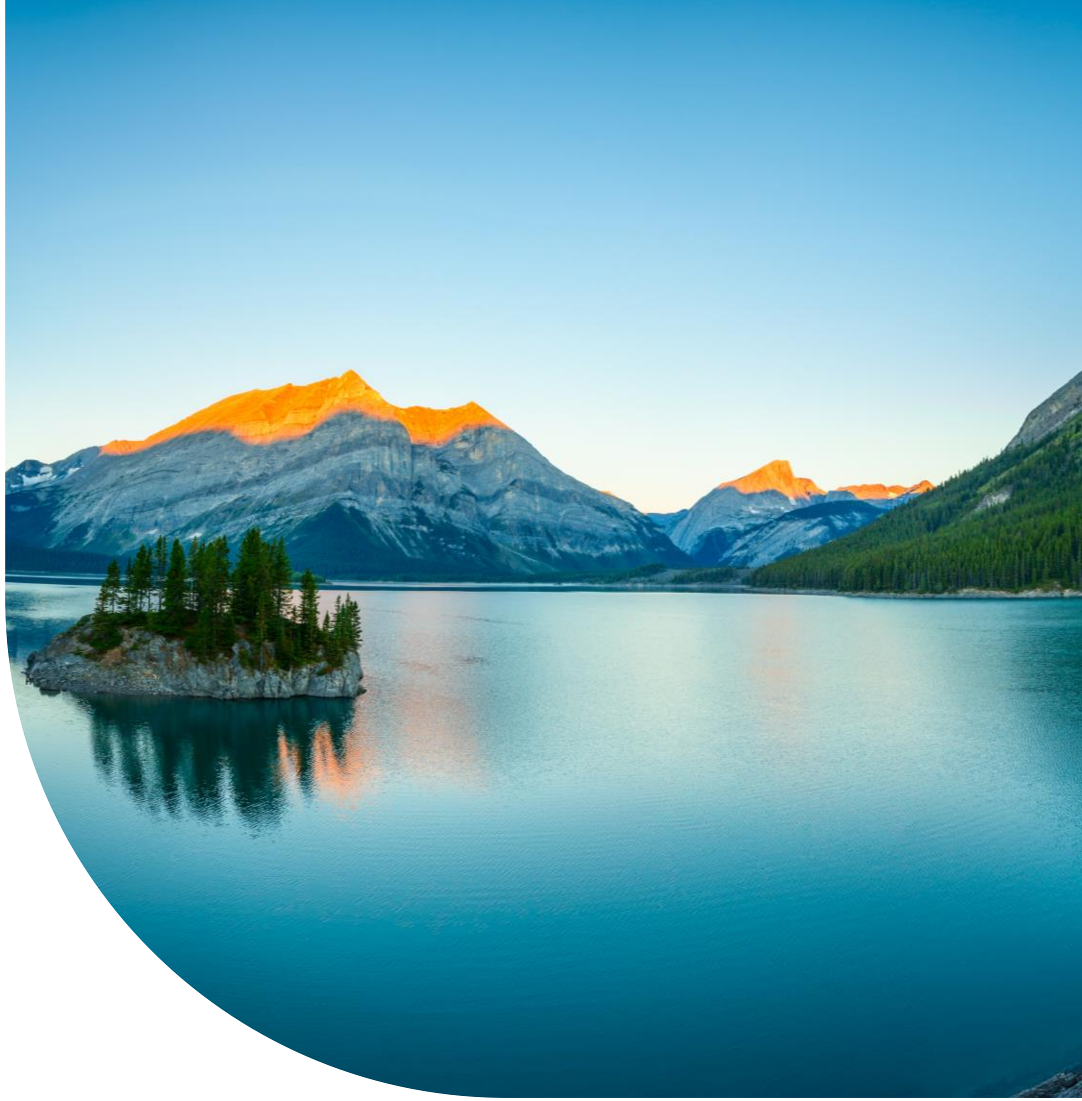
Licensee Life-Cycle and Liability Management Framework for Energy Projects in Alberta – update since *Redwater*

EnviroTech 2022



Presented By

Chidinma B. Thompson, Ph.D
Partner, Borden Ladner Gervais

April 22, 2022

Borden Ladner Gervais

Disclaimer

- The content of this presentation is intended to provide general information only, and does not constitute the provision of legal or other professional advice.
- Attendees are encouraged to seek and obtain proper legal advice from a competent professional regarding their particular circumstances.
-

Agenda

Environmental Update

- Why is this topic still important?

- Refresher: *Orphan Well Association v. Grant Thornton Ltd.*, 2019 SCC 5 ("Redwater").

Legislative and Policy Changes

- The GOA's liability management framework.
- Legislative amendments to enable the new framework.
- AER Directives and Policies to implement new framework.

Case Law Update

- *PricewaterhouseCoopers Inc v. Perpetual Energy Inc*, 2021 ABCA 16 and 2022 ABCA 111.

- *Manitok Energy Inc (Re)*, 2022 ABCA 117

Why is Licensee Liability Management still important?

Acquisition or Divestitures

- triggering transfer of oil and gas assets and licenses, for continuation of oil & gas operations or to repurpose wells or sites for alternative use (e.g., helium, lithium, geothermal, etc.)

Insolvencies/Ceased Operations

- triggering forced sale of these assets or environmental obligations for WIPs.

Environmental, Social and Governance (ESG)

- Preparing for ESG disclosure and reporting where required.
- ESG factors are those that are financially material to a company's business or affect company value and investor decisions.

Refresher: *Orphan Well Association v. Grant Thornton Ltd.*, 2019 SCC 5 (“Redwater”)

Facts:

- Redwater Energy Corporation, with a secured debt owing to the Alberta Treasury Branches (“ATB”), went into receivership, and later into bankruptcy.
- GTL, the Receiver/Trustee disclaimed 107 assets out of 127. The AER and the OWA sought declarations that the disclaimer was invalid and an Order compelling the Trustee to fulfil Redwater’s statutory environmental obligations.

Issues:

- Ability of a Trustee / Receiver to ‘disclaim’ property; and
- Priority of the Regulator’s claims for environmental obligations, including the payment of the security deposit to address the claims.

Orphan Well Association v. Grant Thornton Ltd., 2019 SCC 5

<u>Decision</u>: 5:2 split, majority overturning the Alberta Courts' decisions. Provincial statutory enforcement powers of the Regulator not in conflict, and can co-exist, with the federal BIA.

- **Ability of a Trustee / Receiver to 'disclaim' property exists, but disclaimer only intended to address personal liability of trustees. The liabilities disclaimed <u>remain obligations of the bankrupt estate</u>.**
- **<u>A Regulator is not a Creditor</u>: A regulator exercising a power to enforce a public duty is not a creditor of the individual or corporation subject to that duty. In seeking to enforce the bankrupt's end-of-life obligations, the Regulator is acting in a bona fide regulatory capacity. The Regulator is acting in the public interest and for the public good.**
- **Super-priority of environmental regulatory obligations is not automatic.**
- **To determine whether a regulatory obligation amounts to a claim provable in bankruptcy, it must pass a test.**

Orphan Well Association v. Grant Thornton Ltd., 2019 SCC 5

- **The 3-part test is set out in *Newfoundland and Labrador v. AbitibiBowater Inc*. 2012 SCC 67 (Abitibi):**
  - there must be a debt, a liability or an obligation to a creditor;
  - the debt, liability or obligation must be incurred before the debtor becomes bankrupt; and
  - it must be possible to attach a monetary value to the debt, liability or obligation.
- **"<u>Monetary value"/"Sufficient certainty" test</u>: It must be sufficiently certain that the regulator will perform the environmental work and seek reimbursement.**
- **In *Redwater*, the Regulator's claims were not financial claims or claims 'provable in bankruptcy' because they were too remote or speculative. Therefore, they must be paid by the Trustee <u>in priority</u> to any other claim.**

The Government of Alberta's Liability Management Framework

- **July 2020, the GOA announced a new Liability Management Framework that is a more robust corporate health assessment, using a wider variety of parameters;**
- **applies at all phases of energy development, rather than late in the life cycle, and timely closure;**
- **does not include Oilsands Mines and Coal Mines.**

Five Components of the Framework

- Licensee Capability Assessment System (LCA) – uses business intelligence to assess ability to meet obligations;
- Licensee Special Action (now called Licensee Management Program) - proactive support in areas of concern;
- Inventory Reduction Program (plus Area-Based Closure and Closure Nomination) - closure spending targets;
- Legacy and Post-closure Sites Program - a panel will be established to consider;
- Expansion of the Mandate of the Orphan Well Association – includes protecting value of producing assets.

Legislative Amendments to enable the new framework

- Bill 12: *The Liabilities Management Statutes Amendment Act*, 2020 which came into force on June 15, 2020. The Act amended the *Oil and Gas Conservation Act* and the *Pipeline Act.*

- The OGCR and the PR (the Regs.) were also amended to allow AER to set "closure quotas"- minimum amount of closure work, money to be spent on closure activities, or both.

- The Act also enabled an amendment regulation, OC 174/2020, June 3, 2020, which amended the *Orphan Fund Delegated Administration Regulation*, Alta Reg 45/2001.

- The amendment expanded the scope of authority to the Orphan Well Association (OWA), and the activities that it may fund.

- Of significance is the power of OWA to enter into agreements with any person for any reason related to exercising and carrying out its delegated powers, duties and functions.

- The orphan fund may be used to pay for obligations of the OWA under these Agreements.

AER Directives and Policies to implement the new framework

- April 2021 - New edition of Directive 067 (Eligibility Requirements for Acquiring and Holding Energy Licences and Approvals) was released.
  - Additional requirements to provide updated financial information at the time of application, and throughout the energy development life cycle, within 180-days of the fiscal year end.
  - S. 4.5 - whether a licensee poses “unreasonable risk” (directors, entities, compliance, insolvency, etc)
- December 2021 – New Directive 088 and Manual 023 (Licensee Life-cycle Management) were released.
  - Implement 3 of the Components of the Framework – LCA, LMP and Inventory Reduction Program.
  - Phased transition away from the Licensee Liability Rating Program. Amendments to Directive 006 and Directive 13. Licence transfer applications moved from Directive 006 to Directive 088.
  - December 1, 2021, Licence transfer applications not yet decided were closed and returned. companies were advised to reapply under the new requirements.

Directive 88 and Manual 023 Liability Management Tools

- A. Holistic assessment and Licensee Capability Assessment - will reoccur at various times as the Licensee moves through the energy development life cycle.

- There are 6 LCA factors used to build an overall Licensee Profile. The LCA factors have two broad groups they assess: Risk and Performance (see Table 1 Manual 023).

- The 2 Risk Group factors and their parameters are weighted as low, medium, and high:

    - Financial health - assess the level of financial distress (see Table 2 Manual 023 - financial parameters and associated weightings). The level of financial of distress is used to calculate a licensee's mandatory spend target.

    - Magnitude of liability - estimated total magnitude of liability (active & inactive), including abandonment, remediation, and reclamation using Directives 001 and 011. Has money thresholds. Low (less than $25 million), Medium (between $25 million and $150 million), and High (greater than $150 million).

- The 4 Performance Group factors assess a licensee's performance relative to their peer groups (i.e. Licensees with similar business type, size, and production portfolio). Their parameters are weighted and ranked by a tier ranking system - Tier 1, 2 and 3.

Directive 88 and Manual 023 Liability Management Tools

- The 4 Performance Group factors are:
  - Remaining lifespan of resources – assesses mineral resources and infrastructure, the extent to which existing operations fund current and future liabilities and timeframe when liability will exceed income potential (Table 3 Manual 023 for parameters and weightings. Tier 1 is far, Tier 2 is medium and Tier 3 is near).
  - Operations – assesses management and maintenance of infrastructure, sites and compliance with operational requirements (See Table 4 Manual 023 for parameters and weightings).
  - Closure - assesses rate of closure activities, spending and pace of inactive liability growth (Table 5 Manual 023).
  - Administration - compliance with administrative regulatory requirements, including the management of debts, fees, and levies. (see Table 6 Manual 023. Tier 1 means all invoices paid in full with no penalty, Tier 2 means all others that includes penalties, and Tier 3 means any of invoices not paid.)
- Licensees are only able to see their own LCA data. They can see where they rank relative to their peers, but they cannot see the detailed data for other peers or even who their peers are.
- LCA replaced the use of the LMR for licence transfers and security collection for licence transfers.

Directive 88 and Manual 023 Liability Management Tools

Licensee Assessment Profile					
Risk Group		**Performance Group**			
Level of Financial Distress	Magnitude of Liability	Remaining Lifespan of Resource	Operations	Closure	Administration
Low	**Medium**	**Tier 2**	**Tier 2**	**Tier 3**	**Tier 1**

Figure 3 – Manual 023. The licensee's closure performance is concerning as they have the greatest risk when compared to their peers. In response, AER actions will focus on improving this Licensee's closure performance.

Licensee Assessment Profile					
Risk Group		**Performance Group**			
Level of Financial Distress	Magnitude of Liability	Remaining Lifespan of Resource	Operations	Closure	Administration
High	**High**	**Tier 3**	**Tier 2**	**Tier 3**	**Tier 3**

Figure 4 – Manual 023. Magnitude of liability and level of financial distress are high, and the remaining lifespan of resources are in Tier 3. Licensees with this profile will be prioritized in the Licensee Management Program where the AER will use specific regulatory tools or conduct compliance assurance activities to support licensees in meeting their regulatory and liability obligations.

Directive 88 and Manual 023 Liability Management Tools

- B. Licensee Management Program - is how the AER proactively monitors licensees identified in the holistic assessment at greater risk.
- The AER will undertake specific engagement or regulatory actions with the licensee, including education and compliance assurance measures - changing licence eligibility under Directive 067, requiring security deposits, or issuing orders.
- C. Inventory Reduction Program - sets closure spend targets (mandatory targets and voluntary targets) for each Licensee, in July of each year. This means minimum obligation for all Licensees to abandon, remediate, and reclaim their oil and gas sites.
- The AER will annually publish industry-wide closure spending targets for a five year period. 2022 Industry-wide mandatory target set for $422 million; 2023 set for $443 million.
- Security in lieu of Target: the AER will determine a threshold for licensees to elect to provide security deposit in the full amount of their mandatory target, instead of meeting the mandatory target through closure work. This threshold will be assessed annually.

Directive 88 and Manual 023 Liability Management Tools

- Voluntary closure spend target will offer regulatory incentives in exchange for a higher closure target.
- Example of incentives - extension of deadline for the removal of surface equipment, and maximum three-year extension for expired Crown mineral lease wells.
- Area-Based Closure Program: is a component of the IRP. Licensees may submit work proposals up to a maximum of five years out (Proposed ABC), or work starting within the current or upcoming year (Confirmed ABC).
- Closure spending means reasonable costs actually incurred in the abandonment, remediation, and reclamation of a well, facility, or pipeline. Eligible costs are:
  - inactive and abandoned sites and active sites where a well or facility has been shut in but not met the inactive criteria;
  - abandonment and remediation of pipeline and pipeline installations that results in an abandoned status.
- Ineligible costs include: well and facility suspension, pipeline discontinuation, remediation on active sites. (see Table 9, table 10, and table 11 in Appendix 1 of Manual 023)

Directive 88 and Manual 023 Liability Management Tools

- Closure activity and spend can only be submitted by the licensee of record. Once a licence transfer has been completed, the previous licensee will not be able to submit and receive credit towards their closure spend target for the transferred licences.

- Reporting of IRP: Licensees are expected to report all closure costs within a calendar year they are completed. The AER will deduct the amount of Site Rehabilitation Program funding from a licensee's closure spend reported.

- Licensees may elect to report spending either on an ongoing basis as they are incurred, or when a closure milestone is achieved that results in a licence status change.

- Closure Nomination Program: is another component of the IRP. Starting in late 2022, landowners and others who may qualify can nominate eligible inactive or abandoned oil and gas sites for closure.

- D. Licence Transfers - two types of licence transfer applications:

- (a) Applications to transfer licences between licensees are submitted by both parties;

Directive 88 and Manual 023 Liability Management Tools

- (b) Applications to transfer licences that are part of an insolvency proceeding or a company that is under the care of the Orphan Well Association are facilitated by the AER in a process referred to as a regulator-directed transfer (RDT).

- Eligible Licenses for transfer: licences with status of Issued, Amended, Discontinued, Suspended, Abandoned, RecCertified, or RecExempt.

- Ineligible Licences for transfer: licenses with status of Cancelled or Re-Entered are not eligible to be transferred.

- Rec Certified and Rec Expempt Licenses: Previously, reclamation certified and reclamation exempt licences could not be part of a transfer application. This has now changed, and the AER may apply discretion to require licensees to include the transfer of reclamation certified and reclamation exempt licences that are part of an insolvency proceeding, corporate clean out, or white map sales transaction.

- The AER encourages Licensees to contact the AER to discuss their specific circumstances with respect to reclamation-certified and reclamation-exempt licences.

Directive 88 and Manual 023 Liability Management Tools

- <u>Holistic Licensee Assessment for Transfer Applications</u>: a licence transfer application will trigger a holistic licensee assessment of both the transferor and transferee.

- In addition to the LCA factors, the AER will assess: “Unreasonable Risks” in Directive 067; new licensee with no history; Site-specific risks or designated problem sites; statements of concern submitted; multiple transfer applications or multiple parties involved; repeated transfer of licences; unpaid Crown debt, municipal taxes or surface lease payments; transfer with the intent to repurpose wells or sites for alternative use (e.g., helium, lithium, geothermal, etc.).

- A licence transfer application may be closed as incomplete, approved, approved with conditions, or denied.

- <u>Requirement for Security Deposit in Transfer Applications</u>: To offset any potential increase in risk that may arise from a licence transfer, a transferor or transferee may be required, as a condition of approval, to provide a security deposit to the AER.

- The AER does not provide a preliminary determination of expected security requirements.

Directive 88 and Manual 023 Liability Management Tools

- E. Security Deposits (General): the AER require security deposits throughout the energy development life cycle.

- The maximum amount of security that may be required is the licensee's total liabilities, including the cost of providing care and custody, the cost to permanently end operations, and the abandonment and reclamation of the site.

- Determining the need for and the amount of security: use Holistic Licensee Assessment, additional factors, value of liability under Directive 011; value of Directive 001 site-specific liability; marginal and inactive wells and facilities; present value of future cash flows based on the reserves and economic analysis.

- Refund and Transfer of Security: a request for a refund of security will trigger a holistic assessment of the licensee.

- A transfer application for security will trigger a holistic assessment of the transferor and transferee, considering their current and post-transfer situations.

- Outcome of the request depends on the result of the assessment.

Case Law
PricewaterhouseCoopers Inc v. Perpetual Energy Inc, 2021 ABCA 16; and 2022 ABCA 111

Facts: the Perpetual group of companies moved ownership of wells with roughly $200 million in abandonment and reclamation obligations (ARO), municipal tax liabilities and about $7 million in valuable assets into a corporation called Perpetual Energy Operating Company (Perpetual).

- Perpetual became solely responsible for the Perpetual group's expensive ARO which were removed from the Perpetual Group's balance sheets.

- Perpetual group sold Perpetual to a numbered company wholly owned by Kailas Capital Corp, for $1. Perpetual then changed its name to Sequoia Resources and went bankrupt about 17 months later.

- PwC the trustee in bankruptcy for Sequoia, sued the Perpetual Group and a former director of Sequoia, alleging that the sale of assets from Perpetual Group to Sequoia was void, as transfer at undervalue pursuant to the BIA, or for judgment for about $218 million.

Issue: The OWA needed clarification of the SCC's decision in *Redwater*, specifically whether the SCC's finding that abandonment and reclamation obligations are not "provable claims" in bankruptcy means that they are not "liabilities" for the purposes of determining the financial status of a corporation or its insolvency.

- …

Case Law
PricewaterhouseCoopers Inc v. Perpetual Energy Inc, 2021 ABCA 16; and 2022 ABCA 111

QB Decision: *Redwater* confirmed that ARO does not exist for financial purposes, they are not “claims” or “liabilities” and therefore should be valued at "nil”.

CA Decision: *Redwater* does not mean that Abandonment and Reclamation Obligations are “assumptions and speculations” that do not exist, such that they are not an obligation or liability of Perpetual/Sequoia, or that they should be valued at “nil”.

The Abandonment and Reclamation Obligations are an obligation of Perpetual/Sequoia, owed “to the public” and the surface landowners, but which are nevertheless obligations which the Trustee of a bankrupt corporation cannot ignore.

As *Redwater* decided, end-of-life obligations are an inherent part of asset value. When they do not constitute a conventional debt payable to an identifiable creditor, it will be appropriate to account for them as depressing values on the left-hand side of the balance sheet.

End-of-life obligations could be loosely thought of as asbestos in the walls of a house. It will need to be rectified sooner or later, and someone will have to pay for it…Until then, the house is worth less than a similar asbestos-free house. The asbestos depresses the value of the house.

Case Law
Manitok Energy Inc (Re), 2022 ABCA 117

Facts: Manitok entered bankruptcy in February 2018. The Receiver sold oil and gas assets to other entities, including Persist Oil and Gas created by Manitok's former management to reacquire Manitok's assets. The sale to Persist stipulated holdbacks to "cover the amounts of the two builders' liens and certain unpaid property taxes".

- The ARO in the estate was $44.5 million, significantly exceeding the value of the assets in the estate.

Issue: how to interpret para. 159 of *Redwater*, and particularly whether abandonment and reclamation obligations of unsold oil and gas assets must be satisfied from Manitok's estate, in priority to first-ranking builders' lien claims based on services provided by the lien claimants before the receivership date.

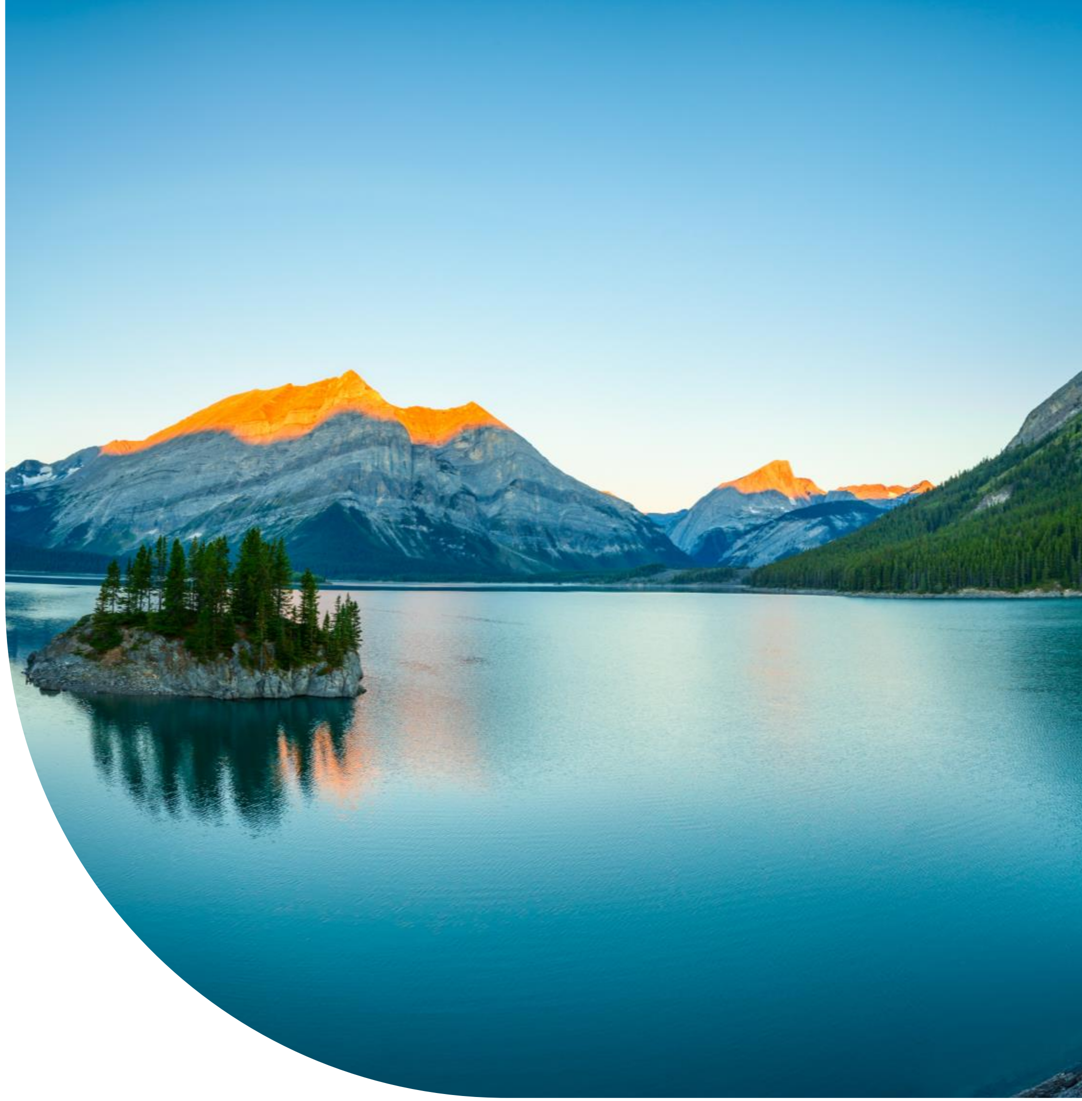
QB Decision: Manitok's situation should be distinguished from *Redwater* because Parliament intended to permit regulators to place a charge on property if it was affected by an environmental condition. Redwater's only "substantial assets" were affected by an environmental condition, so the AER orders did not extend to "assets unrelated to the environmental conditions."

CA Decision: Such interpretation would render *Redwater* meaningless", allow bankrupt companies to escape their ARO, when"[t]he whole point of *Redwater*, is that the proceeds of the sale of the valuable assets must be applied towards reclamation of the worthless orphaned assets". ARO has priority over builder's liens.

THANK YOU AND QUESTIONS

Chidinma Thompson,
Partner, Borden Ladner Gervais
Cthompson@blg.com
403-232-9666

Presented By



Borden Ladner Gervais