

Legal update

Alberta Energy Regulator increases restrictions on transfers following *Redwater* decision

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Energy
Environmental

On June 20, 2016, the Alberta Energy Regulator (AER) published Bulletin 2016-16, outlining interim measures to manage the increased risk of disclaimed oil and gas properties and the associated abandonment and reclamation costs, following the recent decision of the Alberta Court of Queen's Bench in the bankruptcy of Redwater Energy Corporation. The interim measures are effective immediately and include a requirement that a transferee of oil and gas properties have a Liability Management Rating (LMR) of at least 2.0 before the AER will approve the transfer of the AER licences, approvals and permits associated with such properties.

The LMR is a measure used by the AER to estimate the ability of an AER-licensed company to pay for its future costs to close and abandon its wells, pipelines and facilities and to reclaim well and facility sites. The LMR is a measurement of a company's assets versus its liabilities. If a company's liabilities exceed its assets, a security deposit must be posted with the AER.

Background

On May 19, 2016, the Alberta Court of Queen's Bench released its much anticipated decision in *Redwater Energy Corporation (Re)*¹ (*Redwater*). As outlined in a previous [Legal Update](#), the Court in *Redwater* held that, pursuant to the *Bankruptcy and Insolvency Act (Canada)*, a trustee in bankruptcy can disclaim licensed oil and gas properties and is not bound by abandonment orders issued by the AER relating to such disclaimed oil and gas properties. The *Redwater* decision goes on to provide that the AER is not permitted to consider disclaimed oil and gas properties in evaluating a bankrupt's LMR for the purpose of approving and authorizing the transfer of the bankrupt's AER licences, approvals and permits.

As a result of the Court's decision in *Redwater*, the AER and the Orphan Well Association (OWA) have expressed concern that Alberta is now faced with the increased risk that disclaimed oil and gas properties will become orphan wells and the associated abandonment and reclamation costs will fall on the OWA or taxpayers.

AER's response to *Redwater*

On June 20, 2016, the AER published [Bulletin 2016-16](#), which confirms that the AER and the OWA have appealed the *Redwater* decision. Pending the outcome of this appeal, the AER has now taken steps to mitigate the effects of the *Redwater* decision. According to Bulletin 2016-16, the AER has implemented the following interim measures, effectively immediately:

- **Increased discretion to determine eligibility.** The AER will now consider and process all applications for licence eligibility as non-routine and may exercise its discretion to refuse an application or impose terms and conditions on licence eligibility if it considers it appropriate in the circumstances.
- **Evidence of no material changes.** The AER may require evidence from holders of existing but previously unused licence eligibility approvals that there have been no material changes to the licensee since the approval was granted (including licence transfer applications). The AER may now also request confirmation of adequate insurance and evidence that there have been no material changes to the directors, officers and shareholders of the licensee since the licence eligibility was originally granted.
- **An LMR of 2.0 or higher.** The AER will now require a transferee of oil and gas properties to demonstrate that it has a LMR of at least 2.0 prior to the approval of the transfer of licences, approvals and permits associated with the oil and gas properties.

The requirement that transferees demonstrate an LMR of at least 2.0 is significant. Previously, transferees were only required to maintain the minimum LMR of 1.0.

To put this in perspective, according to the AER's Liability Management Programs Results Report dated June 4, 2016, there are approximately 362 licensees with an LMR of less than 1.0, 207 licensees with an LMR of between 1.0 and 2.0, and 219 licensees with an LMR greater than 2.0. Consequently, approximately 569 licensees (or 72%) do not currently meet the new LMR threshold.

These interim measures will remain in place pending the outcome of the *Redwater* litigation or the implementation of "appropriate regulatory measures," which the AER has indicated it is working on to further address the implications of the *Redwater* decision and to ensure that statutory environmental liabilities are addressed.

Implications

There are several implications for Alberta oil and gas licensees in the wake of the AER's new interim measures.

First, transactions involving the transfer of AER-licensed oil and gas properties may slow considerably. Many potential buyers are now likely not in a position to acquire oil and gas assets due to the higher LMR threshold and the prospect of having to post greater security with the AER. It is reasonable to expect that the value of AER-licensed properties with a low associated LMR will be further discounted given the limited number of potential buyers who can or would want to acquire such properties and the associated new obligation for increased security deposits. Many AER-licensed properties with a low associated LMR may end up being "stranded" in the hands of licensees with low LMRs.

Second, it is possible that those licensees that have an LMR not significantly in excess of 2.0 will begin to focus more on acquiring oil and gas properties in nearby jurisdictions, such as Saskatchewan and British Columbia, where the LMR thresholds are not as onerous for transferees. This of course depends on whether the regulators in these other jurisdictions adopt similar interim measures to Alberta or if they take a wait-and-see approach to the conclusion of the *Redwater* litigation and the impact of the AER's interim measures.

Third, the AER has indicated that it is also working on "appropriate regulatory measures" to further address the Court's decision in *Redwater* and to ensure that statutory environmental liabilities are addressed. Such measures may include additional charges or assessments and new ways to enforce abandonment and reclamation obligations. In any event, until those measures are announced, the industry will be facing a period of significant uncertainty.

It is also unclear if the current LMR requirement of 1.0 for existing licensees will also be raised to 2.0. With the new Bulletin, a company buying AER-licensed properties must have an LMR of at least 2.0 following the purchase, meaning that they must have at least twice as many assets as liabilities or else they will have to post security. Existing licensees need only have an LMR of 1.0, meaning that they do not have to post security until their liabilities exceed their assets. This appears unfair, as an existing licensee is also at risk of entering creditor protection.

Finally, the asset side of the LMR formula is partly based on historical average commodity prices. However, the AER has not updated its average commodity prices in several years. An update to reflect low oil and gas prices in the last two years will further erode LMRs and be another push to insolvency for oil and gas companies with low LMRs.

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Footnote

¹ 2016 ABQB 278.

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