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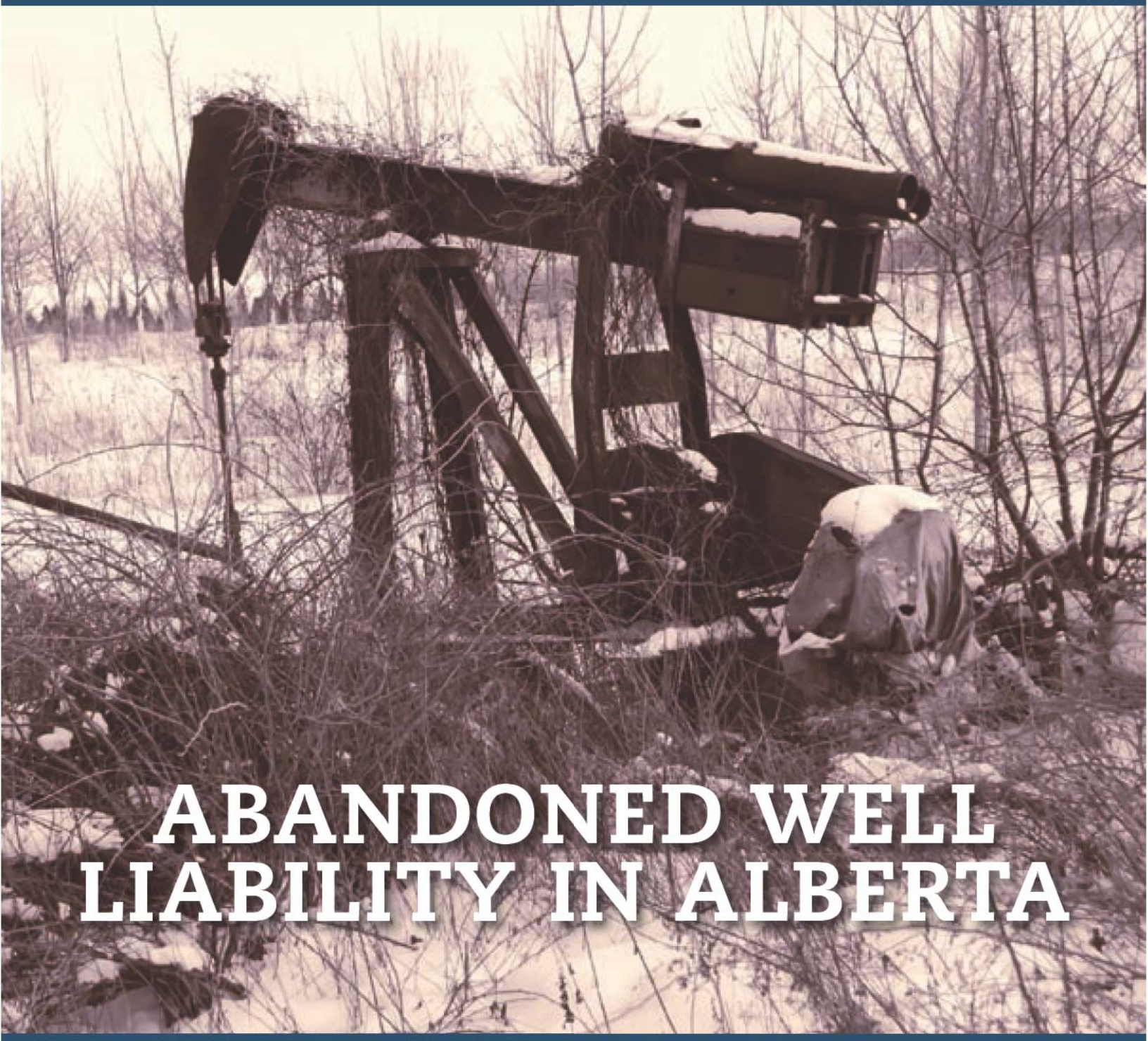

ABANDONED WELL LIABILITY IN ALBERTA

Look What's Surfaced
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How Regulatory and Accounting Rule Changes Impact Inactive Wells
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CAPL Member Profile
Greg Strachan

Abandoned Well Liability in Alberta

(Regulatory vs. Contractual Obligations)

A RECENT FRONT PAGE HEADLINE IN THE *CALGARY HERALD* STATING "FIGHT BREWING OVER DORMANT WELLS" reminded me again about the scope of regulatory and contractual liability lurking in background of acquisition and disposition activity in Alberta. Abandoned well liability is one of those issues that everyone kind of thinks about, but since the costs are not immediate, the issue tends not to be a focus in transactions.

However, as the WCSB matures, many of these old, stinky, abandoned wells will have issues with vent flow leaks (including sour gas), cement plugs crumbling, pressure build up in old fields and surface contamination clean up from junk oozing

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out of cracked plugs. These issues, combined with a more active ERCB oversight function and less tolerant land owners, means that many companies are now dealing with abandoned well issues more often than they would like.

Licensee Liability (That's Not Our Well Tough Luck)

The first call will almost always come from the ERCB. A problem will be identified with an abandoned wellbore and the ERCB will contact the current licensee and tell them to fix the problem, pronto. In many instances you will have a meeting, do a little research and with some confidence come to the conclusion that the well in question is "not your well". Thank goodness. Call the board back and explain the misunderstanding. Problem solved, right? Wrong.

The Oil and Gas Conservation Act (OGCA) makes it abundantly clear that continuing liability for abandoned wells is firstly the responsibility of the current licensee. No ands, ifs or buts. The ERCB is not concerned with who "owns" the wellbore. It is concerned only with who is shown as the licensee in its records.

From a public policy point of view this makes sense. Under this approach the ERCB does not need to get involved in complicated and nasty legal fights over where ownership finally ends up. Believe me, this becomes a very complicated question very quickly (as discussed below). If you are the licensee in the ERCB's records, you fix the problem, period.

Compliance with this policy is ensured through *Directive 019*, which provides for company wide consequences for noncompliance. This means the Board can move you up the noncompliance matrix and ultimately place your company on global refer status or issue closure orders on all your licensed wells, facilities and pipelines if you do not follow their remediation plan for the abandoned well you don't own. As the Borg say, "resistance is futile".

Insolvent or NonExistent Licensees

The next big surprise comes when the ERCB identifies a problem well but it turns out that the current licensee is insolvent or nonexistent (i.e. corporation is dissolved). One might think that it is these types of situations that the orphan well fund was created for. In a sense it was, however the board only dips into public money as a very last resort. If the current license cannot pay or does not exist the board will look to two other categories of persons to affix liability:

- Other working interest participants (WIP) in the well (OGCA Sections 27 and 29); and
- Prior licensees or WIPs (OGCA Section 31).

I remember a situation a few years ago where a licensee became insolvent and this triggered the board to demand the abandonments of about 10 to 15 wells. By this time the ERCB License Transfer Application (LTA) had already been amended to require that on transfer of well licenses, not only the transferee but the WIPs in the well were included on the transfer. So, the board sent a nice letter to the next largest WIP listed on the transfer and advised them that all the wells had to be abandoned (in about 90 days). Needless to say, this had an impact on my client's development budget for that quarter.

Then we have the prior licensee liability problem. Think back to all those very clever deals where you sold an ugly old field to a Newco when prices went through the roof last year. They paid top dollar for current production and did not even notice all the abandoned junk that you dumped in the deal. Now Newco is out of cash and is noncompliant with the board. Abandonment orders are coming from the board and Newco is broke. Who is the board going to call? Wait for it. You. Even though you were able to foist contractual liability on Newco, the board does not care. If Newco cannot pay, you must pay. Me thinks this should at least be a consideration in deciding which bidder you select on disposition programs.

Contractual Liability (The Sale Agreement Chain)

Let's take a step back from regulatory liability. As important as it is with respect to what you must do in the first instance when the ERCB calls, you cannot forget that regulatory liability has nothing to do with who is ultimately responsible to pay for the abandonment or clean up costs for a given wellbore.

Ultimate responsibility always rests with who owns the wellbore or who agreed to be liable for past, present and future environmental liability. These matters are dealt with in sale agreements.

There will often be a total disconnect between regulatory liability and contractual liability. This is where you need to dig into all the old sale agreements back to when the well was drilled. You need to try to figure out who is responsible for the well down the chain of ownership and then almost certainly start a court action to sue the ultimately responsible party (and everyone down the liability chain) to recover your costs for cleaning up the mess. Many nasty letters will be circulated. It is not a simple question. It will often take years to resolve.

There are a couple of general trends in sale agreements in Alberta transactions that you can consider as you are trying to figure out the chain of liability:

- Many older sale agreements were "white map" sales of all of a company's assets and liabilities in a particular area. This means all wellbores on the lands, within a defined area, or used in relation to operations are considered part of the sale; and

- In such agreements, environmental liability for all abandoned wells (and facilities) in the sale area was conveyed to the purchaser. In a somewhat unique indemnity clause, the purchaser agrees to be liable for environmental liability in the past, present or future with respect to such abandoned wells.

This means that most abandoned wells (and liability for same) were conveyed to the purchaser. This would continue in each subsequent sale of lands in the area over time.

Depending on the definitions of "Assets" and "Wells" in the sale agreement, such liability would attach to all wells in the area, not just those on the well schedule. It can get very complicated trying to figure out if an abandoned well which isn't on a well list falls under the "Assets" or environmental indemnity in a particular agreement. It only gets worse the longer the well has been abandoned. Again, tough questions that result in most vendors and purchasers down the chain being named in the lawsuit to recover costs.

For an excellent walk through of a sale agreement with respect to the issue of whether an abandoned facility was an "Asset" see Justice P.A. Rowbotham's decision in *Anadarko Canada Corp. v. Canadian Natural Resources Ltd.* (ABQB 2006 CarswellAlta 1000).

Inability to Transfer Abandoned Well Licenses

Since about 2000 we have additional complexity with regard to abandoned well liability in Alberta. The Board in its infinite wisdom decided that it would no longer allow the transfer of licenses for abandoned wells. This was later amended to disallow the transfer of licenses for abandoned and reclamation certified wells.

This regulatory change created a huge disconnect between contractual liability and regulatory liability. Following the general sale agreement trends discussed above, liability for many abandoned wellbores would be conveyed to a purchaser. However at closing, we were unable to transfer the licenses for the abandoned wells to the purchaser since the EUB (at the time) would reject well transfers that included abandoned wells.

So now there are thousands of abandoned well licenses trapped in the name of upchain vendors, while contractual liability has flowed down chain to the current purchaser/owner of the lands. The ERCB contacts the licensee (being the guy unlucky enough to have held the well license on abandonment) and it must initiate the clean up.

That company then tries to work its way down the corporate liability chain to see who it can recover its costs from. Let's just say that not very many down chain companies rush to reimburse the licensee for its costs. Honestly, I cannot blame them. The question of where the liability ball finally stops is really tough to figure out. Going to court is often the only answer.

Recent Sale Agreement Trends

The ERCB decision to deny the transfer of abandoned wells (and the colliery problem of the ERCB noncompliance consequence of transferring any well licenses on expired mineral rights) has lead to some subtle changes in sale agreements that only further complicate the abandoned well liability issue.

The definition of Wells will often now exclude abandoned wells, or abandoned and reclamation certified wells and even any wells on expired mineral rights (other than injection or disposal wells). This may be partly due to purchasers not wanting to take on unknown future environmental liabilities not tied to active asset. However, the change is being facilitated by vendors who have an innate desire to have the ERCB LTA match the well list in the sale agreement.

From a purchaser's point of view this change is all good. However, for a vendor it may mean that abandoned well liability will now stop with you and not move down the purchase and sale chain as had occurred in the past.

For the poor licensee, this means even more complications in trying to figure out who is the party contractually responsible for clean up costs.

Joint Venture Partner Liability (Where do I send the JIB?)

An entire article could be devoted to the ancillary question of joint venture partner liability for abandoned well clean up costs. Problems include:

- determining which partners are responsible, current partners or partners when the well was abandoned;
- when does a JOA terminate with respect to abandonment liabilities;
- if the JOA has terminated, does that mean the licensee/operator is responsible for 100% of the costs;
- what happens when you stop issuing NOAs for JOAs with only abandonment liabilities; and
- why the heck do we do full NOAs for JOAs on lands where abandoned wells were excluded in the sale agreement (disclaimer I am guilty of doing this just like everyone else. Try sending out a partial JOA excluding only abandoned wellbores and see how the third parties react).

It really makes my head hurt. Needless to say, when your regulatory or accounting guys ask you to ok a JIB for an old abandoned well, you should quietly move the request into someone else's inbox. Really, really tough question to answer.

The Orphan Well Fund

Lastly, a quick comment on the orphan well fund. It still exists under the OGCA and provides a mechanism for the licensee (or other party who gets directed to act) to recover the defaulting WIP's share or suspension, abandonment and reclamation costs. This will be relevant where you have insolvent partners, which unfortunately might occur more often over the next little while. I have only dealt with the fund once (years ago), however the process was relatively painless. Simply fill out a form after you have calculated the defaulting WIP's share of the cost and the board reimburses you from the fund if it agrees with your claim.