  
our surveillance*

-13-

"Abandonment Certificate" would be useful in determining such limits of responsibility.

V Receiverships

The Task Force is supportive of amendments to the Bankruptcy Act to ensure that trustees in bankruptcy are charged with the responsibility for contributing towards a bankrupt party's share of abandonment costs. There are compelling arguments for changes to the existing insolvency legislation to ensure that public safety takes precedence over the rights of creditors.



(C)

12.0

ALBERTA'S ORPHAN WELL PREVENTION PROGRAM  
SUPPORT PROCESSES

BY

JOHN NICHOL, P. ENG.

MANAGER, DRILLING AND PRODUCTION DEPARTMENT

ALBERTA ENERGY AND UTILITIES BOARD

18 October 1995

**ABSTRACT**

In the latter half of the 1980's, the severe and uncertain economic climate in Alberta's oil and gas industry focused EUB attention and concern to the escalation in the number of ownerless "orphan wells." Increases in corporate insolvencies, bankruptcies, defunct companies and reluctant licensees, coupled with rationalization activities that were shifting assets between different sectors of the industry, all contributed to growing fears of unmanageable future well abandonment liabilities. Additionally, the numbers of inactive wells were increasing dramatically raising concerns over their potential to become orphans including concerns about wellbore integrity and public and environmental safety.

Industry responded by accepting the responsibility to develop and support an abandonment fund to deal with existing orphan well problems and meet future obligations. In accepting this liability, both industry and regulatory partners recognized the need to address improved control systems and processes to minimize the orphan well burden. This paper will discuss both the current support processes that have been developed as well as their future directions.

## INTRODUCTION

The industry abandonment fund was established and "restricted" to pay for the share of downhole abandonment costs of insolvent or non-existent licensees and working interest participants in a well. The fund is presently maintained through an annual levy on inactive wells and a first-well licence fee. It does not pay for reclamation or facility/pipeline abandonment and removal. The fund is managed by the EUB and its overall activities are directed by the Fund Advisory Committee (FAC). The FAC and its predecessor, the Orphan Well Steering Committee, has struck numerous subcommittees to review certain aspects of the orphan well issue. This paper will be referring to these various subcommittees. Details regarding the abandonment fund and its administration will be discussed in another paper being presented to this conference by David Sandmeyer.

The FAC Facilities, Pipelines and Reclamation Subcommittee is currently investigating the related matters of reclamation and facility/pipeline abandonment. This subcommittee is mandated to submit recommendations to the FAC on the administration and funding for these associated costs. The subcommittee has yet to submit its report. This paper will focus only on what has been developed to date specific to wells. Therefore, readers should note that the processes discussed in this paper may be amended accordingly to accommodate the future recommendations of this subcommittee.

## 12.2

It should also be noted that the current EUB restructuring which created the Facilities Division from five previously separate departments, may see several of these fund support processes, (eg: transfers of approvals or licences), amalgamated into one process thereby allowing the industry to make one application to transfer a property. An example of this amalgamation of processes is also being presented to this conference in a paper by Al Chare regarding facility applications.

Both industry and regulatory partners recognize the need to address improved control systems and processes to minimize continued growth of the orphan well burden. They recognize that certain key aspects of the orphan well issue can be improved through greater surveillance of both new licensee applicants and a review of existing well-licence transferees and transferors. This review would also include a detailed analysis of inactive wells, as these are seen as the most likely source of future orphan wells. These processes were developed to ensure licensees are responsible and accountable, limit the abandonment fund liabilities, protect the Alberta public interest and encourage the timely abandonment of wells.

The abandonment fund support processes to be discussed in this paper are itemized below and will be presented individually. They are:

- Inactive Wells
- Well Licence Transfers
- First Time Company Criteria
- Corporate Surveillance/Compliance
- Legislation and Regulations
- Well Abandonments



## **INACTIVE WELLS**

One of the inevitable consequences of a maturing Alberta oil and gas industry and continued unstable price regimes has been the rapid increase in the number of inactive wells over the past decade. This has led to prolonged periods of suspension for marginally economic wells, pending improved economics or new recovery techniques, and has also sustained a brisk market for property divestitures.

The EUB and industry are very concerned about the increase in inactive wells and continue to implement measures to address the situation. EUB Interim Directives ID 90-4 and 91-5 set out suspension guidelines for inactive wells and a schedule for compliance with the guidelines. The guidelines categorize wells according to well fluid type and release rates to reflect increasing levels of risk. Ensuring wellbore integrity, protecting public and environmental safety, minimizing potential for wellbore damage and providing for safe wellbore re-entry are the objectives of the guidelines.

The EUB currently conducts three different types of reviews on inactive wells. The EUB measures industry adherence to the suspended well guidelines through a random audit program of licensees of inactive wells. Audited licensees that fail to comply with the guidelines are subject to EUB compliance/enforcement policy.

The Suspended Well Subcommittee of DACC (Drilling and Completions Committee) that developed the guidelines recognized the added costs to industry associated with implementing the guidelines. However, it was seen as a necessary step to ensure that companies review their inventory of inactive wells and to provide encouragement to abandon uneconomic inactive wells rather than leaving them suspended. To date, the EUB has not seen this reduction occurring.

Accordingly, in July 1995, the industry associations and the EUB issued a joint newsletter advising that a program, specifically targeting inactive wells that have not produced for 10 consecutive years, would be implemented commencing 1 July 1996. Licensees with wells in this category will have to submit a program outlining how they will address their particular situation. The establishment of abandonment deposits as an alternative is also discussed. Interested parties are invited to provide input on possible changes and improvements to the program or suggest alternative ways to address this particular problem.

The EUB and the industry associations were also concerned about the possibility of orphan wells resulting from licensees holding more than twice as many inactive wells as active wells. Licensees in this category were deemed to be "high" risk in terms of abandonment fund protection, particularly if the licensee had shown no licensing or transfer activity in the past year. Licensees that failed this screening criteria are requested to submit a program outlining how they will reduce their inactive wells within a specified period of time. Failure to adhere to the program may result in the EUB requesting abandonment deposits for the inactive wells.

As part of the EUB restructuring, an internal committee is reviewing all EUB suspension processes related to inactive wells, pipelines and facilities. A consolidated approach to approvals for continued suspension, audits, technical requirements, abandonment requirements, legislation and surveillance will be reviewed, again with the view to deal with a production entity as a whole versus in the various parts.

### **WELL LICENCE TRANSFERS**

As previously mentioned, well licence transfers resulting from property divestitures has remained very active. EUB Interim Directive ID 93-2 sets out the requirements for the issuance of a new well licence and approval of a well licence transfer. The FAC Well Licence Criteria Subcommittee developed the criteria to be used and administered after examining the EUB's original policies and procedures regarding transfers. The transfer was seen as an opportune point at which to take a very close look at the new and existing customers involved and the wells that were changing hands. Marginally economic wells would be of particular interest.

Again, the industry and the EUB recognized that the expanded criteria would be more intrusive than the previous system. However, the criteria would not restrict the ability of an individual or company to participate or invest in the Alberta oil and gas industry. Only if they chose to file an application to hold an EUB well licence would they then be subject to the new requirements. The subcommittee adopted the philosophy that holding a well licence is not a right but a privilege for which an applicant must qualify.

The primary components of the criteria are as follows:

- Company operational/surveillance review
- \$10,000 first well licence fee
- Well-screening ratio determine if further review required
- Well classification methods to evaluate wells
- Well deposit for wells that do not meet the criteria
- Deposit reduction for multiple well transfers
- Deposit refund criteria

As part of the EUB restructuring, an internal committee is reviewing all transfer processes with a view to consolidate them into one process. A possible outcome from this would be a single form and guide. Industry would be able to make one application to transfer all EUB licences, approvals and permits associated with a property divestiture.

#### **FIRST TIME COMPANY CRITERIA**

EUB Interim Directive ID 93-2 also introduced criteria for first time companies applying for a well licence. Since July 1993, 171 new companies have applied to hold well licences. Divestiture by larger companies has provided the small producer with new opportunities. These producers represent a significant aspect of the industry because they produce wells to an economic limit that is typically much lower than a larger company. Conservation, by capturing as much of the reserve as possible, is thereby better served.

## 12.7

However, it is the EUB's observation that many of these producers appear less equipped for the regulatory regime that exists today especially when it comes to funding the abandonment liability which is usually less than five years away when a property is sold. When properties change hands the abandonment liability typically remains unfunded because the property has simply been discounted for the cost of abandonment. Industry and the EUB both desire a business environment that not only provides for the last barrel in a well to be "economically" produced but also ensures that abandonment obligations are met.

The criteria established was seen as a "means test" to attempt to measure a company's ability, both financially and technically, to comply with regulations and fulfill its obligations as a well licensee. This would be in much the same manner as obtaining a drivers licence whereby you must take a written and practical examination prior to obtaining the licence. A new company is required to pay a first well licence fee of \$10,000 which is deposited to the industry abandonment fund. Additionally, the company must introduce itself by providing the details contained in Part 1 of EUB Interim Directive ID 93-2.

It is anticipated that the FAC Facilities, Pipeline and Reclamation Subcommittee, will recommend that this criteria be applied to all parties requesting an EUB operator code if they are applying for a pipeline or facility approval. If such is the case, the criteria will probably be applied to those companies seeking these types of approvals.

The criteria prescribed by EUB Interim Directive Id 93-2 includes:

- Corporate Profile
- Right to Produce and Access Land Surface
- Appointment of Agent (Where applicable)
- Corporate Level Emergency Response Plan
- Insurance
- Working Interest Ownership
- Suspended Facilities
- Declaration

Additionally, the EUB corporate surveillance/compliance record will be checked.

#### **CORPORATE SURVEILLANCE/COMPLIANCE**

EUB Interim Directive ID 93-2 also introduced to the industry that the EUB would be proactive in monitoring and maintaining a company "track record" to be reviewed each time an application to drill or transfer was filed. Please note that this is not a detailed record of a company's compliance history but rather a centralized point where major deficiencies would be noted. This corporate surveillance/compliance record would provide to internal EUB users a one-window communication vehicle for exchanging information regarding major deficiencies. The record is intended to enhance the EUB compliance and enforcement processes.

Any outstanding deficiencies identified in the review, such as non-payment of fees or non-compliance with EUB regulations would have to be addressed by the company before an application would be approved. Al Chare, in his paper on the new facility application process, references the connection to this record. It is the EUB's intention to further develop and expand the use of this record as an enforcement/compliance tool. Leo Touchette, in his paper, also makes reference to how this record would be used in an escalating consequence approach to enforcement.

Withholding of applications would typically be a last resort. Further, a company would be made fully aware in advance that this would occur. The withholding of services is not a new concept in law, however, its application to oil and gas regulation does represent a new approach. For example Sections 57.1 and 57.2 of the Motor Vehicle Administration Act provides for the withholding of services by the Registrar in respect to a person that has not paid a fine under the Highway Traffic Act or to a debtor under a maintenance order issued pursuant to the Maintenance Enforcement Act.

The industry has supported the concept that all applicants be subject to an operational history/surveillance review prior to the granting of approvals. This was seen as critical in developing an overall orphan well prevention program. The FAC Well Licence Criteria Subcommittee, in establishing planning concepts to guide itself in developing criteria for drilling and transfer applications, agreed that a degree of control was warranted and reference this in item 6 of their planning list.

It reads as follows:

*"There is an increasing incidence of new licensee applicants who have a previous record of corporate deficiencies, both within direct and associated companies. Deficiencies include failure to respond to EUB directives, unpaid surface/mineral lease rentals, etc. The licensee criteria must consider means to force compliance in such cases, before licence transfers are accepted."*

Within this function, the EUB is also involved with the industry associations through the FAC Peer Review Group in conducting working interest searches of defunct or reluctant companies. This is done in an attempt to find responsible parties and to take the necessary compliance/enforcement action to ensure wells are abandoned thereby limiting the number of wells going to the abandonment fund. The EUB has established working relationships with other jurisdictions within Alberta that share a common concern with companies that do not fulfill their regulatory responsibilities.

## **LEGISLATION AND REGULATIONS**

Bill 5, the Oil and Gas Conservation Amendment Act, 1994, which became effective 25 May 1994, enacted the various statutes developed by the FAC Legislation Subcommittee. These enhancements to the Oil and Gas Conservation Act created the abandonment fund and other related supporting legislation. The corresponding regulations have yet to be released. It is anticipated that the recommendations forthcoming from the FAC Facilities, Pipelines and Reclamation Subcommittee will require further enhancements to these statutes to accommodate funding and administration of these other related activities.



The key changes resulting from Bill 5 are as follows:

- Creation of an abandonment fund, levy and penalties
- Creation of a limited liability chain
- Ability to refuse transfers
- Requirement for abandonment deposits
- Responsibility for well abandonment costs
- Cost recovery including issuance of cost orders

These changes enhanced the legislative authority for many of the policies and procedures used by the EUB. Of particular importance, is the need to make sure that the responsibility for the proper abandonment of wells rests with the beneficiaries of the wells.

## **WELL ABANDONMENTS**

This function relates to all of the other EUB's activities that identify problem situations and ensure the timely abandonment of wells. This includes those cases where the EUB has had to order a well abandoned. These activities are no less significant in helping to achieve the goals of the orphan well prevention program. Activities in this area not previously mentioned in this paper include:

- Mineral expiry surveillance and enforcement
- Industry cost order applications
- Administration of the Abandonment Criteria Subcommittee recommendations respecting inactive wells
- EUB conducted abandonments and cost recovery

EUB General Bulletin GB 94-9 announced recent changes to the mineral expiry process. The industry was advised that, as part of this process, the EUB will be issuing abandonment orders. The EUB is aware that Crown and certain freehold mineral owners are currently reviewing their minerals associated with non-producing properties and terminating the leases.

EUB Informational Letter IL 95-03 describes the cost order application process. Where a reluctant working interest participant refuses to pay its proportionate share of the abandonment costs, the participant who incurred the costs may make application for the payment of the costs to be ordered by the EUB. The EUB can order the reluctant participant's share of the abandonment costs, plus a 25% penalty, payable to the participant that incurred the debt. The order can be entered as a judgement of the court and enforced according to the procedures of the court.

## **SUMMARY**

Each of the preceding areas are administered by different working groups at the EUB and are constantly evolving. If the reader wishes to obtain more information or discuss any of these areas in more detail, please contact the Drilling and Production Department of the EUB.

Thank you for this opportunity to present this paper which illustrates the collective efforts of the staff involved in these processes that strive to ensure that the Alberta public interest is protected and the industry's abandonment fund liabilities are limited to the best extent possible.

**SPEAKER: John R. Nichol, P.Eng., Manager, Drilling and Production Department, Alberta Energy and Utilities Board**

Mr. Nichol has been employed by the EUB for over 24 years, and in his current capacity is responsible for the licensing of wells, production facilities and water/waste disposal schemes. His department is also responsible for all aspects of measurement and accounting of oil and gas production in the province, including detailed production audits. He holds a B.Sc. and Diploma in Civil Engineering from the University of Manitoba. Mr. Nichol has served on numerous industry/government committees and held a number of executive positions with the Petroleum Society of CIM, including Chairman of the Edmonton Section. Mr. Nichol is one of the EUB representatives on the Orphan Well Steering Committee and is currently Chairman of its successor, the Fund Advisory Committee.

**(D)**

# Memorandum

September 27, 2000

FROM: Surveillance Branch, Corporate Compliance

TO: Board Advisory Committee

## **PROPOSAL FOR THE CANCELLATION OF THE LONG TERM INACTIVE WELL PROGRAM**

**CO-ORDINATOR: HOWARD FEDORAK**

### **Issue**

The Corporate Compliance Group of the EUB seeks BAC endorsement on a recommendation that the Long Term Inactive Well Program (LTIWP) be discontinued in conjunction with the implementation of the Licensee Liability Ratio test.

### **Recommendation**

The Corporate Compliance group proposes to cancel the Long Term Inactive Well Program. The Liability Management Project (LMP) is introducing a new Licensee Liability Ratio (LLR) to replace the current Well Screening Ratio which is used to assess the corporate health of licence holders. The LLR will more accurately assess the asset to liability ratio of each licensee and require financial security deposits from licensees not achieving the specified LLR threshold.

### **Discussion**

This LTIWP program, introduced in November 1997, was deemed necessary as long term inactive wells were considered to pose a significant financial risk to the Orphan Fund through the potential creation of future orphan wells.

This five-year program had two documented purposes:

- to substantially reduce the population of long-term inactive wells, and
- to minimize the financial risk to the Orphan Fund (by obtaining financial security in the form of deposits for long term inactive wells).

In its two years of existence, the LTIWP has proven successful in addressing these mandates. EUB data confirms that approximately 1200 long-term inactive wells have been abandoned since

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the introduction of the program, thereby significantly reducing the population of long-term wells. In addition, the LTIWP to date has collected approximately \$24M in deposits on approximately 1500 long-term inactive wells. In collecting this financial security on non-producing wells, the LTIWP is meeting the second program objective of decreasing financial risk to the Orphan Fund.

Notwithstanding the success to date of the LTIWP, the Corporate Compliance group proposes to cancel the program. As previously stated, the Liability Management Project is introducing a new Licensee Liability Ratio (LLR) to replace the current Well Screening Ratio which is used to assess the corporate health of licence holders. The LLR will more accurately assess the asset to liability ratio of each licensee and require financial security deposits from licensees not achieving the specified LLR threshold. Long-term inactive wells are considered as liabilities in this evaluation and will be subject to security deposits if the licensee has an overall LLR value below the specified value. Therefore, all wells and facilities that represent potential liabilities, including long-term inactive wells, will be subject to a deposit requirement if the licensee has an unacceptable asset to liability ratio and thus poses a risk of creating orphan wells.

Further consideration for cancellation of the LTIWP was based on a concern expressed by industry that the LTIWP requires licensees to address or place deposits on specific wells. It has been suggested that this prescriptive approach hampers industry's ability to selectively administer its wells. In some cases program requirements dictate that action be taken on long-term inactive wells when it would be more prudent to address other wells. In the LLR program, licensees with low LLR values are required to abandon, produce, transfer or place deposits on wells that represent liabilities, but the licensee may choose the priority with which specific wells are addressed.

A fundamental principle inherent with this proposal is the continued protection of the Orphan Fund. Based on this premise, Corporate Compliance proposes that all deposits currently held on long-term wells be retained and that the refund criteria outlined by the LTIWP be maintained. However, it is further proposed that once the retrospective licensing procedure is completed and the monthly LLR protocol implemented, industry may request a refund of all, or part of its security deposits, based on the refund rules associated with the LLR process. Those rules allow for a company to request a refund of a portion, or all of its deposits, if, after being determined to be a high-risk company, it increases its LLR for a specific time period.

In summary, the cancellation of the LTIWP at this time assists in facilitating an orderly transition to the new requirements represented by the LLR review. Corporate Compliance believes that the LLR requirements will not only support, but enhance, the fundamentals of the Long Term Inactive Well Program in assuring the protection of the Orphan Fund and the Public of Alberta.

Howard A. Fedorak

**(E)**

## **Process Forward Expanded Orphan Program**

**Sponsors: Jim Dilay; John Nichol**

### **Background**

- ID 2000-11 issued on October 24 2000 implemented enhanced licence transfer and corporate abandonment and reclamation risk assessment requirements in support of an expanded Orphan Program.
- While initially supportive of the screening requirements CAPP and SEPAC, in the face of considerable member and non-member negative reaction to the screening requirements, requested the EUB via the industry – government Fund Advisory Committee to review the screens. The EUB agreed.
- In December 2000, the FAC formed a TLR – LLR Review Team to develop an interim replacement TLR for licence transfer assessments; and then an alternative corporate liability risk assessment screen.
- The FAC considered the TLR – LLR Review Teams recommended interim TLR on 23 March 2001. CAPP and SEPAC supported the interim TLR. Both the EUB and the industry associations acknowledged the short comings of the interim replacement TLR if used for the long term, but believed it to be acceptable for the short term use until an alternative LLR could be developed and implemented.
- About the same time the industry also expressed concerns respecting the formation and operation of the Delegated Administrative Organization provided for in Bill 13. The main concerns related to providing equivalent liability protection for industry volunteer Directors similar to that afforded government employees and authority to undertake reclamation.
- The Board accepted the recommended interim replacement TLR on 9 April 2001 but included a sunset clause dated 31 December 2001 to ensure focus to the development of suitable abandonment and reclamation risk management requirements and processes. ID 2000-11 Amendment was issued 12 April 2001.
- Given the concerns respecting the screens and the DAO, the Board requested a discussion paper summarizing the anticipated path forward.
- Several Board Members attended the 27 April 2001 FAC meeting to directly express their desire to ensure potential public interest and intergenerational liability related matters are effectively addressed and appreciate the extent of industry’s commitment to the Orphan Program. There was general agreement to undertake a actuarial review/risk assessment of the program to ensure its overall objective of protecting the public purse from industry abandonment and reclamation liabilities.

### **Process Forward**

- The attached **Draft** Gantt Chart provides a high level overview of the anticipated process forward for the Expanded Orphan Program as well as other EUB Liability Risk Management initiatives being planned or underway. Note the timeline for the development of necessary MOUs has not been formally discussed with AENV.



## **Orphan Program Liability Assessment and Screening**

- The FAC TLR – LLR Review Team received a CAPP/SEPAC developed LLR alternative proposal for consideration on 3 May 2001.
- EUB personnel are currently reviewing the proposal to identify matters requiring further clarification. These items will be subject to further deliberation by the TLR-LLR Review Team, specifically by the LLR Task Group.
- The TLR- LLR Review team has 3 Task Groups: LLR; Consultation; and Abandonment and Reclamation. The LLR Task Group is reviewing matters related to assessing the risk a particular licensee may pose to the Orphan Fund, industry and company liability performance measures, as well as the impact of any screen recommend; the Consultation Task Group is developing a consultation plan to ensure more widespread awareness of the screens under development; and the Abandonment and Reclamation Task Group is addressing matters related to determining suitable security amounts. In addition, the Review Team is developing a set of Guiding Principles for the Orphan Program. GB 2000-28 feedback received to date respecting the October 24 TLR and LLR is available to the Review Team.
- The Review Team has established a target date of 30 May 2001 to prepare recommendations to the FAC.
- Assuming endorsement by the industry associations and acceptance by the EUB, a short public consultation process from June to September is proposed. Preliminary stakeholders identified include the industry associations, GB 2000-28 respondents, other industry (non-CAPP / SEPAC members), as well as the public interest groups contacted prior to the acceptance of Bill 13 in the legislature is proposed. Information dissemination-feedback (paper and electronic) and select focus groups are being reviewed as potential consultation methods.
- A subsequent amendment to ID 2000-11 would then be prepared by the EUB. The target release date of the amended ID is November 2001.
- LMS systems development has been significantly impacted by the changes requested by industry, extending the target completion to the target date and cost (\$500 000) for the updated screening assessment requirements. The matter of industry funding these changes will be discussed by the FAC.

## **Orphan Program DAO**

- Orphan Program operations for 2001 will be adversely impacted if the issues respecting indemnification and reclamation authority are not quickly addressed. Operations proposed for 2001 have been estimated at approximately \$7.5 million.
- CAPP by letter to the Chair dated 2 May 2001 expressed its concerns and advised that it was not be prepared to nominate directors without resolution. Failing resolution it proposed reconsideration of previously rejected alternatives to address the consolidated budgeting issue the DAO is designed to address.
- At a 4 May 2001 meeting with CAPP and SEPAC representatives the EUB proposed a solution that would see minor revisions to the OGC Act via the Miscellaneous Statutes 2001 Amendment Act (end of Spring Session 2001) to address

indemnification for matters under EUB jurisdiction; AENV proposed a solution for reclamation matters, where specific Environmental Protection Orders would be issued for orphans (currently done), with AENV retaining the DAO as its Agent (initially on a EPO by EPO basis) to undertake the necessary work. Reclamation Certificates would be issued to the orphan licensee. Industry reaction was positive to the proposed solutions.

- OGC Act changes via the Miscellaneous Statutes Amendment Act to be discussed by the Chair with the Minister.
- AENV personnel are reviewing its portion of the proposed solution with its ADM; and DM.
- Assuming the government is receptive, an initial meeting of the DAO could be held in mid May, thereby allowing development of a business plan, budget, and levy request to the EUB.

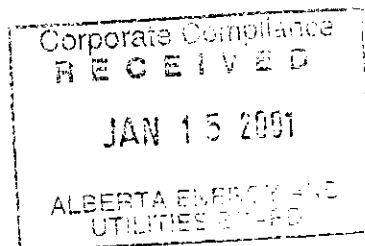
### **Summary**

- EUB personnel are actively working with industry stakeholders to develop an acceptable liability assessment screen as part of the overall Orphan Program.
- A public consultation of the liability assessment screen developed will be undertaken to ensure appropriate awareness of EUB liability management requirements prior to formal implementation.
- Solutions to address industry concerns respecting the DAO have specifically been identified and are actively being pursued.
- An actuarial review/risk assessment of the Orphan Program will be pursued.

**Prepared by: Hal Knox**  
**9 May 2001**

**(F)**

Canadian Association  
of Petroleum Producers



January 12, 2001

Mr. Neil McCrank, Chairman  
Alberta Energy and Utilities Board  
640 - 5 Avenue S.W.  
Calgary, Alberta  
T2P 3G4

Dear Mr. McCrank:

**Re: Liability Management Plan Implementation**

I am writing to express CAPP's deep concern regarding the apparent consequences of the Liability Management Plan which has been developed under the direction of the Fund Advisory Committee.

I wish to emphasize that CAPP continues to support an industry funded orphan facilities management program which includes mechanisms that minimize risks to the fund. However, recent data demonstrates that the current formula for calculating both the Licensee Liability Rating (LLR) and the Transfer Liability Rating (TLR) will result in deposit requirements far in excess of amounts deemed by industry to be appropriate for the fund. Consequently, CAPP makes the following recommendations:

1. The Fund Advisory Committee agree to defer implementation of the LLR pending a review of the existing formula.
2. Establish a joint technical task group (with representatives from CAPP, SEPAC, and the EUB) under the Fund Advisory Committee to review the current formula and make recommendations for changes to the formula.
3. The Fund Advisory Committee immediately review the TLR and make interim changes that allow the TLR to continue during the transition period to a workable LLR.
4. Establish agreement of the Fund Advisory Committee that the TLR be discontinued once the LLR is functioning properly.

January 12, 2001  
Mr. Neil McCrank, Chairman  
Alberta Energy and Utilities Board  
Re: Liability Management Plan Implementation

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Page 2

5. Immediately communicate to industry these actions.

I look forward to your response to these recommendations and trust that together we can address concerns and establish a workable Liability Management Program.

Sincerely,



William Friley  
Chairman

Cc: John Nichol, EUB  
David Sandmeyer, Rife Resources  
Ross Douglas, Manacal Energy  
David Wolf, SEPAC

**(G)**

## TLR and LLR REVIEW COMMITTEE

**Meeting Minutes:** February 2, 2001

### Attendees

EUB: Hal Knox, Leo Touchette, Kelly McLean, Howard, Fedorak, Terry Weedon, Mark Kavanagh, Bob Stoddart, Melanie Woytiuk

CAPP: David Pryce, Ross Douglas, Joanne Nutter, Bill Thornton, Orest Kotelko

SEPAC: Keith MacDonald, David Wolf, John Squarek

### 1.0 Salutations

Introductions were made. Orest Kotelko representing CNRL attended the meeting at the request of CAPP.

### 2.0 Review of Previous Meeting

The minutes of the last meeting were accepted subject to the addition of the words “ and sliding scale deposits” to the parenthesis following “variables that could be considered in the TLR” under the heading “Discussion”. Motion made by David Wolf, seconded by Ross Douglas.

### 3.0 Additional Examples of Scenario Comparisons

The EUB provided two examples of the impact of the TLR base case and the 4 proposed alternative scenarios on 2 large transfer applications. The committee reviewed these 2 examples, the previously provided case 17, and a verbal example of a proposed heavy oil/bitumen transfer provided by Bill Thornton as “a reality check” on the impact of the existing options on actual transfers.

Orest Kotelko presented a request to amend Scenario 4 as approved at the last meeting to consider EL well equivalents for economic wells, a sliding scale for deposits (deposits required only to get to 1.0), and using 5% rather than 20% to determine the deemed inactive status of facilities.

The committee discussed Orest’s proposal as well as the existing components of scenario 4 in some detail. Discussions addressed: the possibility of evaluating heavy oil/bitumen TLRs in a manner different than conventional TLRs; use of other forms of security to fulfill deposit requirements; a fixed reduction in calculated security deposits; security deposit caps; sliding scale deposits; what constitutes a service well; and the relative risk of all proposed changes to the Orphan Program.

CAPP and SEPAC representatives confirmed their position that the TLR is an interim measure that will be eliminated once an acceptable LLR is implemented.

### Decisions:

1. The committee confirmed its support for scenario 4, and will recommend this option to the FAC with the following provisos. On a parallel path:
  - a) work will continue on evaluating the extent of security deposits arising from the use of the TLR,

- b) work will continue on trying to reach agreement on heavy oil/bitumen ELs, and
  - c) work will continue on required adjustments to retrospective facility licensing (to address issues around multi-well pads, compressors etc.).
2. All agreed upon changes will be contained within a single Interim Directive that will be reviewed by the FAC. The ID will not be issued until agreement is obtained on the 3 above noted provisos.

#### **4.0 Crude Bitumen EL Update**

Kelly McLean advised the committee that preliminary discussions with industry representatives on the heavy oil/bitumen EL issue have occurred, however there appears to be problems in data interpretation. Discussions are continuing.

#### **5.0 LLR Review Plan Development**

Due to time constraints this issue was not discussed at length. Committee members agreed to develop a list of factors to be considered in a re-design of the LLR and to prioritize identified factors at the next meeting.

#### **6.0 Administration**

##### **6.1 Draft Terms of Reference**

Due to time constraints committee members agreed to review the draft Terms of Reference provided by the EUB, and to provide their comments electronically, by Wednesday, February 7, 2001.

##### **6.2 February 2001 FAC Meeting Report**

The EUB will present the recommendations of the TLR and LLR Review Committee to the FAC at their meeting of Tuesday, February 6, 2001.

#### **7 Other**

There were no additions to the agenda or items discussed under this heading.

#### **8 Next Meeting**

The next meeting of the TLR LLR Review Committee will be held on Thursday, February 8, 2001 at 2:00 p.m. at the offices of the EUB, in the Second Floor Video-Conference room.



## TLR and LLR REVIEW SUBCOMMITTEE

### Meeting No. 12 April 19, 2001

#### Attendees:

EUB: Howard Fedorak, Bob Stoddart, Mark Kavanagh, Valerie Vogt, Terry Weedon, Karen Leussink, Sandra Shields, and Tashi Sheka.

AENV: Chris Powder.

CAPP: David Pryce, Ross Douglas, and Orest Kotelko.

SEPAC: David Wolf, Keith MacDonald, George Fink and Tim Presber

#### Absent:

David Sandmeyer, Joanne Nutter, Leo Touchette, Hal Knox

### Agenda Items

#### 1.0 Salutations

#### 2.0 Additions to the Agenda

There was one addition to the agenda. Orest Kotelko requested a brief discussion of the data requirements of the Deposit Task Group.

#### 3.0 Review of the Previous Meeting's Minutes

The minutes of the meeting held April 12, 2001 were accepted as presented.

#### 4.0 ID 2000-11 – Amendment

*ID 2000-11 – Amendment* implements on an interim basis the revised licence transfer requirements developed by this subcommittee. The EUB distributed copies of the ID to members who had not yet obtained a copy. There was no discussion on the content of the ID, however minor formatting problems with the text version posted on the EUB's Web site were noted. **The EUB will ensure corrections are made on the Web site.** Howard and Tashi provided a brief update on the progress and results of the reprocessing of transfer applications submitted since October 24, 2000 under the new rules implemented April 12, 2001.

#### 5.0 Guiding Principles Discussion

David Pryce introduced the revised draft Guiding Principles for the *Alberta Orphan Program – Upstream Oil and Gas Industry*, dated April 4, 2001, and agreed to lead the subcommittee through the document. David noted that the principle of the numbered points is contained within the initial phrase and is presented at a high level. The bullet points are intended to provide clarity with respect to the intent of the principle. David stated his belief that these principles were developed to guide the subcommittee in the design of a liability assessment process, and that they would become a public document being posted on the CAPP Web site.

**Goal:**

After some discussion the Subcommittee agreed the draft goal of the program should be revised to read: *“The goal of the Alberta Orphan Program is to prevent orphan costs from being bourn by the public”*.

There was considerable discussion with respect to the relationship of the Orphan Program to the EUB’s overall responsibility for liability management, and how this affects the objectives of the Orphan Program. The subcommittee determined that this was an appropriate topic for FAC consideration, and requested the EUB to make this an agenda item at the next meeting. **Howard Fedorak will pursue having this item added to the agenda of the next FAC meeting.**

The subcommittee agreed that liability management is clearly the responsibility of the EUB, while responsibility for ensuring that the cost of orphans is not bourn by the public is the responsibility of the Orphan Program. Liability management programs attempt to reduce the abandonment and reclamation liability of the industry, while the Orphan program attempts to minimize the risk to the public purse. It was agreed that given the interrelationship of liability management programs and the Orphan Program, industry has the right to participate in the development of liability management programs design to reduce the number of orphans.

The subcommittee reviewed and accepted the first three principles. The supporting bullets points for principles 1 and 2, and the first 2 supporting bullets points for principle 3 were accepted by the subcommittee with the wording changes noted hereafter. The final 2 bullet points in principle 3 were discussed but not agree upon due to time constraints. Subcommittee members agreed to provide their comments to David on the remaining principles in time to permit a revised draft of the principles to be tabled at the next meeting. **The EUB committed to providing a single response.**

**Principle 1**

The subcommittee accepted this principle with the third bullet being amended to read *“the ongoing and co-operative aspect of industry support of this program must be clear to the public, industry and regulator”*. Change made to reflect that Orphan Program has been implemented through legislation.

**Principle 2**

The subcommittee accepted this principle with the addition of a second bullet that states, *“supports the EUB’s liability management programs – use of levy and deposits”*. While there was discussion around the term “corporate health rating” this term was considered acceptable as a placeholder for whatever test is developed by the subcommittee.

**Point 3**

The subcommittee accepted this principle and the first 2 bullets with the word *“prevent”* being replaced by *“minimize”* in the second bullet.

**6.0 Data Requirements and Availability**

Mark Kavanagh advised the subcommittee of the informational requirements of the Security Deposit Task Group. Sandra Shields presented the subcommittee with a table listing the facility

information that is currently available, and informed the subcommittee of information that will be available in the first or second week of May, after the business units verify that systems are manipulating data correctly. The EUB stressed that available facility information has not been validated and that it does contain errors. Sandra confirmed that the requested 4 month average production for wells and throughput for facilities will not be available, and that while the inactive listing will have well equivalents for facilities, the active listing will not have this information. Sandra also confirmed that non-reporting and non-linked facilities will show as inactive in these listings.

Subcommittee members accepted the disclaimer and concurred that this information will be acceptable. Orest Kotelko advised that production and throughput information is available through IPL.

Orest Kotelko requested a listing of Alberta's total well population, suspended wells and cased hole abandonments, preferably going back to 1986. **The EUB agreed to provide this information.**

#### **7.0 Adjournment**

The meeting was adjourned at 9:00 a.m.

#### **Next Meeting**

7:30 – 9:00 a.m.

Thursday April 26, 2001

2<sup>nd</sup> Floor Video Conference Room

Alberta Energy and Utilities Board

**(H)**

## TLR and LLR REVIEW SUBCOMMITTEE

**Meeting No. 23**  
**July 5, 2001**

**Attendees:**

EUB: Hal Knox, Bob Stoddart, Leo Touchette, Tashi Sheka, Valerie Vogt, Mark Kavanagh, and Terry Weedon,

CAPP: David Sandmeyer, David Pryce, Bill Thornton, and Orest Kotelko.

SEPAC: Tim Presber, David Wolf, and George Fink (partial)

AENV: Chris Powter,

**Absent:**

Keith MacDonald, John Squarek, and Ross Douglas.

**Agenda Items**

**1.0 Salutations**

**2.0 Additions to the Agenda**

George requested an opportunity to address the proposed .75 present value and salvage (PVS) factor for facilities in the draft LLR formula at the beginning of the meeting, as he could not attend the entire meeting. This issue is addressed under 4.1 PV Factors.

**3.0 Review of the Previous Meeting's Minutes**

The minutes of the meeting held June 28<sup>th</sup> were approved with a further correction to item 4.1.4 Bitumen Production of the June 21<sup>st</sup> meeting. The statement should read *"The subcommittee agreed that there will not be a separate netback for bitumen at this time. The Subcommittee decided that should a bitumen only producer become an orphan in the future the need for a separate netback would be reviewed again. Bitumen only producers could still be reviewed at any time by an EUB initiated audit if there was a concern about corporate netback for the few bitumen only producers."*

**4.0 Draft Recommendation to FAC**

The Subcommittee approved the proposed draft recommendation to the FAC with minor editorial changes. It was noted the PVS factor needs to reflect the Subcommittee's decision for active facilities and to recognize further ongoing discussions with mid-streamers.

**4.1 PV Factors**

CAPP and SEPAC representatives proposed that the PVS factor for active facilities be reduced to 0.5 because the use of 0.5 for active facilities (with 0.75 for active wells, and 1.0 for inactive wells and facilities) would still have captured all known producing orphan companies and that facilities are usually amongst the last facilities in a development to be abandoned. They expressed a view to establish the "bar" as low as possible (that would have identified known orphans) in conjunction with regular monitoring of the overall effectiveness of the Program. They noted the "bar" could be subsequently raised via adjustment of the PVS factor if necessary.

EUB representatives expressed strong reservations with reduction of this factor and requested information showing the 0.5 factor as applied to the known orphan be made available. EUB staff reserved final support for the factor pending review of the update PVS information (as applied to known Orphans) including information that may be forthcoming from the planned consultation. Orest agreed to provide the subcommittee with the updated PVS information.

After the considerable discussion, the Subcommittee agreed to recommend to the FAC that a PVS factor for active facilities of 0.5 be used for the consultation.

## **4.2 LLR Listing**

### **4.2.1 Further Impact Analysis**

The EUB provided additional information on the list of 838 licensees that would fail the proposed LLR formula under the 0.75 factor for active wells and facilities and the 1.0 factor for inactive wells and facilities. The list contains 298 licensees that are defunct, and 76 licensees that are not subject to the program (municipalities, educational institutions, farm and domestic gas wells, orphans, under enforcement actions etc.). A corrected list would show 416 active (Alberta Corporations Act) licensees that would be below the LLR threshold of 1.0.

The EUB undertook to review and confirm which licensee types are not part of the Orphan Program.

### **4.2.2 Draft Consultation Letter**

The Subcommittee reviewed the draft consultation letter provided prior to the meeting. After a good discussion it decided to recommend to the FAC that the EUB direct a letter to all licensees in the province (rather than to just those that would fail the proposed LLR) informing them of the proposed LLR program and requesting their feedback. The same letter should be sent to all licensees, and the letter should contain: a copy of the GB announcing the EUB's LLR consultation initiative, a document explaining the proposed LLR program, and for those licensees with an LLR below a specific value (perhaps 2.0), a listing of their wells and facilities to enable them to independently verify their LLR and to correct any incorrect information. The proposed consultation letter was accepted with minor editorial changes.

## **4.3 Mid-Streamer Update**

David Pryce advised that CAPP and SEPAC representatives had met with a group of mid-streamers and that they required additional time to consider the proposed LLR program and how they should be involved. This led to a lengthy discussion on what constituted a mid streamer, which mid-streamers were part of the Orphan Program, and how their concerns could be addressed.

The Subcommittee agreed that sulphur recovery gas plants and waste management facilities were NOT part of this program or the Orphan Fund but that other oil and gas mid-streamers, including gas storage companies, were part of the program and Orphan Fund. It was further agreed that mid-streamers included in the program would be considered on an application

basis as previously decided. The recommendation to the FAC will indicate that discussion on the specifics of the application of the proposed LLR formula to mid-streamers is still being discussed.

#### **4.4 Document Review**

The review of required LLR documents was addressed in Items 4.0 and 4.2.2

#### **5.0 Other**

There were no issues discussed under this agenda item.

#### **6.0 Next Meeting**

Subcommittee members were invited to attend the FAC meeting scheduled for Thursday July 12, 2001 at 9:00 a.m. in the EUB's 14<sup>th</sup> Floor Board Room at which meeting the Subcommittees recommendations will be presented.

Additional meetings as necessary will be scheduled after the 12 July FAC meeting.

#### **7.0 Adjournment**

The meeting was adjourned at 10.20 a. m.

**(I)**



## LICENSEE LIABILITY RATING (LLR) PROGRAM

### **Program Development**

Bill 5, The Oil and Gas Conservation Amendment Act, 1994 established the Orphan Well Program. This program provided for the oil and gas industry to pay for the abandonment of wells that had no financially viable responsible owner (orphan wells) with funds collected through an annual levy administered by the Alberta Energy and Utilities Board (EUB).

Bill 13, The Energy Statutes Amendment Act 2000, expanded the Orphan Well Program to include pipelines, upstream oil and gas facilities, and the surface reclamation of wells, facilities and pipelines. The Orphan Program continued to be fully funded by the oil and gas industry.

The EUB, in collaboration with stakeholders, developed the Licensee liability Rating (LLR) program to implement the objectives of the expanded Orphan Program, and to minimize the financial risks posed to the Orphan Fund. The LLR program was implemented effective May 1, 2002 by *Interim Directive (ID) 2001-8*.

### **Program Benefits**

The LLR Program is a good news story for government, industry and landowners, and has the following benefits:

1. Provides a responsible balance between maximizing resource recovery and protecting the people of Alberta from the costs associated with abandoning and reclaiming oilfield sites left by licensees unable or unwilling to address these liabilities.
2. Minimizes the risk to the Orphan Fund by assessing the corporate health of licensees monthly and on proposed licenses transfers, and requiring a security deposit where a licensee's deemed abandonment and reclamation liabilities exceed its deemed production assets.
3. Requires the Orphan Fund, supported by a levy on the oil and gas industry, to pay for the abandonment and reclamation of orphan well, facility and pipeline sites.
4. Provides a level playing field for industry, so that responsible licensees do not bear the abandonment and reclamation costs of non-compliant companies,
5. Increases public safety and environmental protection through minimizing the number of orphan sites, and expediting the abandonment, reclamation of orphaned oil and gas development sites.

### **Stakeholder Consultation**

The proposed LLR program was developed in collaboration with stakeholders through 32 meetings and a series of workshops over an 18-month period. The EUB solicited the views of parties not directly involved in the development of the proposed LLR program by mailing a copy of *General Bulletin (GB) 2001-17 Proposed Licensee Liability Rating (LLR) Assessment, Expanded Orphan Program, Public Consultation* to every licensee of a well or facility in Alberta, and to every party consulted on the legislation to expand the Orphan Program.

This GB was also placed on the Web sites of the EUB, Alberta Environment, the Canadian Association of Petroleum Producers (CAPP), and the Small Explorers and Producers Association of Canada (SEPAC). As well, the EUB held 2 public presentations in Calgary advertised in 4 different editions of the Daily Oil Bulletin. The views of all parties submitting representation

were considered and a number of changes were made to the proposed program in response to the representation received. (A chronology of LLR events is provided as Appendix 1 and a listing of changes made in response to consultation is provided as Appendix 2)

The revised LLR Program was approved by the Fund Advisory Committee (FAC) of the Orphan Fund, as well as by the Board of Governors of CAPP, and the Board of Directors of SEPAC. (The FAC is comprised of senior representatives of the EUB, CAPP, SEPAC, Alberta Environment, Alberta Energy, Alberta Agriculture, Food and Rural Development, and Alberta Sustainable Resource Development). The FAC, CAPP and SEPAC continue to strongly support this program. The Independent Oil and Gas Association of Canada (IOGA) was not in existence at this time.

### **Security Deposit Transition**

In order to reduce the impact on any licensee required to place a security deposit on implementation of the program, the EUB provided a deferred payment plan option that allowed an affected licensee to place its deposit in three essentially equal payments over a 2-year period, and accepted letters of credit as an alternative to cash deposits.

### **Appeal provisions**

The LLR program allows a licensee to request a detailed review (appeal) of its rating where it believes the LLR formula does not accurately reflect either the licensee's deemed assets or deemed liabilities. A total of 6 different factors used in determining the LLR assessment are subject to review.

### **Program Review**

On implementation of the LLR Program, the EUB committed itself to reviewing the effectiveness of this program with stakeholders within 12 to 18 months. This review has been scheduled for September of this year, and was announced in *GB 2003-3*.

### **Current Status**

Of the original 1402 licensees evaluated in May of 2002, only 8 licensees having production are in high-level non-compliance with the LLR Program. Security deposits required by the EUB have declined from \$41.7 million before the implementation of the LLR Program to \$11.0 million in February of 2003, while the number of licensees required to place a security deposit has declined from 355 to 251.

**(J)**

## LLR ID Issues

- Done*
1. Confirm what information will be available to licensees during transition period (Jan 1 to April 30) and how information will be conveyed. (Web site letter etc). Orest believes we need to provide for each licensee: list of wells and facilities with \$ calculated for abandonment and reclamation for each, **facility well equivalent and facility design capacities**, as well as licensee LLR and required security deposit to permit verification. Need to put what info available and how to access in ID.

**PROPOSAL: Not an issue. Add to ID**

- Done*
2. Confirm process for Bob to request required information from non-producer licensees to permit verification of individual netbacks for all non-producers by April 2002. Should this be in ID.

**PROPOSAL: Put direction in ID requiring non-producers to request individual netback by date specified. Authority to require. Propose by January 30, 2002**

- N/A/R*
3. How will liability for a pipeline potential problem sites included in licence transfer applications be calculated.

**PROPOSAL: Be silent on this. Don't anticipate this will likely happen in first year. Assign task to facility liability calculator task force.**

- Done*
4. Confirm shrinkage, conversion and netback figures generated this year apply to the 2002 calendar year, as opposed to November to November period.

**PROPOSAL: Use Calendar year**

- Done*
5. Liability calculation for potential problem sites on licensee's monthly LLR after transfer assessed reclamation at 20 times normal. Problem with different calculation on monthly vs transfer re-occurs with elimination of 6 month holdback for security deposit refunds.

**PROPOSAL: Override system. Calculate reclamation at 20times until Phase II completed. Add to ID. Notify Subcommittee members. Re-evaluate on review of program.**

- N/A/R*
6. Confirm O.K. to include volumes flared and vented in a licensees asset calculation. Orest wanted dropped. Bob advises this would be difficult.

**PROPOSAL: Consider on 1<sup>st</sup> review. Use existing data. This favours industry.**

- Done*
7. How will we calculate facility abandonment costs when appealed through detailed review?

**PROPOSAL: No idea.**

- Done*
8. Can we put dates back into ID for security deposit payment schedule (Orest , Mark, Chris etc.)

**PROPOSAL: Yes. Put dates back in.**

- N/A/R*
9. Do we require a 3<sup>rd</sup> party assessment of O/S reclamation when appealed through detailed review? (Appendix 8 Mark).

**PROPOSAL: Do not require 3<sup>rd</sup> party assessment.**

10. Do we permit transfer of licences for domestic gas wells? (Val)

**PROPOSAL: Yes. Val to elaborate on issue.**

Val  
11. Alternative to “defunct” (Val)

**PROPOSAL: Val to talk to Danielle and give preferred alternative to Terry**

NAR  
12. Do we need to incur a debt before we can use a licensee’s security deposit? (Val).

**PROPOSAL: No. We will draft regulation for use of security deposit that explicitly permits us to use a security deposit without incurring debt. Hold off using provision until regulation passed.**

NAR  
13. Can we use re-submitted Security Deposits if there was not enough in forfeited? Val

**PROPOSAL: Yes. Why not.**

NAR  
14. Can producers request detailed review of their Netback in the same way as non-producers (signed statement by corporate officer with EUB audit)? Tim.

**PROPOSAL: Advise Tim No. Consider on 1<sup>st</sup> review of program. Request written interpretation from Privacy Commissioner.**

Hu  
15. Need to, process for consulting or advising industry colleagues of EUB changes?

**PROPOSAL: No more consultation. Advise Subcommittee members of changes required as a result of developing business rules for implementation**

N/A/R  
16. Do we permit licensees to request detailed review of shrinkage and/or conversion factors, do we consider these as part of detailed review of netback, or are these not a ground for appeal as they are in M<sup>3</sup>OE not netback factor? Bob, Orest

**PROPOSAL: Yes. Add to ID. Advise Subcommittee members of Change.**

N/A/R  
17. Change in application of existing security deposits to outstanding security deposit under LLR. Change from 1/3, 1/2 balance, remainder to all with credit for 1/3, 1/2 balance remainder.

**PROPOSAL: Clarify in ID. Advise Subcommittee members.**

**(K)**

*EUB Letterhead*

September 23, 2003

Mr. Archie W. Kennedy  
Senior Vice-President  
Operations & Business Development  
ConocoPhillips Canada  
P.O. Box 130, Station "M"  
401 – 9<sup>th</sup> Avenue S.W.  
Calgary, AB T2P 2H7

Dear Mr. Kennedy,

Stakeholder Consultation Licence Liability Rating (LLR) Program

I wish to thank you for your letter of September 16, 2003 providing ConocoPhillips Canada (ConocoPhillip)'s comments on the Alberta Energy and Utilities Board (EUB)'s LLR Program Review.

Initially I wish to correct a couple of misconceptions. While the EUB believes that the abandonment and reclamation costs used in the present LLR formula are understated, in some cases significantly so, it is not considering the development of an "actual cost experience" database to obtain more representative costs at this time. As part of the LLR Program Review the EUB is considering updating existing formula parameters to more accurately reflect current costs. If approved, such a change would likely be phased in over a number of years to facilitate licensees adjusting to these increased costs.

The EUB is also not proposing to include a separate calculation to capture pipeline liability within the LLR formula, nor to include large facilities within the program. The liability associated with all but transmission pipelines is included within the LLR Program even though it is not expressly calculated in the formula. As well, large upstream oil and gas facilities (sulphur recovery gas plants, stand alone straddle plants and oil sands processing plants having a design capacity of 5000 m<sup>3</sup>/day or greater) are the subject of a separate liability management plan that is currently under development. You may wish to refer to GB 2003-13 for additional information on that program. Upstream oil and gas facilities not meeting this definition of large are already included within the LLR program.

As the EUB is currently reviewing proposed changes to the LLR Program, it is not in a position to comment on the nature and/or extent of any changes that may result from this review. As part of this review the EUB is evaluating system and administrative costs of proposed changes, as well as their impact on the principles, objectives, operation and effect of the LLR Program.

The EUB appreciates ConocoPhillip's support of the current LLR program and concurs that only modification necessary to improve the LLR Program should be made. I trust this letter addresses your concerns however should you have any questions or require additional information please call me at (403) 297-2583.

Yours truly

Terry Weedon,  
Regulatory policy Advisor  
Corporate Compliance Group



**(L)**

DRAFT

## LICENCE COST PROCESSOR

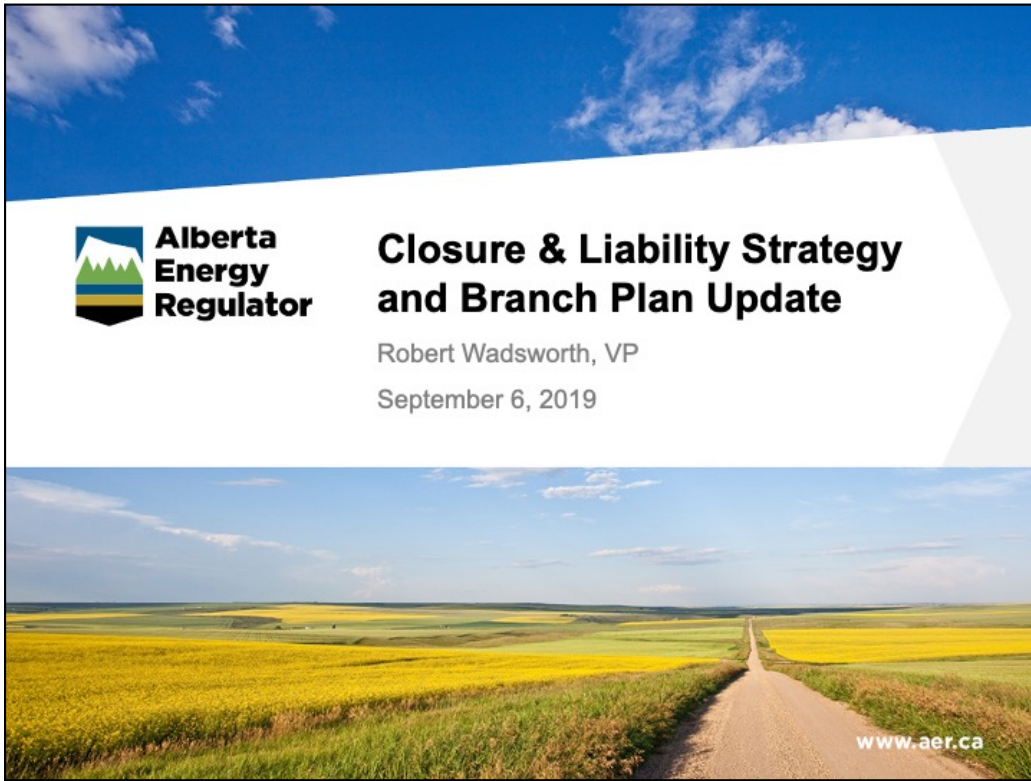
### Decisions

- take out? determinator of cost*
1. The LLR formula should reflect reasonable, not necessarily "current" abandonment and reclamation costs. The Licence Cost Processor (LCP) should reflect the level of risk the Orphan Fund is prepared to accept not necessarily accurate abandonment and reclamation costs.
  2. The EUB should update these cost annually, and implement them in conjunction with other LLR Industry Parameters.
  3. A joint government/industry (FAC?) task group needs to review EUB proposed changes to abandonment and reclamation costs annually prior to implementation.
  4. The methodology used by the EUB to determine proposed LCP updates for wells is acceptable for this year. (The methodology used for proposed facility well equivalent and reclamation costs was deferred to the next meeting).
  5. *OUT? FOR FAC ONLY* The proposed cost increase is to be phased in over a 5-year period, with the first increase of 20% to be imposed with LLR Industry Parameters at the beginning of April 2004, **subject to determination of impact at next meeting.**
  6. The EUB will assess the impact of implementing 20% of the proposed cost increase and provide for the next meeting.
  7. Security deposits required as a result of LCP cost increases will be due in the normal time frame of LLR assessments. (LCP costs will be phased-in; security deposits required by cost increases will not).
  8. Cost increases will have to be carefully managed due to their impact and anticipated backlash. (suggest the EUB issue GB as soon as cost increases are approved announcing the cost increase, and the location of new calculator on Web site, also suggest letters to all licensees effected by cost increases and the use of shadow billing, etc.)
  9. EUB to place calculator with new costs on its Web site to facilitate licensees determining the impact of cost increases on their company's monthly LLR and its impact on acquisition and divestiture activities. (Announced in GB).

### LLR Licence Cost Processor Task Group Considerations

1. The EUB should consider establishing a process and database to capture actual abandonment and reclamation costs with information being submitted by industry on a voluntary basis.
2. The EUB will have to use an industry survey tool to supplement cost data voluntarily submitted by industry (information from abandonment and reclamation companies, industry associations, licensees etc.)
3. The EUB should consider moving to a less complex formula for determining well abandonment costs (e.g. \$/metre) rather than the current process.
4. If the 5-year phase in of current costs is accepted, the annual increase in costs required in each of the following 4 years will be adjusted for any cost changes required for that year (annual increase/decrease in costs).
5. Starting in 2004, the LCP should move to a rolling 5-year average to smooth cost fluctuations (average to be phased in; e.g. 2004 will use average of 2003 and 2004; 2005 will use average of 2003, 2004 and 2005 etc.)

(M)



We may want to update the title – discuss with Dave.

## D006 Problem Summary

### » Liability Management Ratio (LMR)

- LMR ratio is limited to 2 parameters
- Companies' focus is on achieving LMR, not closure
- Does not reduce inactive liability
- Security demand occurs when company is not financially able to pay
- Poor predictor to assess capability to address end of life obligations
- Companies operate at a loss to maintain an LMR of 1.0

AER 2

### TREVOR

- Is only deemed assets and liabilities and those values for calculation are outdated
- Ratio is resulting in behavior to achieve particular LMR
- Does not address closure obligations or encourage reduction in the inactive inventory
- Doesn't focus on companies with bulk of the liabilities

Jackie's Comment for speaking notes: What about LMR being a known poor indicator of corporate health? Or that we're aware it's used by the lending community for purposes for which it wasn't intended?

(N)

# Bulletin [20XX-XX] - DRAFT

[Date of issue - Month Day, Year]

## Licensee-Specific Liability Management Ratings no Longer Published on Website

Effective [DATE], we will no longer include the security-adjusted liability management ratings (LMRs) of individual licensees in the monthly [LMR reports](#) posted on our website.

The LMR compares a company's assets to its liabilities and taken on its own is not a good indicator of licensee capability. LMR is only one factor used in a holistic assessment ~~assessing of~~ a licensee's ability to fulfil its end-of-life obligations; the AER exercises discretion when making decisions based on LMR. ~~Taken on its own, LMR is not a good indicator of licensee capability.~~ Removing ~~this licensee -specific LMR from the website~~ ~~information~~ ~~deemphasizes the focus on LMR~~ ~~from the website~~ ~~and~~ may prevent it from being used to inform business and lending decisions that may have unintended consequences.

Moving forward, only the industry-level general summary of total ~~estimated~~ ~~estimated~~ liability and current security held will be available on our website. Companies will continue to be able to view their own LMR, and its breakdown, through the [Digital Data Submission \(DDS\) system](#).

For questions about the LMR or our liability management programs, please contact our Customer Contact Centre or email [LiabilityManagement@aer.ca](mailto:LiabilityManagement@ aer.ca).

# Bulletin [20XX-XX] - DRAFT

[Date of issue - Month Day, Year]

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Effective [DATE], we will no longer include the security-adjusted liability management ratings (LMRs) of individual licensees in the monthly [LMR reports](#) posted on our website.

The LMR compares a company's assets to its liabilities and, taken on its own, is not a good indicator of licensee capability. It is only one factor used in a holistic assessment of a licensee's ability to fulfil its end-of-life obligations; the AER exercises discretion when making decisions based on the LMR. Removing licensee-specific LMR from the website deemphasizes the LMR and may prevent it from being used to inform business and lending decisions that may have unintended consequences.

Moving forward, only the industry-level general summary of total estimated liability and current security held will be available on our website. Companies will continue to be able to view their own LMR, and its breakdown, through the [Digital Data Submission \(DDS\) system](#).

For questions about the LMR or our liability management programs, please contact our Customer Contact Centre or email [LiabilityManagement@aer.ca](mailto:LiabilityManagement@ aer.ca).





# Key messages

## Liability Management Rating

November 2019

The Alberta Energy Regulator’s (AER) monthly [liability management rating \(LMR\) reports posted on aer.ca](#) will no longer show the LMR of ~~every individual~~ licensees in Alberta.

### Key messages

- The AER calculates a ~~ratio~~ [ratio of licensees’ deemed assets and liabilities](#) – known as the LMR – ~~for each licensee every month based on a ratio of the licensees deemed assets and liabilities on a monthly basis.~~
- The LMR is ~~gone~~ [parameter](#) used to determine whether a licensee will be able to fulfil its end-of-life obligations.
- The AER ~~publishes~~ [has previously published](#) a monthly LMR report on aer.ca with the [security adjusted](#) LMR of each licensee. The report also includes a general summary of the ~~average~~ [industry-level](#) LMR, as well as total estimated liabilities.
- Moving forward, only the general summary will be available on aer.ca, while companies will continue to be able to view their own LMR, ~~and its breakdown,~~ through the [digital data submission system](#).

• We know that LMR by itself is ~~not a~~ [no longer](#) a good indicator of a company’s financial health ~~as it only evaluates a licensees’ deemed assets and deemed liabilities.~~

• [In addition, we know publishing company-specific LMR information publicly can have unintended consequences.](#)

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### Response points

- ~~While we will still consider LMR, it~~ will not be the sole factor taken into consideration when determining a licensee's ability to address its end-of-life obligations.
- The AER is working to broaden its assessment processes to allow for a more holistic approach to assess a company's ability to address its end-of-life obligations.
- We are developing an assessment that gives us better insight into a company's ability to deal with liabilities.

s. 24(1)(a)(b)

s. 24(1)(a)(b)

Please direct media inquiries to Communications and International Relations at 1-855-474-6356 or [media@aer.ca](mailto:media@aer.ca).

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