Alberta Energy Regulator

Liability Management: Alberta’s Holistic Full Life Cycle Approach

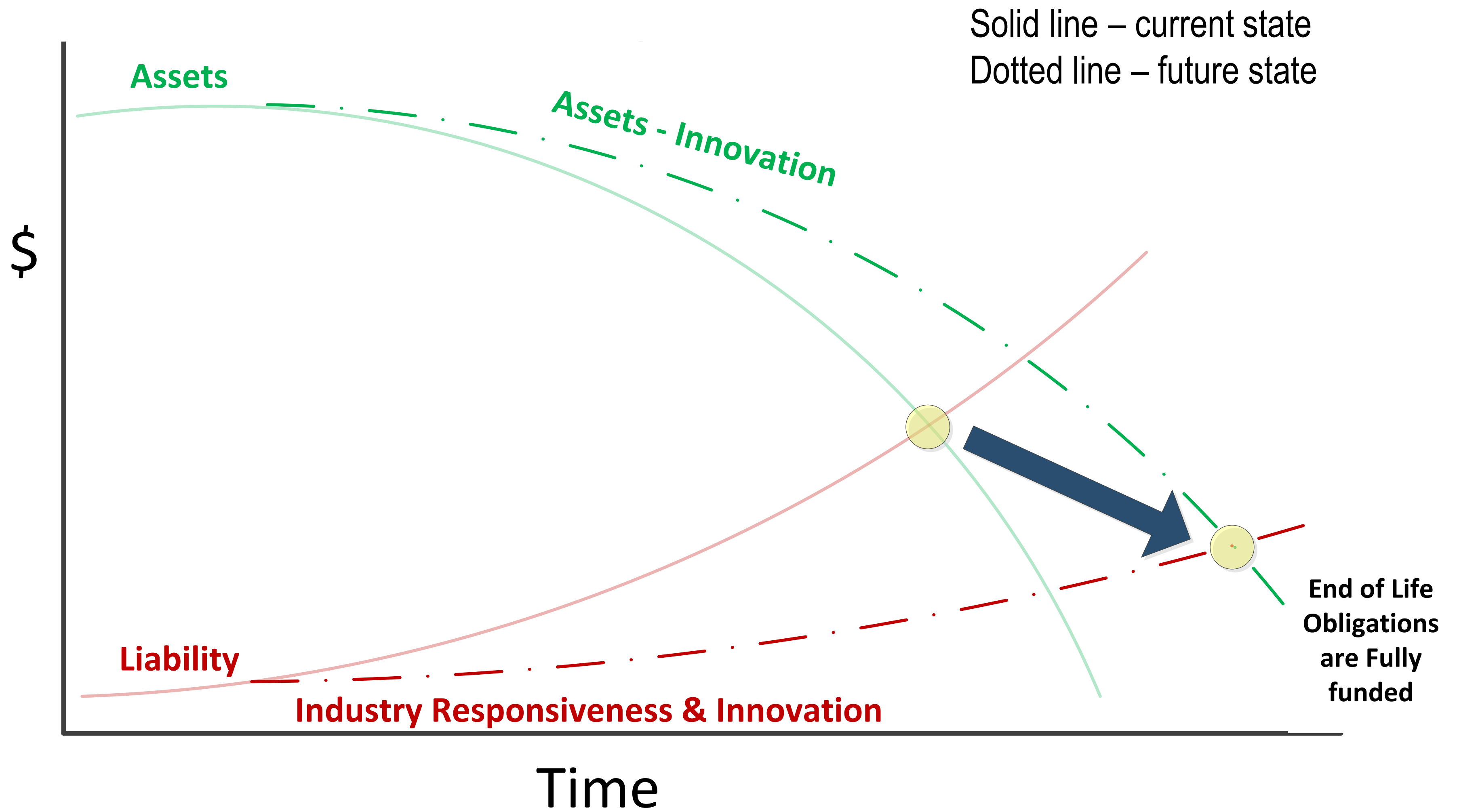
IOGCC Annual Conference

October 2023

Agenda

1. Strategy and Context
2. New Liability Management Framework
3. Progress and Next Steps

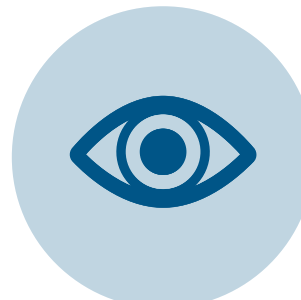
AER’s Long Term Strategy



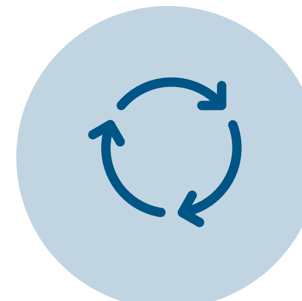
Situational Context for Oil and Gas

Mature basin

Period of prolonged economic downturn

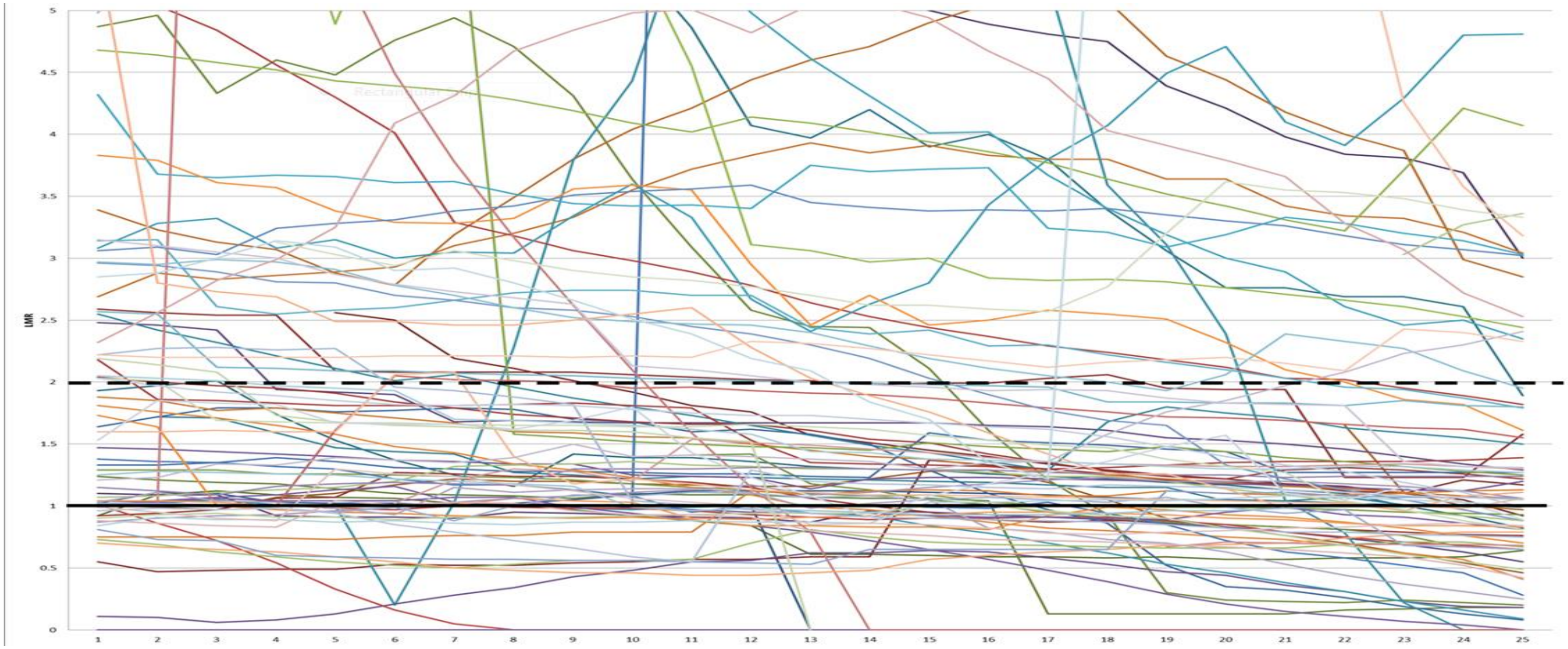


System is highly reactive



No holistic evaluation of licensee

LMR Fluctuation: Insolvent Licensees



- Graph shows companies with LMR numbers ranging up to 5.
- There were 5 additional companies who went insolvent with LMRs above 5.
    - LMRs were 6.35.6.36, 9.52, 23.41 and 23.45

Directive 067: Eligibility Requirements for Acquiring and Holding Energy Licence and Approvals

Revisions increase scrutiny and ensures eligibility is **granted to and maintained** by responsible parties

Acquiring and holding a licence or approval for energy development in Alberta **is a privilege**, not a right

Companies **must** provide financial information annually, and as required by the Regulator

Identification of additional unreasonable risks for obtaining and maintaining licence eligibility

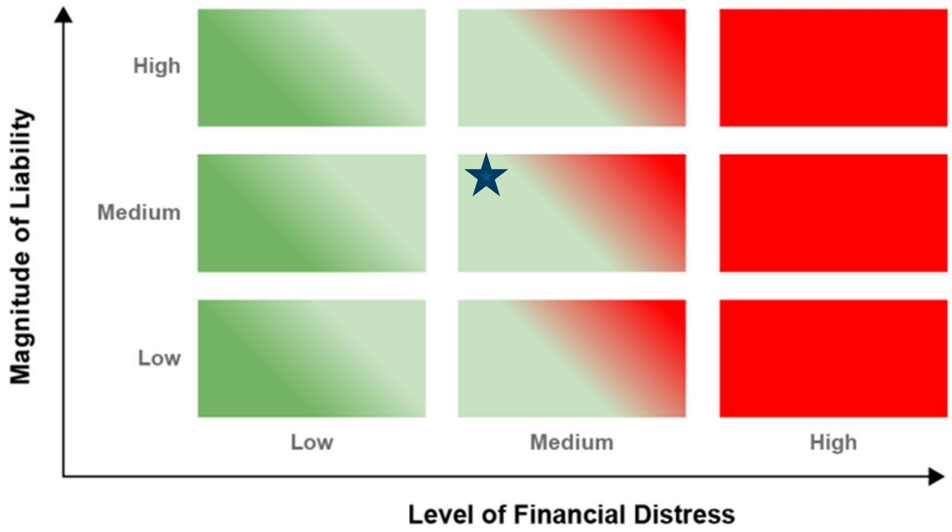
- *Additional criteria*
- *Resolve outstanding noncompliances*
- *Major changes in information or arrangements (e.g., Working Interest Participants [WIPs])*

Licensee Capability Assessment

Risk Groups

- **Financial Distress:** Assessment based on analysis of financial statements
- **Magnitude of Liability:** Estimated total magnitude of liability *(active & inactive),* including abandonment, remediation, and reclamation

➢ *Example of a licensee's level of financial distress relative to magnitude of liability*



Financial Capability & Risk Assessment

Table 2. Level of financial distress: parameters, definitions, risk ranges, and associated weightings

Parameter	Description	Low	Medium	High	Relative Weight
Net profit margin (three-year average)	Ratio of net profit over revenues, or the percentage of income kept as profit. This is averaged over three years to smooth unusual gains/losses in a single year.	>0%	≤0% and >−25%	≤−25%	30%
Current ratio	Ratio of current assets (i.e., cash and other assets that are expected to be converted to cash within a year) over current liabilities (i.e., amounts due to be paid to creditors within a year) to measure whether a company can pay their obligations as they come due.	>90%	≤90% and >70%	≤70%	30%
Debt to equity	A ratio of debt over equity to measure financial leverage, indicating the degree to which a company has financed its operations with borrowed money versus wholly owned funds. Debt includes amounts due to related parties and shareholders.	≥0 and <1.33	≥1.33 and <1.67	≥1.67 or <0	10%
Interest coverage ratio	A ratio of earnings over interest expense, used to determine how easily a company can pay interest on its outstanding debt. Earnings are before interest, tax, depreciation, amortization and various non-cash, one-time, irregular, and non-recurring items.	>3.0	≤3.0 and >2.0	≤2.0	20%
Cash flow from operations to debt	A ratio of cash flows from operations over debt, which indicates how easily a company can repay its debt. Debt includes amounts due to related parties and shareholders.	>35%	≤35% and >20%	≤20%	10%

Performance Group Factors

Performance Group Assessment Components

Performance Group Factors			
Remaining Lifespan of Resources	**Operational**	**Closure**	**Administrative**
Remaining lifespan of mineral resources and infrastructure, and the extent to which existing operations may fund current and future liabilities	Management and maintenance of regulated infrastructure and sites, including compliance with operational requirements	Rate of closure activities and spending, and pace of inactive liability growth	Compliance with administrative regulatory requirements, including the management of debts, fees, and levies

*Compliance is integrated into each performance indicator

Inventory Reduction Program

- **Closure Spend Quotas:** Minimum industry closure spend quota based on inactive inventory. Increasing spend requirement to bend the inactive liability curve
  - Based on financial health – capable and not capable

- **Closure Nomination:** Enables eligible requesters to request wells and facilities be closed that have been in an inactive or abandoned state for five or more years

- *Companies encouraged to apply an area-based closure approach to increase efficiencies and have budgets go farther.*

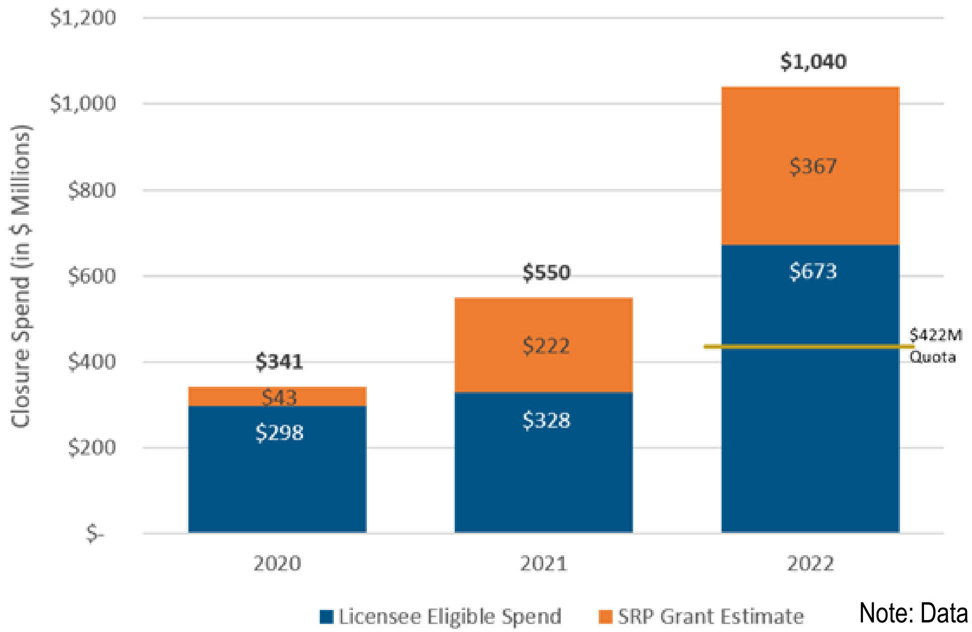
Area Based Closure Approach

- Drive economic and operational efficiency
- Economies of Scale
- Integrated planning and resourcing
  - Online platform
- Sharing of best practices and best technology

2024 Licensee Quota Approach

- Maintain two spend rate approach
  - **Capable: Low / Medium financial distress licensees:** focus on greater liability reduction
  - **Not Capable: High financial distress licensees:** balance liability reduction with maintaining infrastructure integrity and managing public safety and environmental protection
- Higher Spend Rate = 6.6%; Lower Spend Rate = 3.6%
  - Small adjustment to higher spend rate due to shift of companies from high to low distress
  - Most licensees will receive similar quotas to 2023

Closure Quotas Spending



Note: Data as of July 2023.

* 2022 Closure spend includes reported OneStop spends only (some Licensees did not report all SRP funded closure spends)

Licence Transfer Application & Security

Directive 088 (s 5.0) & Manual 023 (s 6.1.2):

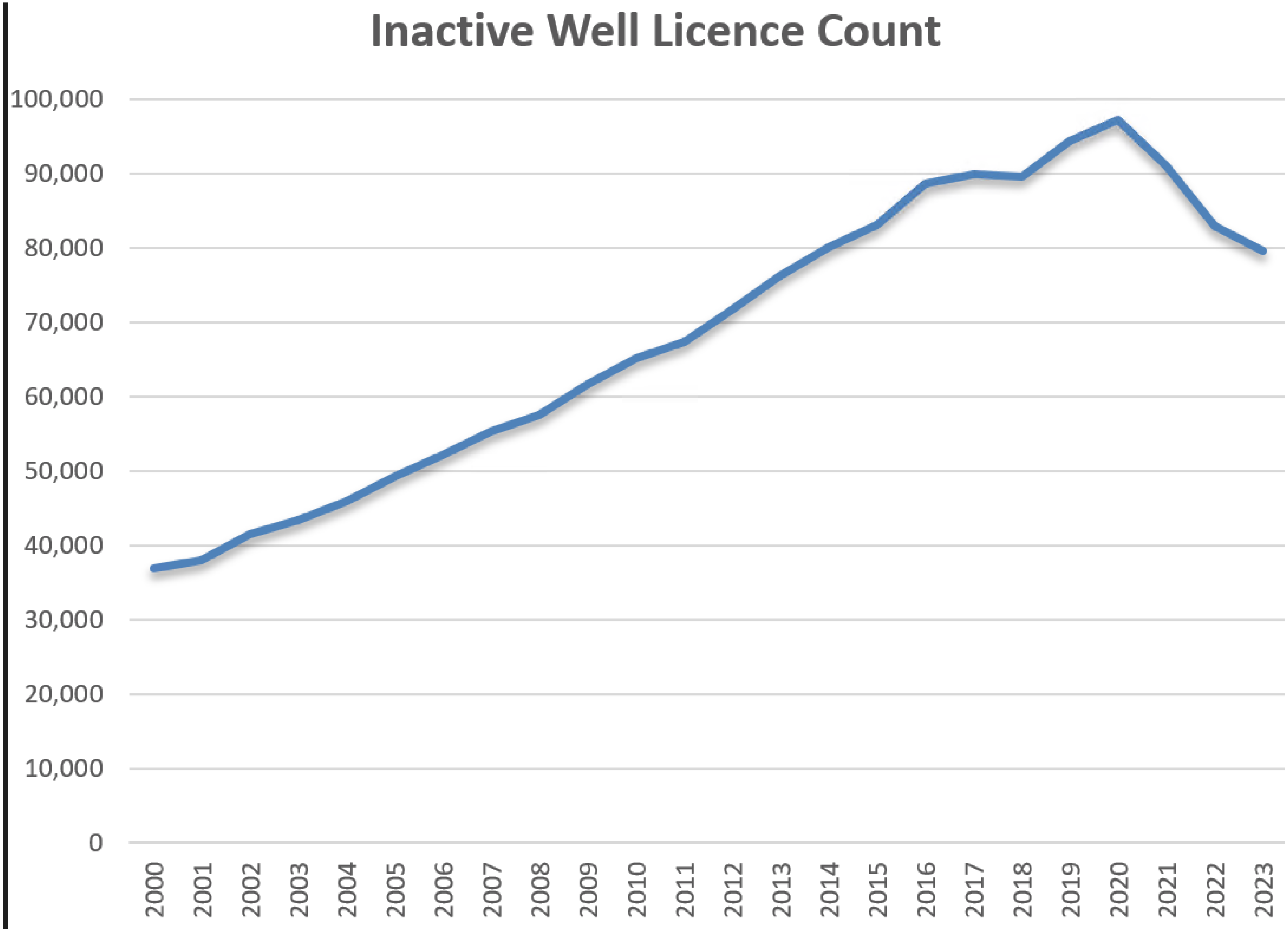
- A licence transfer application triggers a holistic licensee assessment (HLA) of both the transferor and transferee.
- The HLA is used to determine whether security deposits are required from the transferor or transferee to offset any potential *increase* in risk that may arise from a licence transfer application.
- Table 9 provides a sense of what security may be required

Table 9. Range of security that may be required at time of transfer based on financial distress and crossover timeline

Crossover timeline		Level of financial distress					
		Low		Medium		High	
Far	>7 years					26%	62%
Medium	3–6 years			26%	62%	74%	84%
Near	0–2 years	26%	62%	74%	84%	95%	100%

Note: Crossover timeline is the estimate of the timeframe when the magnitude of inactive liability will exceed the forecasted operations cash flow from remaining proven, developed reserves.

Initial Results



Next Steps

- Update securitization framework
- Update liability estimates
- Legacy fund
- Transparency of closure and liability performance
- Integrated liability approach for all energy sectors

? Questions

Thank you