Alberta's new Liability Management Framework

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The issue of end-of-life liabilities for oil and gas facilities has been one of growing concern in Alberta, as in recent years there has been a marked increase in the province's inventory of inactive and orphan wells. In early 2020, the Government of Alberta announced that it was considering a number of changes to the liability framework to address both historical issues, current operations and future processes to help stem the flow of orphaned assets. On July 30, 2020, the Government of Alberta responded by announcing its Liability Management Framework (Framework). The Framework outlines a series of measures directed toward shrinking the province's backlog of orphaned and inactive wells but no specific details were provided.

As part of the Framework's implementation, the Government of Alberta directed the Alberta Energy Regulator (AER) to create new liability management programs.

The new Licensee Capability Assessment (LCA) is the foundational piece of the Framework, and is a significant departure from the current licensee liability rating (LLR) program. Under the existing LLR program, the determination of an approval holder's ability to meet end-of-life obligations for its assets was determined using a liability management rating, a simple assets-to-liability ratio comparing the cash flow or netback of the aggregate AER licensed assets of the approval holder to the deemed costs to suspend, abandon, remediate and reclaim such assets. The new LCA allows the AER to adopt a more holistic approach when assessing an approval holder's ability to meet end-of-life obligations for its assets.

To facilitate this move to the LCA regime, on January 13, 2021, the AER proposed changes to *Directive 067: Eligibility Requirements for Acquiring and Holding Energy Licences and Approvals* in draft form for comment (Draft Directive 076), outlining new eligibility requirements for current licensees and new licence applicants. The draft changes introduce additional information requirements, **notably a financial capability and risk assessment**, at the time of application and throughout all stages of an energy development's life cycle. The AER may require licensees to provide full or partial security or impose other requirements it considers appropriate in the circumstances to address issues identified through these assessments.

The new requirements for financial transparency and information gathering are the most significant. At the time of application to be an approval holder and within 120 days of an approval holder's fiscal year, financial statements (audited or management prepared)[1] are to be provided to the AER, as well as a summary (in a prescribed form of Schedule 3) of the licensee's balance sheet, profit and loss statement and cash flow statement. In addition, the licensee is to provide information as to breaching debt covenants or defaults under any debt agreements *during or after the reporting period*, and information as to entering into any financing agreements or material acquisitions or divestitures a*fter the reporting period*. Finally, if the licensee is a subsidiary, the parent's financial statements and Schedule 3 must be provided.

While we note that the draft Schedule 3 does not require information on all corporate entities within an organization, or consolidated financials, we expect that the AER may request this information in the future. Important to note is that

Draft Directive 067 directly links the ongoing compliance with the above to the ability for a licensee or approval holder to maintain eligibility to hold licences and approvals. Upon review of the information provided, the AER may request additional information, including reserves information. Recent changes to the *Oil and Gas Conservation Rules* require the AER to keep financial information confidential for five years, and reserves information for 15 years.

The AER will use this new information primarily for assessing eligibility, the capability of a licensee to meet its regulatory and liability obligations throughout the energy development life cycle and to ensure the safe, orderly, and environmentally responsible development of energy resources in Alberta throughout their life cycle.

Further to the new financial information requirements, *Draft Directive 067* expands the factors the AER may consider when assessing whether a licensee or approval holder poses an "unreasonable risk". These additional factors significantly broaden the scope beyond the licensee in question and include (but are not limited to):

- Outstanding non-compliances of current or former AER licensees or approval holders that are directly or indirectly associated or affiliated with the applicant, licensee, or approval holder or its directors, officers, or shareholders;
- Corporate structure;
- Working interest participant arrangements, including participant information and proportionate shares;
- The financial health of the applicant, licensee, or approval holder and entities currently associated or affiliated with the applicant, licensee, or approval holder or its directors, officers, and shareholders;
- The assessed capability of the applicant, licensee, or approval holder to meet its regulatory and liability obligations throughout the energy development life cycle and its ability to provide reasonable care and measures to prevent impairment or damage in respect of a pipeline, well, facility, well site, or facility site;
- Outstanding debts owed to AER or the Orphan Fund by the applicant, licensee, or approval holder, or by current or former AER licensees or approval holders that are directly or indirectly associated or affiliated with the applicant, licensee, or approval holder, or its directors, officers, or shareholders;
- Involvement of the applicant, licensee, or approval holder's directors, officers, or shareholders in entities that have initiated or are subject to insolvency proceedings (which includes bankruptcy proceedings, receivership, notice of intention to make a proposal under the Bankruptcy and Insolvency Act, proceedings under Companies Creditors Arrangement Act);
- Cancellation of or significant reduction to insurance coverage; and
- Any other factor the AER considers appropriate in the circumstances.

The above factors were in addition to the existing factors that the AER already took into consideration of its assessment of an applicant, licensee or approval holder, including the compliance history in Alberta and elsewhere of such entity and its directors, officers, shareholders and other entities associated or affiliated with any of them.

Last, the AER has included a new section on "Maintaining Eligibility" emphasizing that an existing licence or approval holder must meet licence eligibility requirements on an ongoing basis. There are changes that now require immediate notification (insolvency, insurance is cancelled or significantly reduced) and for those changes subject to the 30 day notification requirements, the existing list has been expanded to include changes to working interest participant arrangements, including participant information and proportionate shares, are to be reported. This is a significant departure from the historical practice of collecting information only a few times in the lifecycle of a registered well, pipeline or facility and presumably will result in more onerous continuous reporting requirements. The changes will require organizations to be cognizant of and proactive in managing the impact or risk to its AER licence eligibility

status for a number of ordinary course matters or changes. The Draft Directive 067 continues to allow a licensee or approval to request an advance determination before effecting a change that could impact its eligibility assessment.

Changes to come

The AER has requested stakeholder feedback of its draft *Directive 067* by February 14, 2021 and we understand the AER may also engage in industry consultation regarding LCA in early 2021. Other directive changes and new regulatory requirements underpinning the new Framework are also being assessed, including the establishment of processes to address legacy and post-closure site liability. Dentons will continue to monitor these and other developments relevant to the Canadian energy industry and provide additional updates to our clients and the public.

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1. There are provisions addressing the circumstances where audited financials are not available. Notably, if the applicant is a new company with no financial history then details of financing are to be provided.↩

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