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Alberta's Orphan and Unreclaimed Oil and Gas Assets in July 2022

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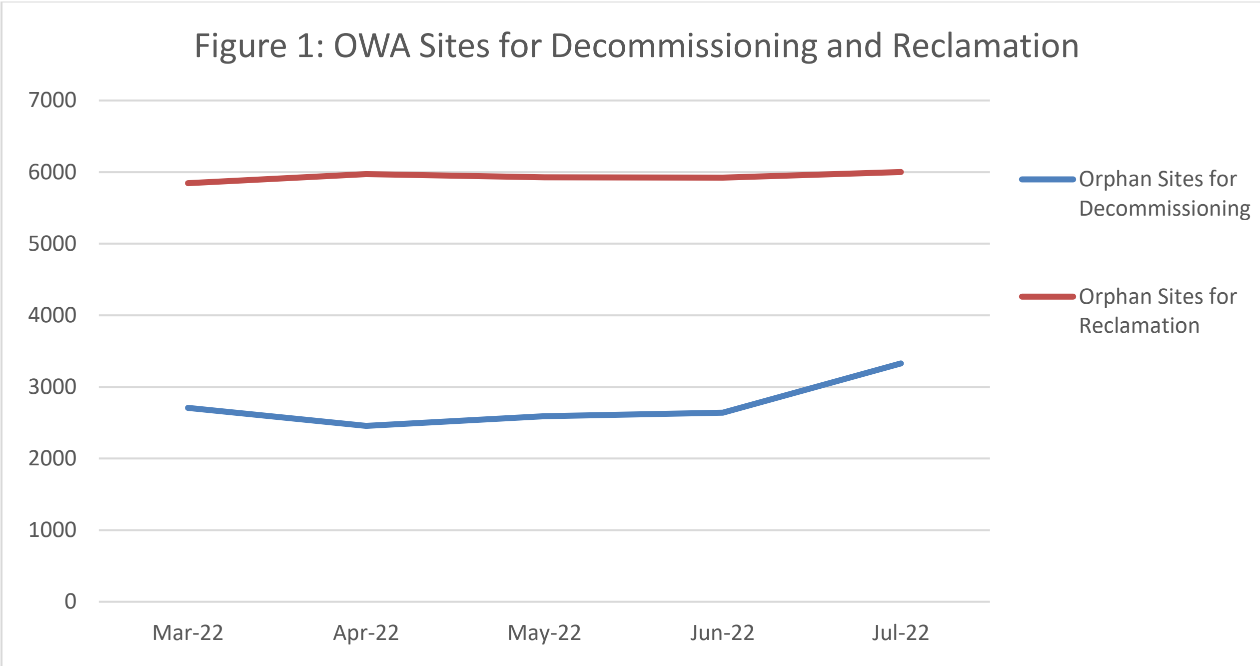
Annual Report Commented On: Orphan Well Association Annual Report 2021/2022; AER Bulletin 2022-23 Mandatory Closure Spend Target Set for 2023

The Orphan Well Association (OWA) released their annual report for 2021/2022 this month, and the AER posted Bulletin 2022-23 updating the mandatory closure spend targets. This post discusses these two documents and describes the current state of Alberta's orphan and inactive oil and gas assets. For greater background on the OWA and the history of the problem, see here.

Industry Will Be Paying for the Orphans from the 2018 Oil Price Downturn Until 2035

The orphan inventory of sites to decommission and reclaim has been roughly steady over the past 5 months (see figure 1). This is caused by the delays between when an oil and gas company enters bankruptcy and when that process concludes and their final assets are officially declared orphans by the Alberta Energy Regulator and moved into the orphan well inventory. For example, most of the new orphan wells received by the OWA in 2021/22 came from Trident Exploration (OWA Annual Report 2021/2022 at 16) even though Trident Exploration ceased operations in May 2019. Twelve hundred pipelines from Sanling entered the official orphan inventory in April 2022 even though Sanling entered bankruptcy in April 2021. The OWA is aware of the delay between a company entering bankruptcy and the assets becoming orphans, and considers it in their forward planning. In an earlier post, I had called these 'missing orphans', but to be clear these are not missing from OWA accounting or planning, they are only 'missing' from the official inventory. A better name might be something like 'pending orphans'.

So as the OWA has been decommissioning orphans, those decreases have been matched by the gradual inflow of new orphans trickling in from the period of low oil prices following the 2018 oil price downturn. The OWA believes this is the tail end of the wave of orphans produced by the 2018 price crash (OWA Annual Report 2021/2022 at 3). The number of sites needing reclamation has also remained steady (see figure 1), mostly because the reclamation process involves several years of monitoring vegetation growth and so takes several years to show up as a decrease in orphans in the inventory.



Together, the delay in assets becoming official orphans listed in the inventory, and the long delay between OWA's spending on reclamation and the final reclamation certificate being granted to remove the orphan from inventory mean that looking at the changes in the orphan inventory month-by-month is not useful for trying to get a grasp on the situation. What is more useful is to consider how long the orphan well levy takes to secure the money for the OWA to decommission and reclaim the orphaned assets produced by an oil price downturn. You can see the current system has not performed well when you consider how long Alberta's regulatory system will take to obtain payment from industry to clean the orphans produced by the 2018 oil price crash.

Three details are important to see how the system reacted to the 2018 oil price downturn. First, the OWA inventory appears to now hold the last of the orphans created by the receiverships caused by the 2018 oil price crash (OWA Annual Report 2021/2022 at 3). Second, "As of March 31, 2022, the total remaining closure cost is estimated to be slightly less than $700 million, roughly even with last year's estimate." (OWA Annual Report 2021/2022 at 5). Third, that the OWA currently owes a combined $314 million to repay loans from the provincial and federal governments (OWA Annual Report 2021/2022 at26). In sum, the situation in July 2022 is that the oil and gas industry is still more than a billion dollars away from paying for the orphans produced by the 2018 oil price downturn and industry intends to be repaying loans related to that work until 2035.

I consider the OWA's report to take an optimistic view of the situation. The OWA has more confidence in the AER's 'new' regulatory framework than I believe is justified. The new framework is similar to the old framework and there is no clear reason to think it will perform significantly better during a downturn in oil prices when the value of all oil and gas assets falls drastically.

The current plan for funding the OWA does not seem to anticipate any future crash in oil prices. The belief that currently high oil prices will stay high into the foreseeable future (at least until

2035) is exactly the unfounded belief that caused the 2018 oil price downturn to catch the OWA and the AER unprepared. This is a key problem in the design of the orphan fund levy: the funding to pay for the orphans from the previous crash comes from the following boom. If the oil price declines and does not rise again (as is almost certainly required to slow climate change) there will be no money for the OWA to perform the needed decommissioning and remediation work after the final price decline.

The OWA's annual report shows a clear understanding of the cyclical nature of oil prices and the inevitability of a downward price swing. The OWA's post-crash funding system is not suitable for those realities. This is not the OWA's fault – it is the regulatory system designed by Alberta Energy, the AER, and oil industry lobby groups.

There are signs that the next oil price downturn will bring another massive wave of orphans. First, although there have not been major bankruptcies while oil prices have risen, this does not fix the financial situation of all companies in the industry (as shown by the ongoing decision by many companies not to pay their property taxes). The AER's July 2022 Liability Management Rating Results Report still shows more than 30,000 licenses held by companies with an asset-to-liability ratio below 1.0, and more than 120,000 licenses held by companies with an asset-to-liability ratio below 2.0. These companies are at a high risk of a bankruptcy that will orphan most of their assets when oil prices decline. Although the high oil prices keep them from entering bankruptcy, these oil and gas companies hold decommissioning and clean-up costs higher than they can pay for even with very high oil prices. The AER's new risk-management system is unlikely to be able to do anything to fix the finances of these companies. It is already too late for monitoring and enforcement action. The AER and OWA should be anticipating most of these assets becoming orphans during the next downturn.

Second, an affidavit filed related to the bankruptcy of Manitok Energy claims that some of the companies who purchased wells from Manitok's bankrupt estate have not been paying their property taxes. This is a troubling sign that non-producing wells with no value were shifted out of a bankrupt company to another company nearing bankruptcy. Such transfers kept the assets from being orphaned in the short term but do not get the assets cleaned up, kicking the problem down the road without fixing it. The assets of these companies will become part of another bankruptcy and likely become orphaned during the next oil price downturn.

Third, the oil and gas industry did not pay the full costs of orphaned assets produced by the 2018 oil price downturn and instead relied on government largesse. An affidavit filed by the President of the OWA in the Trident case shows that the Trident bankruptcy was prolonged so that the money from the federally funded site rehabilitation program could be used by the receiver to clean up Trident's wells that otherwise would have become orphans (Affidavit of Lars De Pauw sworn June 6th, 2022, at para 14). It is not clear to me why the site rehabilitation program excluded orphan assets, but it seems the prolonged receivership was used to access the site rehabilitation money for wells that otherwise would have become orphans.

The Good News: The AER Increased the Mandatory Spend Targets

The AER's new liability management system includes mandatory spend targets, a requirement for companies to spend a certain amount on closure work each year. This mandatory spend deals with the liabilities of inactive assets and not orphan assets. The AER did increase the planned mandatory spend targets for 2023-2026. When announced on June 8, 2021 with bulletin 2021-2023 the targets were:

Year	Industry Wide Mandatory Target
2022	$422 million (set)
2023	$443 million (set)
2024	$465 million (forecasted)
2025	$489 million (forecasted)
2026	$513 million (forecasted)

And Bulletin 2022-23 on June 28, 2022 shows the new targets:

Year	Industry Wide Mandatory Target
2023	$700 million (set)
2024	$764 million (forecasted)
2025	$883 million (forecasted)
2026	$909 million (forecasted)
2027	$992 million (forecasted)

Bulletin 2022-23 also provides three rational reasons for the increase: (1) that the industry spend in 2021 was already higher than the planned 2022 target (and all the targets up to 2026); (2) the very high oil and gas prices, and (3) that the oil and gas services sector is experiencing growth and that growth will be supported by the higher mandatory spend. Although the calculation used to set the industry wide mandatory target is still opaque, and the overall amounts might still be too small, these significant increases are a positive development. Any increase helps to bring down Alberta's massive inactive liability problem and shrink the size of the future orphan problem.

Conclusion

The Alberta oil and gas industry plans to be paying for the orphans produced by the 2018 oil price downturn until 2035, and if the next downturn in oil prices arrives any time before 2035 Alberta will have to deal with the new wave of orphans while industry is still paying for the last wave of orphans. The orphan well problem typically stays relatively quiet during the period of high oil prices, and then comes roaring back when prices fall. To protect the 'polluter pays' principle, Alberta Energy needs to switch to a system that secures money for clean-up in advance and accept that this will cause short term financial pain for industry. At the very least, Alberta Energy should switch to a system that gets the money for clean-up much faster than 17 years.

On the inactive well front, although the AER still has not provided a clear explanation of how they are calculating mandatory spend targets, the AER made rational upwards revisions to the mandatory spend targets to adapt to the current high oil-prices.

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