

# Intelligence MEMOS



From: Grant Bishop and Ben Dachis  
To: Albertans Concerned about Orphan Wells  
Date: February 14, 2020  
Re: **LET'S GET THE PRIVATE SECTOR INTO ORPHAN WELL CLEANUP PRICING**

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There are now more than 3,400 old or spent oil and gas wells across Alberta, and the environmental risk is high and rising.

So are the financial liabilities. The public cost for remediation could be in the billions of dollars if companies designated as “financially fragile” by the Alberta Energy Regulator (AER) simply abandon their wells to the taxpayer – an extreme scenario that is not beyond contemplation. A 2017 C.D. Howe Institute [analysis](#) said the number could reach \$8 billion.

The AER has faced [increasing pressure](#) to change the system and says it will have a proposal by April. Currently, the AER uses the valuations of operators’ assets to determine whether a company is financially fragile. This calculation, which can be unreflective of market prices, may underestimate company vulnerabilities.

To misquote Tolstoy: happy oil and gas companies are all alike, but every unhappy oil and gas company is unhappy in its own way.

The scale of potential liabilities requires a fundamental change in approach. There is a better way beyond just reducing the reliance on arbitrary regulatory rules: allowing the private sector to step in to help achieve provincial cleanup goals and put an accurate price on the riskiness of companies.

The Supreme Court of Canada’s decision in *Orphan Well Association v. Grant Thornton* (also known as the Redwater case) last year effectively prevents trustees from “cream-skimming” good assets from bankrupt companies while leaving the public to hold the bag for remediation costs. Nonetheless, the decision did not solve Alberta’s exposure to unfunded cleanup costs.

In the immediate term, the AER needs to be better attuned to the potential for pre-insolvency companies to “dump the dregs,” where an operator conserves the best assets in an ongoing entity, while transferring costly cleanup liabilities into fragile companies. This is what sunk Sequoia Resources and left the AER with a \$225-million cleanup bill, [alleges](#) the company’s bankruptcy trustee.

Second, to reduce public exposure, Alberta should gradually introduce additional bonding requirements that shift environmental liabilities to operators and their creditors. This would leverage the private market to assess and price the credit risk for particular operators. For example, any financial institution issuing a letter of credit for environmental liabilities would need to closely scrutinize a given company’s solvency. Government oversight would merely be the requirement that all companies have the third-party financial security available to clean up their wells.

This has the potential to be expensive and the current fragile state of Alberta’s exploration and production companies cannot be ignored. A phase-in period and varying requirements by company size, cash flow, or production are possible tools to soften the impact.

But in the end, the province must plot a clear path to address the looming risks and provide a schedule for ramping up operators’ obligation to post adequate financial security.

And then there’s the issue of the remediation of oil sands mines, whose fiscal scale dwarfs the well problems. As of June, 2018, the AER [held](#) \$1.46-billion in financial security – \$940-million of that on behalf of oil sands mines – against an [estimated](#) \$31.4-billion liability for oil sands and coal mines. This liability would be equivalent to roughly 9 percent of Alberta’s GDP and more than half the provincial budget.

By requiring oil sands miners to provide collateral to cover their expected remediation costs, [Alberta’s financial security program](#) is a step in the right direction. However, the government policy on oil sands mines falls into the same trap of governments and regulators attempting to quantify something that private insurers can likely do better. A 2015 auditor-general’s [report](#) said the province used the wrong asset calculations to reflect risk, underestimated the potential impact of future price declines, and did not vary the treatment of proven versus probable reserves. The private sector would have every incentive to get these numbers right.

Given the scale of the potential liability, it is essential that Alberta ensure the adequacy of financial security for ultimate environmental cleanup and structure programs to promote progressive closure and prompt remediation. If the government does not fix the problem, taxpayers and financially healthy oil and gas companies will need to foot the cleanup bill. And then everyone would be unhappy in the same way.

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