2013/14
Liability Management Rating Summary

BC Oil and Gas Commission

Table of Contents

Photos in this report are by BC Oil and Gas Commission staff.

About the

BC Oil and Gas Commission

The BC Oil and Gas Commission is the provincial regulatory agency with responsibilities for regulating oil and gas activities in British Columbia, including exploration, development, pipeline transportation and reclamation.

The Commission's core services include reviewing and assessing applications for industry activity, consulting with First Nations, cooperating with partner agencies, and ensuring industry complies with provincial legislation and all regulatory requirements. The public interest is protected by ensuring public safety, respecting those affected by oil and gas activities, conserving the environment, and ensuring equitable participation in production.

For general information about the Commission, please visit www.bcogc.ca or phone 250-794-5200.

Mission

We regulate oil and gas activities for the benefit of British Columbians. We achieve this by:

- Protecting public safety,
- Respecting those affected by oil and gas activities,
- Conserving the environment, and
- Supporting resource development.

Through the active engagement of our stakeholders and partners, we provide fair and timely decisions within our regulatory framework.

We support opportunities for employee growth, recognize individual and group contributions, demonstrate accountability at all levels, and instill pride and confidence in our organization.

We serve with a passion for excellence.

Vision

To be the leading oil and gas regulator in Canada.

Values

Respectful

Accountable

Effective

Efficient

Responsive

Transparent

2013/14 Liability Management Rating Summary

About this Summary

Decommissioning and restoration of oil and gas sites in British Columbia is regulated by the BC Oil and Gas Commission (Commission). Permit holders are required to properly deactivate and abandon wells, facilities and pipelines, and restore disturbances to meet regulatory closure. The purpose of the Liability Management Rating (LMR) program is to ensure permit holders carry the financial risk of their operation through to regulatory closure by identifying those whose deemed liabilities exceed deemed assets (a LMR below 1.0) and to require security for the risk inherent in the calculation. The objectives for the LMR program are as follows:

1. To protect the Orphan Site Reclamation Fund (OSRF), and ultimately the Crown, from bearing the costs associated with abandonment and reclamation activities.

2. To ensure adequate security is provided by permit holders to address the risk that oil and gas sites will not be adequately abandoned and reclaimed.

3. Provide incentive for industry to actively manage liability obligations.

The LMR is the calculated ratio of estimated operational assets and security deposit to estimated decommissioning liabilities for permit holders. The LMR equation is as follows:

$$\text{LMR} = \frac{\text{Deemed Assets} + \text{Security Deposit}}{\text{Deemed Liabilities}}$$

Additional information can be found at: http://www.bcogc.ca/industry-zone/liability-management-rating-program.

This report outlines the measurement of key indicators that are used to determine the amount of permit holder liability the Commission is exposed to, and how the risk exposure changes over time. The metrics are used to evaluate whether the goal of reducing liability exposure to the Orphan Fund is being accomplished.

Background

The authority to collect security falls under Section 30 of the Oil and Gas Activities Act. A permit holder's LMR is used to determine the amount of required security. Following the release of the LMR program, a deemed asset calculation was developed to determine the estimated value of a permit holder's production, processing and disposal infrastructure, and a liability model was developed to estimate abandonment and reclamation costs.

If a permit holder's deemed asset is not sufficient to cover their deemed liability (a LMR below 1.0), security is required. At the time of the LMR program launch for producers, disposers and processors (non-producers), each permit holder identified with a LMR below 1.0 was granted an opportunity to pay security in installments. During normal program operation, LMR reviews are conducted bi-monthly and during asset transfer processes for all permit holders. This allows the Commission to increase security deposits should a permit holder's LMR decrease as a result of a divestment, or a drop in production or throughput. Deposits are returned to permit holders who no longer have assets in B.C. (by regulation), or made a request for a return due to an adequate LMR.

Glossary:

Producers - Permit holders whose operations and deemed assets are primarily in the form of gas and/or oil production.

Disposers - Permit holders whose operations and deemed assets are primarily in the form of downhole oil and gas waste disposal.

Processors - Permit holders whose operations and deemed assets are primarily in the form of processing raw gas into marketable gas.

Permit Holder LMRs

The Commission measures the mean (average) and median (central point) LMR of all B.C. producers, disposers, and processors to spot trends in the overall ability of the industry to meet its closure obligations. Identifying trends that may be indicative of lower industry financial health can inform the Commission of when program changes may be needed.

The following figures illustrate the mean and median LMR for permit holders with time in each business category.

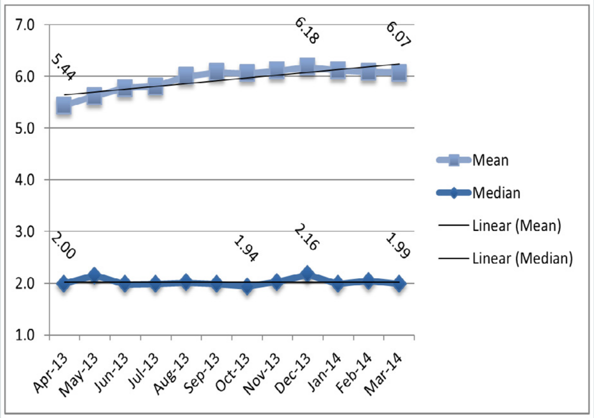

Figure 1 - Mean and Median of Producers

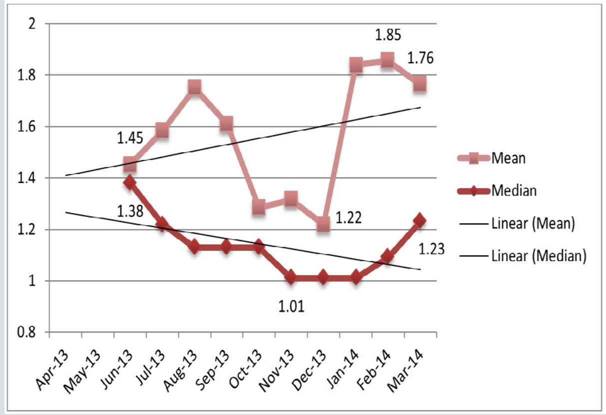

Figure 2 - Mean and Median of Disposers

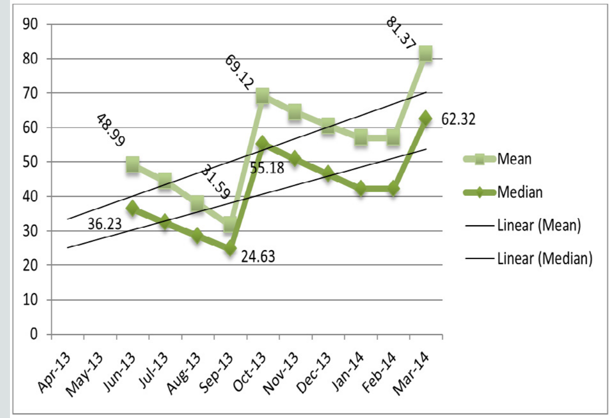

Figure 3 - Mean and Median of Processors

In Figure 1 the mean trend has been consistently increasing, whereas the median trend has remained quite constant. A closer look at the dataset suggests that a small proportion of the producers with high LMRs had considerable gains over the year, which had put upward pressure on the mean. While the more typical (mean) LMR is quite strong, the data is skewed and the median indicates that a greater proportion of operators are well below this level.

While a significant dip in the mean of disposers (Figure 2) can appear drastic, this is not unreasonable or unexpected in a small dataset like disposers. The dip was the result of a significant drop in one permit holder's LMR due to the return of security that was not required. The median trend indicated an overall health that reached barely acceptable levels; however, that trend is expected to increase.

As is the case with disposers, processors (Figure 3) are a very small data set where changes in the data significantly affect the mean and median. Eight of nine processors are significantly above a LMR of 1.0 without the need for security; their LMRs are therefore driven by operational assets which can be volatile. The increasing LMR in both trends indicates the strong health and continuous improvements for all processors.

Note:
1. Data for processors and disposers is only available from June 2013 onwards, when non-producers were included in the program.

At-Risk Permit Holders

Permit holders are identified as a potential financial risk (at-risk) if the total of their deemed assets and security deposit are less than deemed liabilities. The following figure illustrates the proportion of B.C. permit holders that were found to be at-risk with time.

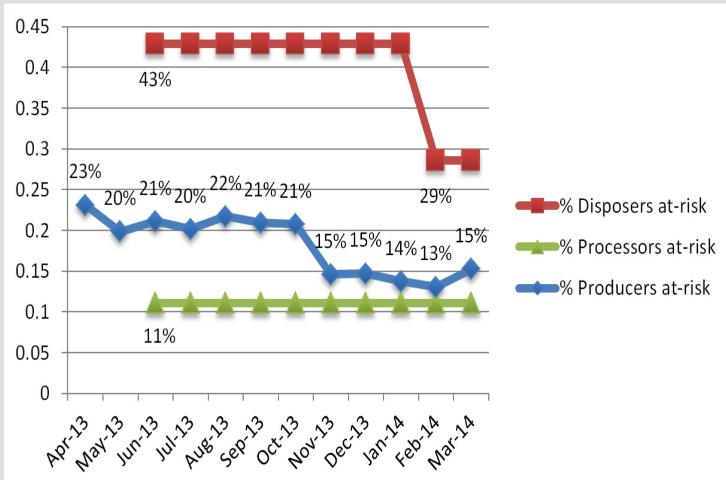

Figure 4 - Percentage of Permit Holders Below Threshold

Reclamation process.

The program identified a general decline in the number of at-risk permit holders during 2013/14, indicating that the number of permit holders with potential financial risk in their operations is contained, and even decreasing. Performance targets set by the Commission expected the proportion of at-risk producers to be 22 per cent at the end of fiscal 2013/14. The actual proportion of at-risk producers at the end of 2013/14 was 15 per cent, indicating the LMR program has reached and exceeded this performance target.

Significant drops in the percentage of at-risk permit holders are evident for producers in November 2013 and for disposers in February 2014. This can be attributed to payments made by permit holders that were granted the ability to pay in installments at program launch.

Note:
2. This target measures the proportion of at-risk permit holders rather than the total number of at-risk permit holders since the total permit holder count changes over time (e.g. a reduction in the count will raise the target percentage).

Unsecured Liability

The LMR framework focuses requests for security to at-risk permit holders. Unsecured liability refers to the amount of deemed liability that exceeds the deemed asset in the calculation and is not covered by a security deposit.

Security deposit requirements fluctuate over time as the number of at-risk permit holders change (e.g. corporate reorganization or production changes). At the time of LMR program launch in November 2011, the amount of unsecured potential producer liability was approximately $37.7 million. At the beginning of the 2013/14 fiscal year this number had dropped significantly to approximately $8.7 million. This was due to a combination of the collection of security deposits and corporate reorganizations. Figure 5 illustrates the total amount of estimated liability requiring future security payment by at-risk permit holders.

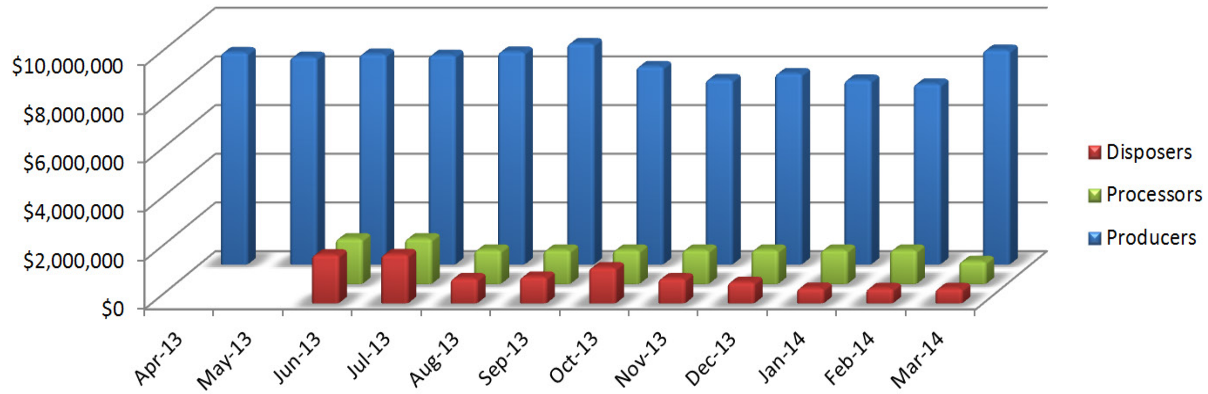

Figure 5 - Total Unsecured Liability by Month

During the 2013/14 fiscal year the amount of unsecured producer liability remained relatively stable, fluctuating by $1.66 million and ending the year at $8.8 million, slightly above where it started.

Non-producers were included in the LMR program for the last 10 months of fiscal 2013/14. In that time the combined unsecured liability of disposers and processors has decreased by 60 per cent from $3.9 million to $1.5 million. With more stability in asset ownership, this decrease is due to the collection of security deposits and an increase in calculated operational assets.

High Risk Permit Holders

The LMR program works with all willing permit holders to reduce their unsecured liability through the submission of security deposits, divestment advice, or liability reduction through asset retirement. Permit holders that have not complied with security deposit requirements are deemed deficient under Section 30 and enter a compliance and enforcement framework. During the 2013/14 fiscal year, seven high-risk permit holders were deemed non-compliant and an additional two were identified as potential orphans. The Asset Integrity & Retirement branch monitors high-risk and non-compliant permit holders and actively seeks solutions to retire the asset. Requests for specific details related to high-risk permit holders can be directed to the Commission.

Closure

Fiscal 2013/14 saw significant success in the LMR program with a decrease in the overall percentage of permit holders deemed at-risk, and a decrease in the total unsecured liability for non-producers. While the percentage of producers owing security has decreased, the total unsecured liability has remained relatively stable. This indicates that the deposit requirements are increasing in size for some at-risk permit holders.

There are a number of at-risk producers still in varying stages of securing their deemed liability and it is expected the majority will continue to submit security as required. This will result in a more significant decrease in the amount of unsecured liability for producers by the end of fiscal 2014/15. An update to the parameters used in the producer asset calculation in November 2014 may result in a spike in unsecured liability and the percentage of at-risk producers for a number of months this coming fiscal.

The program will continue to focus on further reducing non-producer risk through active engagement and efficient communication. Non-producer unsecured liability is expected to continue to decrease as they remain compliant within the phased deposit-payment schedule.

For more information on the Commission’s LMR program, OSRF or enquiries regarding this document please contact Mike Janzen at **Mike.Janzen@bcogc.ca.**