

# Varcoe: Orphan wells and unintended consequences in the oilpatch



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An orphaned gas well on the ranch of Tony Bruder and family has been inactive for 60 years. The Bruder ranch is located near Twin Butte, Alberta. David Rossiter / Postmedia

Unintended consequences.

They're two of the most feared words in the language of business.

It's also something to be avoided when you're the powerful regulator of the largest oil and gas market in the country.

Alberta Energy Regulator CEO Jim Ellis says the agency's recent steps — making the bar higher for companies to transfer oil and gas well licences, following a precedent-setting court ruling — created “unintended consequences” last month.

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That ignited consternation in the oilpatch.

And that's why the AER recently clarified that its new rules won't unilaterally block transactions already moving through the deal-making pipeline.



Jim Ellis, Alberta Energy Regulator CEO

“Initially, we had to take action right away because of what was going on,” Ellis said this week.

“We put the first bulletin out in order to stop any of the bad actors that may have been out there that were looking to divest their stuff, move off and start another company up...

“We recognize that because we don't work in the whole market, we actually tripped and had unintended consequences with that.”

The background behind the affair is complex, but important for the industry, government and the regulator.

In late May, an Alberta Court of Queen's Bench justice ruled that revenue generated from the sale of a bankrupt oil and gas company doesn't have to be used to reclaim its old, non-producing wells.

The case, involving bankrupt Redwater Energy Corp., was seen as a showdown between the rights of secured lenders and the regulator's requirement to clean up these wells.

Chief Justice Neil Wittmann ruled the trustee could decide not to take over Redwater's idle, unprofitable wells — meaning about 70 would become orphans with no operator responsible for the clean-up tab.

In a province where 449,000 wells have dotted the landscape over the past century, it potentially has huge ramifications.

If the ruling holds, that would toss the reclamation costs into the lap of Alberta's Orphan Well Association, a not-for-profit group financed by industry.

Despite completing 185 well abandonments for the fiscal year ending March, the organization has seen its to-do list continue to grow, even before the Redwater decision. The association added 258 new orphan wells last year.

"The low commodity pricing in late 2014 and 2015 has resulted in an unprecedented number of corporate failures in the oil and gas industry, which has contributed to growth in the inventory of orphan properties," the association said in its new annual report.

The AER is appealing the Redwater ruling.

But faced with the court decision, the regulator also issued a directive last month that only companies with a liability management ratio (better known as an LMR) of 2.0 or above can buy well licences — double the previous asset-to-liability threshold.

With the change, however, only 28 per cent of the 788 oil and gas companies in the province meet the higher ratio. Those that don't meet the new hurdle will have to take additional steps (such as posting security) if they want to buy assets.

Industry groups and companies argued the regulator's response would threaten deals already in progress.

In a report issued this month, AltaCorp Capital said the problem with the AER's response was "the haste in which the policy was enacted which gave no forewarning to, and had little consultation with, industry."

Hit with mounting resistance, the regulator clarified the situation earlier this month. It noted companies

with deals already in process could contact it and “arrange a review of their specific circumstances.”

“It wasn’t an elegant counter-measure, but they didn’t have many tools in their tool chest,” said Brad Herald, a vice-president at the Canadian Association of Petroleum Producers and chair of the Orphan Well Association.

“It’s intended to be short-term until the public policy gap gets resolved.”

Ellis agrees the latest directive is an interim step until new regulations deal with the broader issue, or the appeal is decided.

The AER is encouraging companies now involved in M&A deals to contact it early, rather than wait until the end of the process.

“There are really good companies that were just below the 2.0 on the LMR that were in the midst of doing their negotiations and their work — that when the (first) bulletin came out, it actually tripped them and stopped them from doing that,” he said.

“That was not our intention.”

Energy Minister Marg McCuaig-Boyd said the interim rules will stay in place until the appeal process is held on the Redwater decision.

Despite the recent shift to soothe industry fears, that doesn’t mean everyone is satisfied.



Alan Tambosso with Sayer Energy Advisors. Christina Ryan / Calgary Herald

Alan Tambosso, president of Sayer Energy Advisors, which tracks Canadian oilpatch mergers and acquisitions, notes the AER’s latest step only helps transactions that are pending, not future activity.

He estimates only one-third of the 200-plus eligible acquirers under the new rules — or just 10 per cent of all licensees in Alberta — are potentially active purchasers.

"It's going to hurt the juniors more than anybody. It will severely impact their ability to do M&A transactions," he predicted.

Ultimately, Tambosso isn't happy with how the regulator has handled the imbroglio, saying its approach "appears to be poorly executed and poorly thought out."

But the energy regulator believes the initial turbulence has been smoothed out.

"Once we identified there were some unintended consequences as a result of the bulletin, we came out immediately and made those changes to it," Ellis explained.

"And we're quite confident and comfortable right now that, in fact, we're seeing what we anticipated."

*Chris Varcoe is a Calgary Herald columnist.*