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Governance and Accountability: Preconditions for Committing Public Funds to Orphan Wells and Facilities and Inactive Wells

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Announcement commented on: Department of Finance Canada, [Canada's COVID-19 Economic Response Plan: New Support to Protect Canadian Jobs](#), April 17, 2020

As any resident of this province knows, the Alberta oil and gas sector's problem of underfunded environmental liabilities has been growing for decades. On April 17, 2020, in response to the impact of both the COVID-19 pandemic and the [Saudi/Russian price war](#), the federal government announced an injection of \$1.7 billion of public funds to support the 'clean up' of inactive and orphan wells in Saskatchewan, Alberta and British Columbia. With respect to Alberta, \$200 million will go to the Orphan Well Association as a loan to deal with orphan wells (i.e. wells that have no owner) while \$1 billion will go to the Government of Alberta to deal with inactive wells (i.e. wells that are not producing but have not been properly closed and remediated).

The first part of this post examines the background to the [Orphan Well Association](#) and how it has moved from being an industry funded organization to the recipient of significant public funds. We suggest that this change in the source of funding is likely permanent and thus demands a complete rewrite of the governance structure for orphan wells in the interests of transparency and accountability. The second part of this post offers comments on the proposed program for inactive wells. This part of the post is shorter and more speculative because the announcement is remarkably vague and lacking in important details on this part of the program.

Here is what the federal press release of [April 17, 2020](#) has to say:

Orphan and Inactive Oil and Gas Wells

Canada's energy sector is a significant contributor to our national economy. In light of this, and the challenging economic circumstances facing the sector and the regional economies dependent on it, the Government of Canada will provide funding to sustain jobs in the energy sector while cleaning up the environment. This includes:

- Up to \$1 billion to the Government of Alberta to support the province's work to clean up inactive oil and gas wells across the province;
- Up to \$400 million to the Government of Saskatchewan to support work to clean up orphan and inactive oil and gas wells across the province;
- Up to \$120 million to the Government of British Columbia to support work to clean up orphan and inactive oil and gas wells across the province; and

- \$200 million to the Alberta Orphan Wells Association (OWA) to support its work to clean up orphan oil and gas wells and well sites across Alberta. The OWA will fully repay this amount.

Orphan oil and gas wells arise when the developers cannot be located or do not have the financial means to pay for proper decommissioning and site remediation. ...

Inactive oil and gas wells are formerly producing wells. At present, there are approximately 91,000 inactive wells in Alberta, 36,000 in Saskatchewan, and 12,000 in B.C.

....

Clean-up costs can range between \$100,000 to several million dollars per well depending on the complexity and size of the well or facility and the amount of contamination that is present.

Clean up work is typically carried out by small and medium-sized oil and gas service firms. Those firms employ nearly 60,000 people across the three provinces. Clean-up work would be considered an essential service under the government's [Guidance on Essential Services and Functions in Canada During the COVID-19 Pandemic](#).

As part of this funding, local landowners will have the ability to nominate and prioritize wells for remediation, and funding will be prioritized to companies that are in good standing with respect to municipal taxes.

As part of these agreements, the Government of Alberta has committed to implement strengthened regulation to significantly reduce the future prospect of new orphan wells. This will create a sustainably funded system that ensures companies are bearing the costs of their environmental responsibilities.

The funding program will have oversight from a federal-provincial committee, and the federal government will ensure municipal and Indigenous engagement. (Underlining and italics added)

The italicized text indicates that Alberta has agreed to adopt new regulatory measures that will reduce the risk of new orphan wells and that there will be a federal-provincial oversight committee. No further details are available at the present time.

Alberta's Orphan Well Association

The orphan well problem has been known to the oil and gas industry and regulators in Alberta since at least the mid-1980s, when concerns began to surface about operators walking away from financial liabilities associated with the clean-up of depleted wells and aging facilities. For discussion of the background, see Nickie Vlavianos, *Liability for Well Abandonment, Reclamation, Release of Substances and Contaminated Sites in Alberta: Does the Polluter or Beneficiary Pay?* ([LLM Thesis: University of Calgary, 2000](#)). In response, the Alberta Energy and Utilities Board (one of the predecessors to the Alberta Energy Regulator (AER)) established the Orphan Fund in 1992, which was funded through an annual levy on inactive wells (i.e. a fee paid annually by operators responsible for inactive wells). Initially the Fund could only be used

to cover the cost of closure (referred to within the industry as abandonment) but the scope of funded activities was extended in 1996 to cover pipeline abandonment, facility decommissioning, site contamination and reclamation. The recently passed [Bill 12](#) further extends the scope of eligible activities, as detailed in an earlier [ABlawg post](#). The premise of this policy solution was to acknowledge and engage the collective responsibility of the industry to clean up the mess left by a few bad actors in the sector. This kept faith with the polluter pays principle – at least at the sectoral level if not at the level of the individual actor.

Monies from the resulting fund are made available to the Orphan Well Association (OWA) to carry out these activities. The OWA is established as a society under the *Societies Act*, [RSA 2000, c S-14](#) under its formal name, the Alberta Oil and Gas Orphan Abandonment and Reclamation Association. The OWA’s audited financial statements (included in the [OWA’s 2018-2019 Annual Report](#)) tell us that the Members of the OWA are the Canadian Association of Petroleum Producers (CAPP), the Explorers and Producers Association of Canada (EPAC), the AER, and Alberta Environment and Parks (honorary non-voting Member). The OWA bylaws state that the OWA Board of Directors consists of six representatives of these members, and these persons are currently (as listed in that same report): Brad Herald of CAPP as the Board chair, Kendall Dilling (Cenovus Energy), Orest Kotelko (CNRL), Darrel Purdy (Paramount Resources), Jim Streaton (Corval Energy), Trevor Gosselin (AER) and Karen Wronko (Alberta Environment and Parks). According to the bylaws, CAPP is entitled to appoint three board members, EPAC two members, and the AER one member. The Board manages the affairs of the OWA, and each member has one vote on matters considered by the Board.

The OWA receives its public mandate (and its entitlement to the monies in the orphan fund) through the *Orphan Fund Delegated Administration Regulation*, [Alta Reg 45/2001](#) (*Delegation Regulation*). Section 3 of that regulation delegates to the OWA certain listed “powers, duties and functions” of the AER under the *Oil and Gas Conservation Act*, [RSA 2000, c O-6](#), particularly with respect to orphan wells and facilities. The *Delegation Regulation* also establishes a degree of oversight insofar as it requires the OWA to provide the AER with both a business plan and an annual report including audited financial statements. The audited financial statements must include details of any remuneration or benefits paid to members of the board of the OWA and any management personnel. The bylaws of the OWA provide that: “Except as may be prescribed from time to time by a resolution of the Members, the Directors are not to receive any honorarium or remuneration in the course of their duties as directors” (Article 11.1). Note 9 to the financial statements indicates that no remuneration or benefits were paid to Board members. The financial statements were audited by Grant Thornton. There is some irony here. It was Grant Thornton as the trustee in bankruptcy for Redwater along with ATB as Redwater’s secured creditor that tried to unravel the proposition that abandonment reclamation obligations were public duties and not claims provable in bankruptcy: *Orphan Well Association v Grant Thornton Ltd.*, [2019 SCC 5 \(CanLII\)](#), [2019] 1 SCR 150. Had that decision gone the other way, as the OWA acknowledges in its annual report, it “would have set a catastrophic precedent for both our work going forward and for taxpayer liabilities across many jurisdictions and many industries” (at 3).

In addition to the orphan levy paid by the industry and various other industry funded sources (first time licensee fees and any relevant deposits held by the AER), the OWA has more recently received significant public monies, either in the form of grants or in the form of loans, as is the

case with this most recent federal announcement. Figure 1, which is based on the OWA’s annual reports and recent government announcements, shows cumulative funding received by the OWA. 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 a [\\$235 million](#) loan from the previous provincial government in 2017 (coupled with a \$30 million federal grant to cover interest on the provincial loan), [another \\$100 million](#) loan from the current provincial government announced in March of this year, and finally this most recent \$200 million loan from the federal government. In other words, even before the current COVID-19 pandemic and the Saudi/Russian price war, the OWA has been trending towards a publicly funded organization with a burgeoning orphan well inventory (see Figure 2, borrowed from the OWA’s 2018 annual report).

Figure 1. OWA Funding (cumulative in \$ millions)

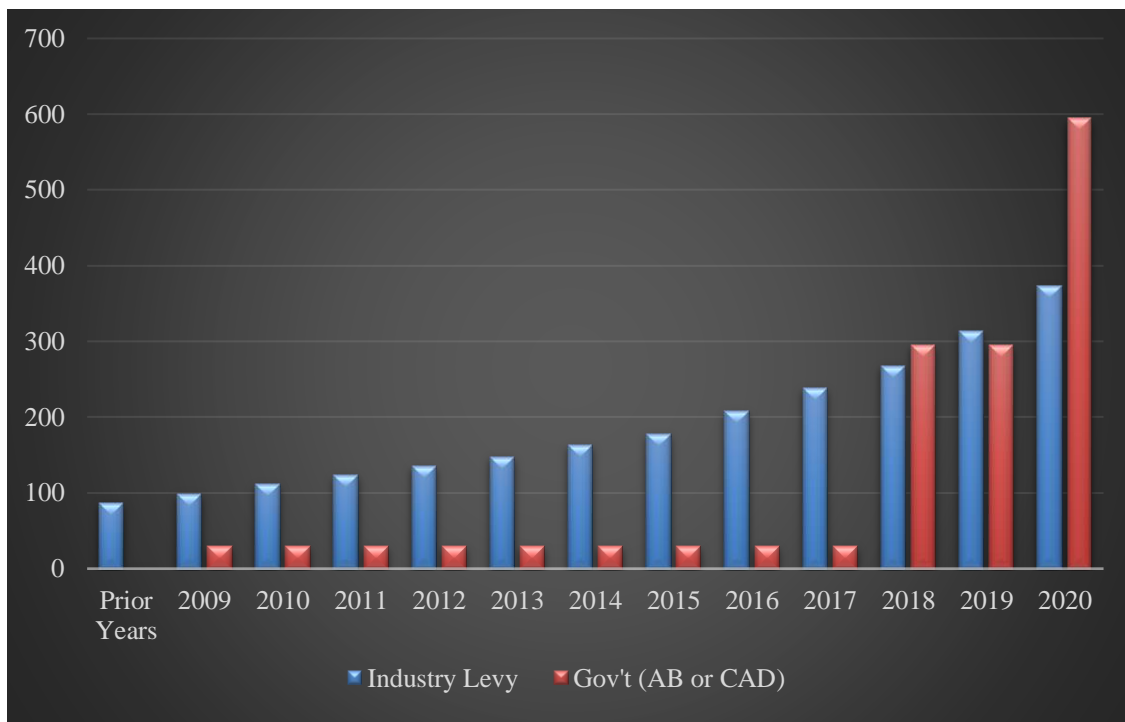
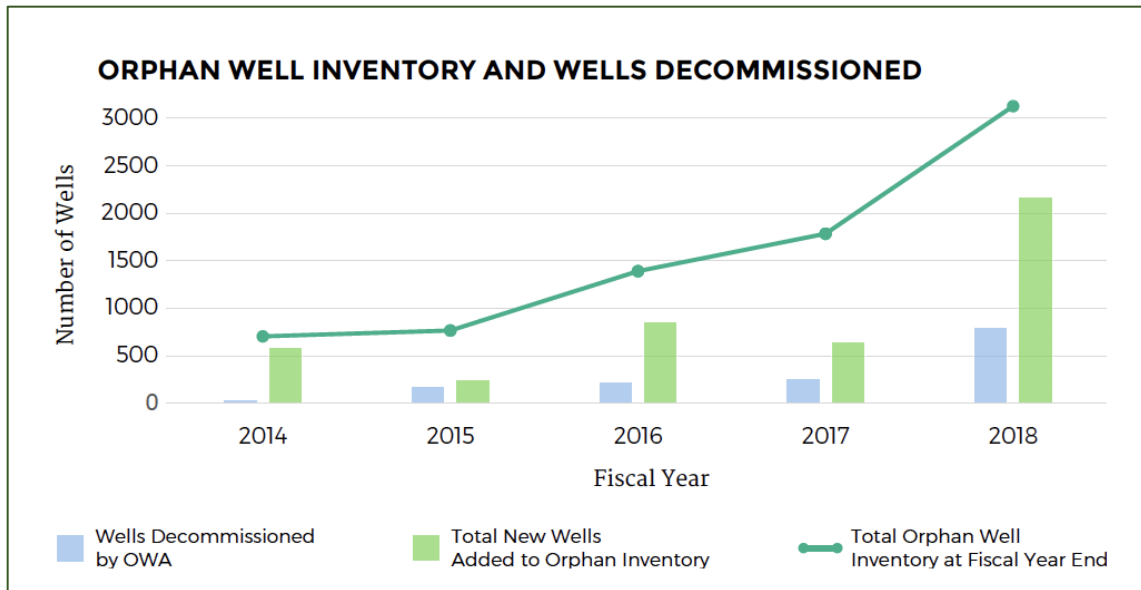


Figure 2: Orphan Well Inventory and Wells Decommissioned (OWA 2018/19)



In sum, the OWA is a closely-held organization. Its membership is dominated by industry with very limited government representation and no representation whatsoever from landowners or civil society more generally. This structure was perhaps appropriate when the orphan fund was exclusively funded by industry but that is clearly no longer the case. Furthermore, while the half a billion in public funds being made available to the OWA in recent years has largely been characterized as loans, there is a significant risk that these loans will never be repaid, especially if oil prices continue in their depressed state much longer. This is because the OWA has no retained earnings and no ability to generate revenue beyond what it receives from industry via the AER levy (or from a further injection of public funds).

These numbers make it difficult to envision how any of these taxpayer loans will ever be repaid out of the orphan levy. Should that be the case, any claim that Alberta adheres to the polluter pays principle will be revealed as a sham. Instead, Alberta’s regime for the orphan well problem will forever represent a massive regulatory failure – nothing more than an attempt to conceal the fact that oil and gas operators who profited immensely from exploiting these resources ultimately got to socialize the losses associated with the clean-up of their depleted wells and aging facilities. This suggests that rather than operating on a polluter pays principle, Alberta has operated for decades on a ‘polluter *may* pay’ principle.

Moreover, while the AER has some oversight of the OWA through the *Delegation Regulation* as noted above, as a society under the *Societies Act*, the OWA is not subject to the usual accountabilities of government agencies, boards and commissions (ABCs), even though it is exercising delegated governmental powers and spending public monies. For example, the OWA is not subject to the [public agency governance policies](#) of the Government of Alberta or the terms of the *Alberta Public Agencies Governance Act*, [SA 2009, c A-31.5](#). Nor is it subject to review by the Auditor General under the *Auditor General Act*, [RSA 2000, c A-46](#) (a supervision that proved to be an important discipline for the AER). Neither is the OWA subject to the *Freedom of Information and Protection of Privacy Act*, [RSA 2000, c F-25](#) (*FOIP*). The OWA’s structure places it outside the definition of a “public body” in section 1(p) of *FOIP*, and it has not been

deemed a public body under Schedule 1 of the *Freedom of Information and Protection of Privacy Regulation*, [Alta Reg 186/2008](#) (*FOIP Regulation*). This could be fixed quite easily under the designation power under section 2 of the *FOIP Regulation*. Since the OWA performs an activity required by an enactment, the Minister of Energy need only ask the Lieutenant Governor in Council to add the OWA to Schedule 1 of the *FOIP Regulation*. The Alberta Energy Regulator, Alberta Petroleum Marketing Commission, and the [ill-fated iCORE](#), are all subject to *FOIP*. The OWA's exclusion seems like an important omission.

In our view, the current governance arrangements for the OWA are inappropriate given the extent to which the OWA is exercising delegated governmental powers and responsibilities and spending public monies. In particular, it is unacceptable that the majority of the members of the board are appointed by industry associations, that there is no representation of civil society, and that it is effectively insulated from the normal review and accountability mechanisms that apply to ABCs fulfilling similar functions. The public needs to know, for example, that the OWA has in place appropriate procedures for ensuring that its process for allocating contracts for operations on orphan sites and facilities is competitive, delivers results at least-cost, and is free of political favouritism. Audited financial statements do not provide these assurances. Moreover, the AER has a long history of being dismissive of concerns raised by landowners and municipalities in relation to energy development on their lands. Neither group should be expected to have any faith that the OWA can deliver on the recent promise that landowners will have the ability to nominate and prioritize wells for remediation, and that funding will be prioritized to companies that are in good standing with respect to municipal taxes.

Funding “to support the province’s work to clean up inactive oil and gas wells”

While the existing arrangements for orphan wells and facilities allow us to offer the above comments on the orphan side of the federal program, it is much more difficult to comment on the inactive well side of the program, both because of the lack of detail in the announcement, but also because Alberta's current regulatory framework for dealing with inactive wells is very limited.

The current rules for inactive wells are based on [AER Directive 013](#): Suspension Requirements for Wells (December 2018) as supplemented by AER Bulletin 2014-19, July 4, 2014, that announced the introduction of the AER Inactive Well Compliance Program (IWCP). The AER introduced this program to address a growing inventory of inactive wells and the large number of wells that were not in compliance with Directive 13. The objective of the IWCP “is to bring all inactive noncompliant wells under the program into compliance with Directive 013 requirements within five years” (i.e. by some time in 2020). The most recent [report](#) on the program issued in January 2020 indicates that “There are 6844 noncompliant wells belonging to 404 licensees in the IWCP.” As noted in the earlier ABlawg post on Bill 12, certain requirements of the IWCP have been [suspended](#) during the COVID-19 crisis.

Directive 13 establishes risk-based *suspension* requirements for wells; it does not itself require that abandonment and reclamation activities be undertaken at any particular point in time. Hence, there is nothing in Directive 13 or anything else in Alberta's regulatory framework to prevent a growing inventory of inactive wells increasing the likelihood of a growing number of orphans.

Conclusion

It is useful to think of Alberta's problem of orphan wells and facilities and inactive wells as two intertwined problems. First, there is the environmental problem of wells and other oil and gas assets sitting unremediated and occasionally unmonitored. Second, there is the externality problem of the oil and gas industry shifting the costs of cleanup to the taxpayer. Such a socialization of costs represents a subsidy to the industry that acts as an incentive for even further environmental irresponsibility. The trick is to solve both problems at once. A massive multi-billion dollar federal program to pay for the cleanup of wells might fix the environmental problem, but it represents a complete defeat on the externality problem. A demand for immediate clean up of all long-term inactive oil and gas wells and the posting of enhanced security would likely have solved the externality problem if implemented decades ago, but if such a demand were implemented now many or most (possibly all?) companies would immediately declare bankruptcy and leave behind too few assets, and it would be a large defeat on the environmental problem.

The federal aid money is not enough to fix the environmental problem on its own, and the federal aid money risks making the externality problem worse. Accordingly, the most important part of the federal announcement is the reference to an apparent agreement that "the Government of Alberta has committed to implement strengthened regulation to significantly reduce the future prospect of new orphan wells. This will create a sustainably funded system that ensures companies are bearing the costs of their environmental responsibilities." What that will entail remains to be seen, but in our view there are two crucial elements to strengthening Alberta's regime: (1) enhanced security or bonding arrangements to ensure that there are funds on hand to deal with reclamation and abandonment, and (2) the imposition of time limits for undertaking these activities where a well has been inactive for a prescribed period of time. Absent these requirements, the inventory of inactive wells will continue to grow as will the risk of orphans.

Details of the bargain between the federal government and the Alberta government ought to be made public as soon as possible, and, to the extent that significant public funds are being deployed, the future management of the problem of orphan and inactive oil and gas assets should be conducted in accordance with the accountabilities that usually apply to those exercising governmental or quasi-governmental powers and spending significant public monies.

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