

Memorandum

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To: Laurie Pushor, CEO

Unintended consequences of Ministerial Order 043/2023 in Insolvency

The Orphaning & Insolvency Team (OI) has identified unintended consequences of Ministerial Order (MO) 043/2023, which requires energy companies to pay taxes owed to municipalities. When the direction is applied strictly without exceptions for assets being transferred out of insolvent or defunct companies, the MO will result in:

- Premature closure of productive assets;
- Orphan Well Association's (OWA) refusal to fund any go-forward receiverships, and associated sales processes, where a Licensee has ceased operations;
- Significant increases to orphan inventory, and corresponding increase to the Orphan Fund Levy to ensure sustainability and timely closure by the OWA;
- Decrease in industrial property base for future municipal tax assessment purposes, as the insolvent licensee's inventory and future tax obligations would not shift to new owners for continued contribution.

In the immediate term, the AER is concerned about the MO's impacts on the insolvency-related processes of Altabon Energy Ltd., Razor Energy Corp., and Sequoia Resources Corp. The total environmental liabilities of these 3 companies are over s.16(1) [REDACTED]. To put this into perspective, the total environmental liabilities in the OWA today is ~\$1 billion dollars. If the MO direction continues to be applied as written, requiring new purchasers to resolve all municipal taxes prior to licence transfers, there is a high risk that any sales processes contemplated will either not be initiated or will not be successful in transferring assets to new parties. This is expected to result in premature abandonment of resources by the OWA that could have otherwise remained in production by new parties and contribute to the future municipal tax base.

The AER met with Energy and Municipal Affairs on April 11, 2024, to share these consequences and to seek clarity in applying the MO. The AER was told that the MO is being applied as intended, and while

the GoA is aware of these consequences, they believe that a “market solution” through legal channels will allow assets sales in insolvency to continue.

Background

In the immediate years following the Supreme Court of Canada’s *Redwater* decision in 2019, the AER observed a sharp decline in lender-petitioned receiverships, and an increase in licensees ceasing operations if they could not successfully restructure through other insolvency processes. This was one of the drivers behind the expansion of the OWA’s mandate to allow them to appoint and fund receiverships.

The purpose of the OWA funding a receivership is to optimize the opportunity for assets to be sold / transferred to new licensees and therefore reduce the volume of inventory, and its associated costs, left to the orphan fund for closure. The choice on whether to fund a receivership is made when assessing how many assets are likely to be sold and transferred to new parties and weighing the anticipated reduction of those liability obligations against the costs to run the receivership sales process and conclude the file.

Recent sales processes from OWA-appointed receiverships have resulted in the following asset transfers, with associated liability costs that have moved to new responsible parties for production and/or closure:

- Trident Exploration: s.16(1) in deemed liability and 64% of Trident inventory (~2,335 wells, plus facilities and pipelines)
- Houston Oil & Gas: s.16(1) in deemed liability and 25% of Houston inventory (~356 wells, 15 facilities and associated pipelines)
- Bow River: 66% of Bow River Inventory (485 wells, 47 facilities, and associated pipelines)
- SanLing Energy: s.16(1) in estimated liability¹ and 28% of SanLing inventory (~624 wells, 73 facilities and associated pipelines)

All of the above inventory now held by new responsible parties would have been prematurely closed with associated closure costs borne by the OWA if the MO had been in place at the time of those insolvencies.

¹ This liability figure is from XI Technology provided by the Receiver, not per Directive 011 estimates as with the licensees above.

Impact on active insolvency files

In the immediate term, the Orphaning & Insolvency Team is concerned about the impacts of the MO on the sales processes of the following companies, given their significant tax arrears and significant environmental liabilities.

The information regarding tax arrears was provided by Municipal Affairs in February 2024 and is **not to be shared outside of the AER.**

Licensee	Tax Arrears	Status	Environmental Liabilities
Alphabow Energy Ltd.	s.16(1)(a)	Notice of Intention to Make a Proposal under the Bankruptcy & Insolvency Act	s.16(1)(a)
Razor Energy Corp.	s.16(1)(a)	Notice of Intention to Make a Proposal under the Bankruptcy & Insolvency Act	s.16(1)(a)
Sequoia Resources Corp.	s.16(1)(a)	Bankruptcy	s.16(1)(a)

The Trustee for Sequoia intends to commence a sales process in late Spring 2024, a process which will cost several hundred thousand dollars to run, funded by the OWA. The OWA has confirmed that **it will not support a sales process** if the bankruptcy trustee or a purchaser is required to pay the entirety of Sequoia’s municipal taxes owing before any applications would be considered. Sequoia was assigned into bankruptcy in April 2018 and it is assumed that municipal taxes continued to accrue in the six years of court proceedings to date.

It is expected that the same challenges will be seen in Alphabow and Razor’s sales processes, if purchasers must resolve all municipal taxes prior to licence transfers being considered.

s.16(1)(a)

In addition to standard licence transfers, many insolvent licensees continue to hold Public Lands Dispositions (PLA) to satisfy surface lease obligations for sites on Public Lands. These are also caught under Directive 088 requirements that result in AER rejection of any applications made for assignment or transfer of dispositions if either party to the assignment has municipal taxes or Crown debt owing.

Inability to transfer any assets, including associated Public Lands Dispositions, from an insolvent licensee to new responsible parties, is expected to reduce the non-residential/industrial property base for tax assessment purposes.

The OWA has concluded that it would see no value in funding any future receiverships given the uneconomic proposition of the OWA or purchaser required to pay all tax arrears owing by the insolvent licensee.

Regulator Directed Transfers (RDTs)

A company can take on an orphaned well, pipeline or facility through the AER's RDT process. RDTs provide opportunities for licence transfer to allow resumption of an existing wellbore and associated site by new mineral lease holders or remaining working interest participants associated with the well or facility.

The OWA is supportive of RDTs to enable production and associated closure by another responsible party. Following release of the MO, RDT interest has declined as the applicant is unable or unwilling to pay the entirety of municipal taxes owing by the Licensee of record/transferor to have a single well transferred. For example, Aeneid Exploration Inc. was a proposed Transferee of an orphaned SanLing well, that was previously unsold and discharged by the Receiver. In late March 2024, this RDT application was closed by the AER on the basis of SanLing having outstanding unpaid municipal taxes exceeding s.16(1)