

February 8, 2024

Grading the AER Liability Management Performance Report

By: Shaun Fluker, Drew Yewchuk, and Martin Olszynski

Report Commented On: [Liability Management Performance Report](#)

On January 17, 2024 the Alberta Energy Regulator (AER) published a [Liability Management Performance Report](#). This is the first published AER report to the public on progress being made by industry under the [Liability Management Framework](#) to reduce Alberta’s massive unfunded closure liability in the conventional (non-oil sands) oil and gas sector. The last comparable report from the AER on liability management was from [September 2005](#). Somewhat predictably, in its [news release](#), the AER reflected positively on industry’s performance and indicated that this will be an annual report with the objective of “. . . improving transparency of industry’s management of conventional oil and gas liabilities as well as to develop performance measure baselines and ongoing assessments of the industry as a whole and licensees specifically.” The response elsewhere was less enthusiastic. Some, like the [Rural Municipalities of Alberta](#), reserved judgment pending further analysis; while others more critically [noted](#) that the Report curiously understates the overall liability amount, using a liability calculation method from 2015 that subsequent analysis by the [AER revealed to be a vast under-estimation](#). The Report provides some aggregated data and licensee-specific information and accordingly gets partial marks for some transparency, but it absolutely fails to give the public adequate context to fully understand whether this should be read as good or poor performance by industry and says almost nothing at all about the AER’s performance. [Secrecy and capture](#) continue to govern liability management in Alberta.

The Closure Liability Problem and the Liability Management Framework: An Overview

Closure liability refers to unfunded abandonment (decommission), remediation, and reclamation work to clean up the mess left behind by active and inactive wells, pipelines, and other facilities on public and private lands in Alberta. The exact amount of the liability is unknown. In March 2023, the Alberta Auditor General [reported](#) total conventional (non-oil sands) liability to be approximately \$60 billion, while others – including the AER – have estimates that suggest the amount is likely more than double that. Alberta has known about the closure liability problem for at least 40 years. Policy and regulatory failure over that time has allowed what was initially a relatively manageable problem to evolve into a massive environmental and financial crisis. Alberta abruptly cancelled its only effective program at addressing closure liability in 2000 after only three years of operation, and little else of substance was proposed or implemented until 2020 when the federal government provided Alberta with \$1 billion to fund closure work. A condition of this federal money was that Alberta [take meaningful policy steps to ensure](#) “a sustainably funded system that ensures companies are bearing the costs of their environmental responsibilities.” In July 2020, the Alberta government responded by announcing the new policy direction of a [Liability Management Framework](#).

The Liability Management Framework has four components: (1) reduce the number of inactive sites with outstanding closure work; (2) assess applicants and existing licensees to ensure their solvency and operational record demonstrates an ability to meet closure and other regulatory obligations; (3) expand the mandate of Alberta’s Orphan Well Association to enhance its ability to undertake closure work for sites without a solvent owner; and (4) develop a regulatory program to address closure liability associated with legacy and post-closure sites for which there is no responsible owner.

For the most part, the AER is responsible for implementing and administering the Liability Management Framework. The *Responsible Energy Development Act*, [SA 2012, c R-17.3](#), gives the AER its overall mandate, authority, and power to regulate the development of energy resources and closure work. More specific powers and legal obligations are set out in various other enactments. For example, with respect to pipelines these enactments include the *Pipeline Act*, [RSA 2000, c P-15](#), and *Pipeline Rules*, [Alta Reg 125/2023](#), (formerly the *Pipeline Regulation*, [Alta Reg 91/2005](#)). These enactments also provide the AER with power to make rules with respect to liability management. Those rules are found primarily in two directives: [AER Directive 067](#) - Eligibility Requirements for Acquiring and Holding Energy Licences and Approvals and [AER Directive 088](#) – Licensee Life-Cycle Management. [AER Manual 023](#) sets out and explains specific procedures used by the AER to assess liability risk of applicants and licensees, as well as implement minimum mandatory closure spending requirements on inactive sites.

The AER website is a labyrinth in terms of explaining how the regulator administers and implements liability management, with many pages conveying information in a manner that is duplicative, convoluted, and confusing (see e.g. [here](#), [here](#), [here](#), [here](#), [here](#), and [here](#)). Perhaps the best place to start is the [Liability Management](#) page, which provides a very cursory description of the components of the 2020 Liability Management Framework. This page mentions that legislative amendments were required to implement the Liability Management Framework, including amendments to AER Directive 067 and the enactment of Directive 088, and provides links to other pages that give some explanation to specific aspects of liability management: [holistic assessment and licensee capability assessment](#), [licensee management program](#), [inventory reduction program](#), [license transfer process](#), and [security deposits](#). All of these pages are also linked to the [Liability Management Programs and Processes](#) page, along with additional pages such as the [legacy and post-closure sites](#), [Orphan Well Association](#), [liability management rating and reporting](#), [mine financial security program](#), and [insolvency](#).

Collectively, the purported purpose of these requirements is to reduce unfunded closure liability in Alberta. To accomplish this, the requirements mandate an annual amount of spending by industry on closure work. They also provide the AER with the power to holistically scrutinize the financial and operational capacity of applicants for new licenses and existing licensees to perform closure work, and to control those risks by refusing to grant or transfer licenses or imposing conditions such as security deposits. The AER describes the licensee capacity assessment as the ‘backbone’ of the holistic approach:

The licensee capability assessment (LCA) is the backbone of our holistic assessment of companies throughout the energy development life cycle in the oil and gas sector.

Introduced through Directive 088: Licensee Life-Cycle Management, the LCA considers a variety of factors to help us evaluate a company, including their financial and liability risk, their performance compared with similar companies, and other operations, closure, and administrative factors, with compliance history being considered throughout.

The information that feeds into the LCA comes from several sources, including financial information that companies are required to provide us through Directive 067. (AER, “[Holistic assessment and Licensee Capability Assessment](#)”)

Additional information collected by the AER to undertake its holistic assessment on companies who apply for new licenses or to transfer existing licenses includes unpaid municipal taxes above \$20,000. This requirement was imposed on the AER by the Minister of Energy in [Ministerial Order 043/2023](#), wherein the Minister also directed the AER to require companies to reduce taxes payable below the threshold amount or give evidence of repayment arrangements with the municipality.

We recently published a critical evaluation of the legal and policy design of these new requirements (plus the orphan fund) in “[A Made-in-Alberta Failure: Unfunded Oil and Gas Closure Liability](#)”. Our analysis was informed by a historical review of Alberta’s approach to managing closure liabilities over the past 40 years in order to assess whether the Liability Management Framework is properly designed to achieve its objective of getting closure work done and ensuring the polluter — not Alberta taxpayers — pays for it. The conclusion of the study is that three factors that have contributed to Alberta’s historical failure to effectively manage closure liabilities remain problematic today in the design of the Liability Management Framework and its current legal and policy framework: poor transparency, excessive discretionary power, and a regulator captured by industry interests.

As mentioned above, the AER’s performance on implementing the Liability Management Framework has also been the subject of a [report](#) by the Alberta Auditor General. ABlawg commented on this report [here](#) and [here](#). One key finding of this report is an absence of meaningful transparency from the AER. This problem manifests in two ways: (1) a lack of external performance measures on closure work; and (2) failure to report meaningful information to people in Alberta. The absence of transparency makes it difficult for the public to assess the AER’s performance and to hold the AER accountable for its regulatory functions in this area.

Specific deficiencies noted by the Auditor General in how the AER reports its performance to Albertans include the following:

Specific goals to ensure accountability for results as it changes key parts of its liability management system have not been established. For example, what AER views as a reasonable and sustainable level of inactive closure liabilities given level of industry activity, economic factors, and other considerations? What is the current closure liability amount and what is an acceptable level? What does AER define as timely restoration of inactive sites and what is the goal for timeliness?

The Ministry of Energy and AER annual reports contain data about the amount of closure activity and spending in Alberta. However, they do not report on the total number of inactive sites in Alberta making it difficult for Albertans to assess if net progress is being made to reduce inactive sites.

AER lacks external performance measures to demonstrate whether its liability management programs are working. The lack of public reporting on performance measures with targets also makes it difficult for Albertans to know if risks are being adequately managed and that the cleanup being done is sufficient. *Reporting on activity alone is not enough to effectively measure the performance and achievement, or lack thereof, of goals.*

AER's most recent estimates, at the time of writing, for industry-wide (active and inactive) closure liabilities in Alberta ranges from \$30 billion for wells and facilities to \$60 billion if pipelines and more recent information are included. AER also has not defined what it considers to be an acceptable and sustainable level of closure liability.

An overall liability estimate includes both active and inactive sites, where active sites may not need closure work completed for years. Contrasted with inactive sites that may require closure work sooner. Also, the potential financial risk to the public depends on who is responsible for the liabilities.

(“[Liability Management of \(Non-Oil Sands\) Oil and Gas, Report of the Auditor General March 2023](#)” at 22 – 23, emphasis added)

Reporting on Liability Management

The foregoing discussion provides necessary context to grade the AER's [Liability Management Performance Report](#). One thing is clear: the Report does not provide the level or content of transparency called for by the Auditor General. Moreover, the Report fails to achieve even the AER's [own description of its objective](#):

This report tracks industry performance as it relates to liability management and the impact of the liability management requirements over time. The purpose of this report is to improve transparency about industry's management of conventional oil and gas liabilities and to develop performance measure baselines and ongoing assessments both of industry as a whole and licensees specifically. (at 1)

The Report is largely a presentation of aggregate data on closure activity and liability risk allocation. In the absence of goals and other measures to assess closure activity, this is not a ‘performance report’ – it is another exercise in public relations.

The Report has 5 sections. The first section – [Conventional Oil and Gas Infrastructure](#) provides data on the lifecycle status of wells and facilities (pipeline data is not reported). Of particular note and concern, approximately 40% of drilled wells in Alberta are either inactive or marginal

producers. Similarly, of the other existing facilities (i.e. not wells), 20% are inactive and the AER did not know the status of another 23% (though the AER was trying to determine their status in September 2023, see [Bulletin 2023-34](#)). These are shocking numbers for a regulated industry.

The second section – [Liability Estimates](#) provides the \$33 billion overall closure liability number, which vastly under-reports the actual liability number (as reported by the Auditor General and [noted](#) elsewhere) because it fails to account for pipelines and has been calculated on the basis of a system that the AER knows is flawed (see [here](#) and also “[A Made-in-Alberta Failure: Unfunded Oil and Gas Closure Liability](#)” at 13-19). Indeed, as far back as 2018, the AER was in possession of analysis (referred to as the Closure Liability Assessment Model CLAM) indicating that inactive liabilities (for wells, pipelines, and other facilities) were being underestimated by 263% (as compared to the estimates generated under *Directive 011*):

| CLAM – A more accurate assessment of liability | | | | | | | | | | | | | |
|--|-------|-----------|-----|-----|------|-------------|------------|-------------|-----------|-----|-----|-------------|-------------|
| Inactive Infrastructure Liability – May 2018 | | | | | | | | | | | | | |
| Method | Wells | | | | | | Pipelines | Facilities | | | | | All |
| Type | Ab | Site Ass. | Rem | Rec | Post | Total | Ab | Ab | Site Ass. | Rem | Rec | Total | Total |
| CLAM | 4.7 | 1.5 | 4.2 | 4.6 | 0.7 | 15.6 | 1.4 | 2.6 | 1.1 | 2.9 | 3.4 | 9.9 | 26.9 |
| D011 | 4.6 | 3.0 | | | 0.0 | 7.6 | 0.0 | 0.8 | 1.9 | | | 2.6 | 10.3 |
| CLAM % Increase | 1% | 337% | | | N/A | 205% | N/A | 329% | 399% | | | 378% | 263% |

\$ Billions

- Active Licensees only
- Inactive infrastructure liability only
- Does not include oilsands mines or Coal

DRAFT – For Discussion Purposes
18

AER Common Liability Assessment Model (CLAM) – August 17, 2018

The AER already announced their intention to update and replace their out-of-date liability estimate in November 2023 with [Bulletin 2023-41](#). That update will purportedly incorporate the data that generated CLAM, but the AER continues to rely on – and publish – estimates that it knows do not provide an accurate picture of current liabilities.

This section also provides a risk matrix on closure liability:

Figure 6. Licensee liability by magnitude of liability and level of financial distress



This data offers *some* measure upon which to assess risk based on who holds the liabilities, but of course these numbers would be expected to change drastically if liability estimates were increased 263%.

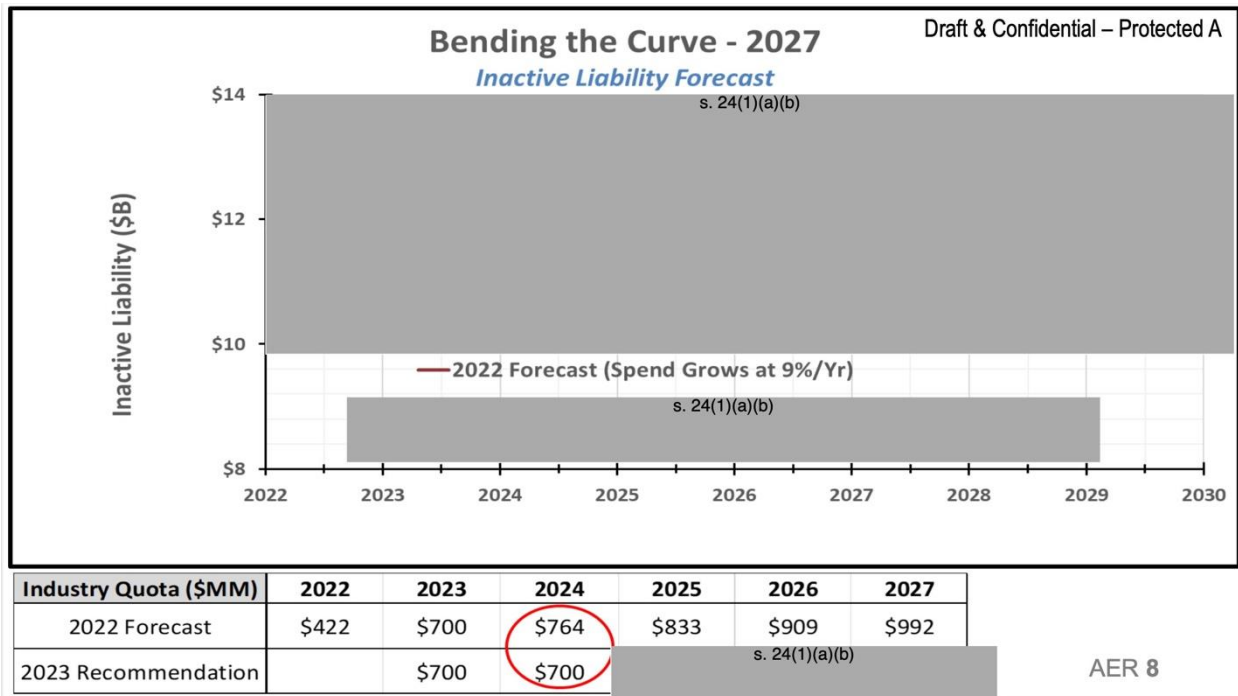
In any event, a footnote to figure 6 clarifies that for magnitude of liability, ‘high’ is \$150+ million, medium is \$25-150 million, and low is under \$25 million, but the Report does not assist the public in interpreting or giving meaning to the categories of low-medium-high for level of financial distress due to “confidentiality requirements”. It is also unclear to us how explaining the categories would violate the confidentiality of particular licensees. The end result is that in order to fully understand this matrix, a reader must go to [AER Manual 23](#) (see 2 - 4) to see how these categories are implemented. The Report provides no information whatsoever on how the AER has used or considered this information in its licensee capacity assessments or company-specific closure work quota requirements. In other words, even if we set aside the issue of (grossly) underestimating liabilities, highlighting in the Report that “[m]ost of the liability (76%) is held by licensees that are in low financial distress” is a misleading measure without additional information on how the AER actually uses this information to ensure those companies in good financial standing get to work on addressing closure liabilities and ensure there is no ‘liability dumping’ from financially-strong companies on to weak companies. Moreover, the AER refuses to disclose any licensee-specific assessment information – even for those seven companies in the “high” liability – “high” financial distress box. Presumably \$2.1 billion in liabilities are poised to be sent to the orphan well association, which receives only a fraction of that amount in annual levies from industry to pay for closure work.

The third section – [Closure Spend Data](#) and the fourth section – [Impact of Closure Spend on Liability Estimates](#) provides industry-level (and licensee-specific) spending on closure work and its impact on reducing inactive sites. The AER news release focuses primarily on this aspect of the Report, highlighting that industry spent above the quota amount. Interestingly, industry spent \$696

million in 2022, which is exactly the mandatory quota set by the AER for 2023 and 2024 (which has since been revised down from earlier estimates). Also, as the Auditor General observed, reporting on activity alone is hardly a ‘performance report’. The Report also clarifies that of the \$1.2 billion spent on closure in 2022, \$383 million is from federal taxpayers through the Site Rehabilitation Program (although the Report itself fails to mention this is federal money) and \$185 million is through the Orphan Well Association (and the Report also fails to note and specify how much OWA spending derives from government loans). The Report also fails to offer transparency on whether industry closure work is focusing on the ‘easier’ sites (which the Auditor General did note in their 2023 report, at 28: “...licensees tend to focus on completing low-cost well abandonment and reclamation activities”) – other than showing more than half of monies spent was directed to abandonment.

The fifth section – [Orphan Fund Levy](#) provides data on the orphan fund levy, closure work spending by the Orphan Well Association, and licensee-specific information on compliance with paying the AER-imposed levy. Similar to the information on closure spending in other sections, this data does not constitute a ‘performance report’ without some discussion of how the AER levy correlates with expected orphan fund workloads and future inventory levels.

The 2024 [Liability Management Performance Report](#) does not include future predictions or goals for the amount of inactive liability or total liability in Alberta. This is information the Auditor General noted they should be including. The omission is odd because requests filed under the *Freedom of Information and Protection of Privacy Act*, [RSA 2000, c F-25](#) have already shown the AER prepares this information internally:



The heavily redacted chart gives away why this information has not been made public: the AER’s current plan (which [no longer includes 9% annual increases to the mandatory spend](#)) will not see

total inactive liabilities begin to decrease until some point after 2027. This plan is unlikely to be popular with the public and it does not mesh with the AER's positive messaging.

Conclusion

Indications of regulatory capture at the AER continue to manifest themselves. The [AER's news release for the liability management report](#) spins an incredibly positive narrative for industry closure activity that has only managed to not keep getting worse over the past couple years in the midst of [record production levels](#) and \$1 billion from the federal government.

The release includes a quote from Laurie Pushor, AER president and CEO: "While this report is showing significant improvement, continued focus and effort is required to ensure the sustained downward trend in reducing inactive well count in the future." Can Albertans reasonably expect continued focus and efforts to reduce closure liability? We remain skeptical. From 2021 to 2023, \$779 million of the \$1 billion in federal taxpayer money provided for the site rehabilitation program was spent, so there is at most \$221 million in public money remaining for 2024 ([and possibly less](#)). The Orphan Well Association spending in recent years has also been bolstered by government loans (to the tune of \$500 million), and unless the orphan levy is greatly increased ([as it should be](#)), the OWA will have to reduce its spending to [repay those loans through to 2035](#). In other words, 2022 and 2023 appear likely to be all-time highs for action on reducing closure liability. Will annual spending remain at current levels, increase, or decrease? After abandoning its public commitment to setting 5-year spending forecasts, only the AER and industry know for sure. Even at current levels, whether \$800 million per year in closure work will be enough to eliminate this problem, and when it will do so, is unknown and uncertain because the AER refuses to be transparent on the real total liability numbers.

Excessive discretion continues to be a problem at the AER. Specifically in relation to this Report, there are no legislated requirements governing what information is in this Report, how it is presented, and when it is published. All of these determinations are made in the full discretion of the AER. The Auditor General is doing good work applying pressure to improve transparency, but almost a year has passed since the 2023 findings and recommendations on reporting and transparency, and these deficiencies remain unaddressed by the AER. The introduction of the mandatory spend requirement was a major improvement to Alberta's approach to liability management, but the effectiveness of the program is severely impaired by the fact that the spend quota will now be established annually by the AER in close consultation with industry, and the AER continues to refuse publication of far too much information and analysis on liability management held in its possession.

For all of these reasons, we grade the AER Liability Management Performance Report as follows:

F

This post may be cited as: Shaun Fluker, Drew Yewchuk, and Martin Olszynski, “Grading the AER Liability Management Performance Report” (8 February 2024), online: ABlawg, http://ablawg.ca/wp-content/uploads/2024/02/Blog_SF_DY_MO_Liability_Report.pdf

To subscribe to ABlawg by email or RSS feed, please go to <http://ablawg.ca>

Follow us on Twitter [@ABlawg](https://twitter.com/ABlawg)

