

Licensee Capability Assessment: What We Heard

The Government of Alberta has updated its policy on how liability will be managed and has directed the Alberta Energy Regulator (AER) to revise and create new liability programs that will help provide a holistic assessment of companies. As part of this work, the AER is developing a licensee capability assessment that gives us better insight into a company's ability to deal with their regulatory requirements and liability obligations throughout the life cycle of energy development.

Along with the licensee capability assessment, the holistic approach includes new and existing liability management programs that will replace the licensee liability rating (LLR) program. Licensees will be assessed on more factors than just their liability management rating (LMR), which is a rating based on a company's deemed assets and liabilities. The licensee capability assessment will look at variety of factors, including a company's financial and liability risk, while also comparing similar companies based on their sustainability and quality of assets and administrative, operational, and closure performance. The assessment will consider more than 30 parameters.

More information about how the AER is implementing the Government of Alberta's policy direction is available on our [liability management webpage](#).

The Alberta Energy Regulator (AER) hosted three virtual information sessions with industry in January and February of 2021 to provide an overview of the upcoming licensee capability assessment. Each session included a formal presentation and finished with a question-and-answer period where any initial concerns could be addressed. More than 230 attendees participated.

Following each session, a survey was sent to all attendees for more in-depth feedback. A condensed version of the presentation was included with the survey to ensure industry had all the information when providing input, which was collected until the end of February. We also received input from industry outside of the survey throughout March and April. This report summarizes the input we received, what we have done in response, and next steps.

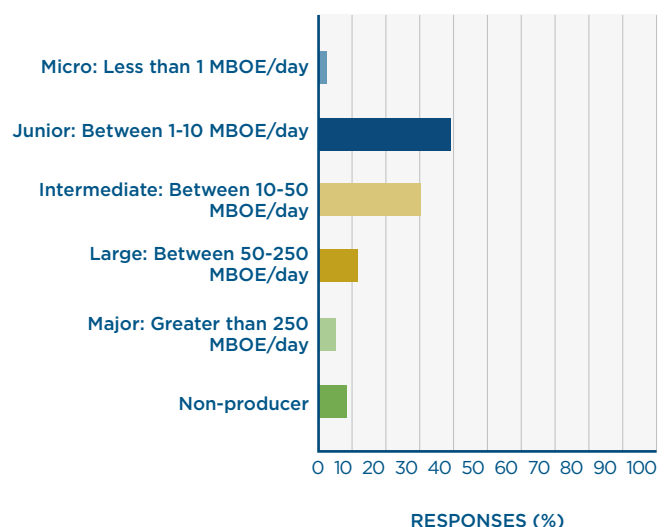
What We Heard

Initial Impressions

We received completed surveys from 37 companies that represented every size of company that we regulate.

Overall, 70% of respondents rated our approach to the licensee capability assessment as good, very good, or excellent.

What size of producer do you represent?



Confidentiality of Financial Information

We are very aware of the sensitivities around confidentiality of financial information for private companies.

We want to be very clear that all financial information that we receive through the licensee capability assessment—as required by *Directive 067: Eligibility Requirements for Acquiring and Holding Energy Licences and Approvals*—will be kept confidential for five to fifteen years, as outlined in section 12.152(2) of the *Oil and Gas Conservation Rules*. This confidentiality was added through changes to the *Oil and Gas Conservation Rules* and *Pipeline Rules* in late 2020. More information on this can be found in *Bulletin 2020-26: Changes to Oil and Gas Conservation Rules and Pipeline Rules*. Companies will only be able to view their own assessment information, and the AER may make some information public at an industry-wide level.

Peer Grouping

More than half of respondents had only a fair or poor understanding of our approach to peer grouping.

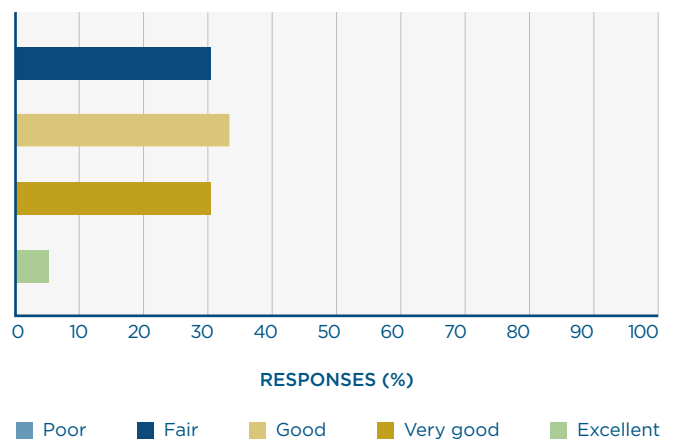
We clearly need to do a better job of explaining what peer grouping is and how it will support the licensee capability assessment.

It comes down to the fact that not all companies are similar. There are many differences—including production levels, size, and commodity type—that would make it unfair to draw comparisons between companies that are nothing alike. An example of where this is clear is natural gas producers and oil producers. It would not be appropriate to include a natural gas and oil producer in the same grouping; they face different challenges.

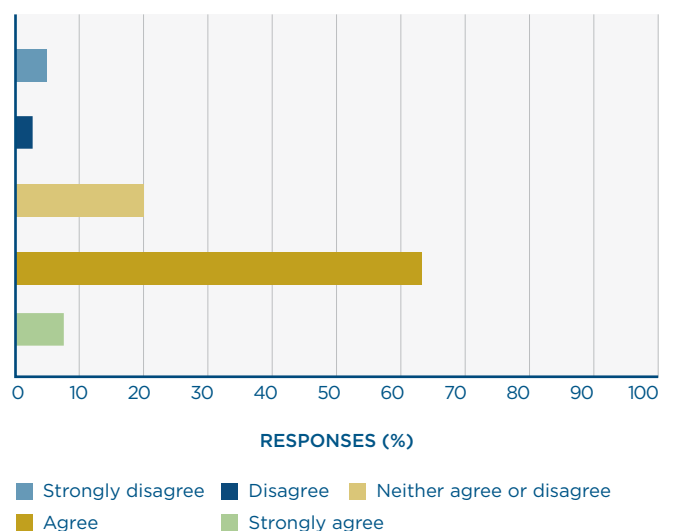
Peer grouping allows us to group similar companies together and gather a relative comparison within that group. We will use peer grouping to create comparisons between similar companies on their sustainability and quality of assets and their administrative, operational, and closure performance. Financial and liability risks will not be included in peer grouping as these two factors will be considered separately in our assessment.

We are confident that peer grouping will help identify those that are outperforming their peers and, combined with the financial and liability risk part of the assessment, will help to determine those that may require specific regulatory actions or steps to help improve performance.

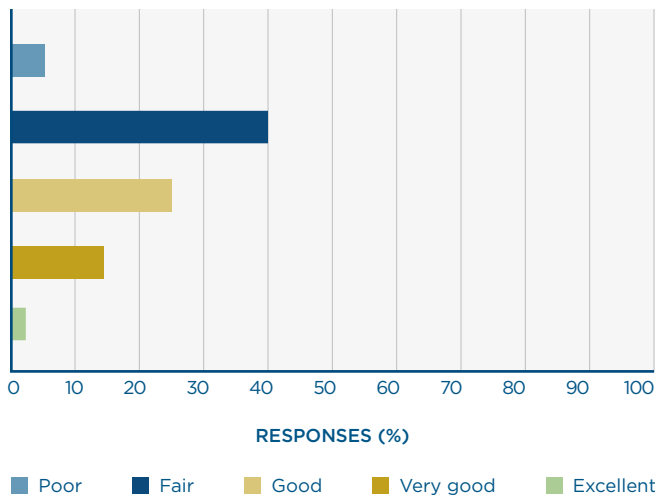
Please rate your overall assessment of our approach to the Licensee Capability Assessment.



To what degree do you believe the Licensee Capability Assessment will achieve its goal to better understand licensee's financial capability, long term sustainability, and closure operational and administrative performance.



How would you rank your understanding of AER's approach to peer grouping?



Parent Companies, Joint Ventures, and Working Interest Agreements

We heard concerns around the impact of the licensee capability assessment on companies with a parent company, involved in joint ventures, and involved in legal interests in assets—known as a working interest agreement. The AER only regulates the licensee, and we only assess the legal entity holding a licence. The financial status of a parent company is considered as context within which the licensee operates and will be incorporated in the consideration of a licensee's financial risk when appropriate. Joint ventures and working interest agreements are outside the AER's scope when determining the financial and liability risk of a licensee.

Additional Information

The AER may request additional information from a licensee and increase the frequency of reporting when a specific risk is identified through our assessment or during the review of an application. If we require further information to support our assessment, we will request

additional information to help understand the underlying issue and to support making regulatory decisions.

Liability Calculations

We heard concerns about the accuracy of the liability estimates and how the magnitude of liability will be used in regulatory decisions. These estimates outline the financial risk associated with each licensee based on the cost of closing out and cleaning up their sites. We know that our liability estimates need to be refined and are working to improve them by using industry-provided data on closure work being performed through the area-based closure program and inventory reduction program, which will introduce mandatory closure spend targets for industry in 2022.

Changes We Have Made Based on Feedback

Financial Risk Assessment

The financial risk assessment includes parameters derived and tested using Alberta data from both healthy licensees and those who ultimately failed. We used these parameters to evaluate oil and gas companies outside of Alberta, again on a range of financially sound and failed, and found that the assessment properly identified financial health. We also compared our parameters with those of well-known third-party credit rating agencies and found them to be aligned. All results were positive in identifying the financial health of most oil and gas companies.

Operating netback measures how efficient the licensee is at producing oil and gas by estimating the operating margin for each barrel of oil equivalent. We heard several valid concerns and feedback received about using operating netback to assess financial risk (e.g., not applicable to midstream, pipeline, and waste management companies who do not produce oil and gas). Upon further review, we have removed operating netback from our financial assessment.

In conjunction with removing netback, we have reassessed and adjusted the weighting of the remaining

financial risk parameters to ensure the assessment continues to identify financial health. We will continuously evaluate and review our financial risk assessment as we receive more financial data from licensees, and adjustments will be considered when appropriate.

Remaining Feedback

While not all feedback has resulted in changes to the licensee capability assessment at this time, we have documented changes that could be implemented at a later date. Some examples include publishing all parameters used in our assessment in an AER document and continued discussions with the British Columbia Oil and Gas Commission to ensure awareness and understanding of a similar assessment that they have implemented.

Next Steps

We provided an update on the licensee capability assessment to the Government of Alberta in late May 2021. The assessment will be introduced through a new directive and required revisions being made to [Directive 006: Licensee Liability Rating \(LLR\) Program and Licence Transfer Process](#). We will collect public feedback on proposed directive changes in the coming months and will issue a bulletin when any feedback period opens. We will continue to use the current transfer process outlined in *Directive 006* until the required directive changes have been implemented for the new liability framework and the licensee capability assessment, which we anticipate will be in fall 2021. The purpose of the licensee capability assessment is to support a more holistic assessment and use the results to drive regulatory decisions. It is important to note that we will continually be looking at ways to improve the effectiveness of the assessment; how it functions in its early days will likely evolve over time.



Submitting Financial Information

Under the new *Directive 067*, companies are now required to provide financial information to the AER when they apply for eligibility to hold a licence, annually, or at any other time when required by the regulator. A [new fillable form](#) (Schedule 3) has been added to *Directive 067* for companies to use when submitting the required financial information to the AER. 2020 financial information must be submitted within 180 days of fiscal year end. We encourage all companies to provide financial statements and Schedule 3 forms based on the fiscal years 2018 and 2019, if not already provided.