Statement in Opposition of SB18-63
Oil Gas Higher Financial Assurance Reclamation Requirements

The Surety & Fidelity Association of America ("SFAA") is a non-profit corporation whose member companies collectively write the majority of surety and fidelity bonds in the United States. SFAA is a licensed rating or advisory organization in all states and is designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience. SFAA members write the vast majority of bonds that secure regulatory obligations. The American Insurance Association (AIA) is an insurance trade organization that represents more than 320 insures, which write all types of property-casualty insurance products, including surety bonds.

SFAA and AIA believe that the bond obligations proposed by Senate Bill 63 may unintentionally have a negative impact on the permit bond market for oil and gas well operators.

A surety bond addresses the risk of uncertainty of performance. In the case of a reclamation bond, the government entity wants assurance that the oil or gas permittee will complete its reclamation plan. A surety provides this assurance by thoroughly reviewing the permittee's financial strength, experience and resources and providing a bond that will give the government entity financial protection in the event the permittee defaults. The defaults to which a surety can underwrite and address effectively are defaults of the permittee's performance: events that can be specifically identified, are controllable by the permittee and subject to objective criteria.

Current Colorado law incorporates these objectives by requiring the operator of an oil or gas well to provide a form of financial security, including a surety bond, that the operator can fulfill its obligations for the operation, closure, reclamation and post closure care for the wells. Unfortunately, Senate Bill 63 eliminates the essential certainty and clarity regarding the scope and nature of the obligation to be performed and the amount and duration of the obligation by proposing amendments that require the bond to secure compliance with *any* provision in the oil and gas law (Article 60) that is a "*reasonably foreseeable eventuality*."

As such, the new bond amount under Senate Bill 63 would have to be in an amount sufficient to finance every reasonably foreseeable eventuality related to ensuring compliance with the law, including full reclamation, spills, leaks, air pollution impacts, explosions, diseases, injuries, and deaths. This is a list of events and conditions that are susceptible to wide variability. Without objective measures, a surety will have great difficulty in being able to underwrite the permittee's ability to fulfill the obligation.

Further, the total financial assurance required will be calculated by multiplying the number of oil and gas wells under the permit by the projected cost to finance every reasonably foreseeable eventuality related to ensure compliance with the law. Therefore, even if the surety could measure the cost, it would be significant, and multiplied by the number of wells covered, it would be questionable if the well operators would be able to qualify for the high bond amounts.

Finally, as noted earlier, when underwriting a bond, a surety makes a judgment about the operational and financial viability of the permittee. The surety essentially is making a prediction about the permittee's future performance. There appears to be no limit on the duration of this new bonding obligation. As the duration of the obligation extends further into the future, the surety's judgment becomes less certain and its risk increases. Considering that the duration of a reclamation bond obligation must be for the duration of the mining and reclamation operation, a surety's liability could conceivably extend for thirty to forty years, even without the complications of the new bonding obligations. Therefore, the bond's obligation may not be reasonably underwriteable if the duration of the obligation were extended further to include this new obligation.

We are interested in understanding if there is a specific problem that the legislature is trying to address to explore whether there is some other means of resolving that concern. However, as currently drafted we oppose the amendments proposed by Senate Bill 63.

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OPINION

A Bold Clean-Up Plan for Alberta's Giant Oil Industry Pollution Liabilities

'RAFT' proposal would replace energy jobs with needed clean-up work.

By Andrew Nikiforuk
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Giant projects, giant clean-up costs. Photo by Jason Woodhead (https://www.flickr.com/photos/woodhead/), Creative Commons licensed.

Regan Boychuk and Brent O'Neil have a bold proposal to put Alberta back to work and onto a more sustainable path.

But their plan doesn't include pipelines, more bitumen exports, earthquake-causing fracking or lowering Alberta's already tiny resource royalties.

The two Albertans just want a moment of your time to consider something different.

They call the plan Reclaiming Alberta's Future Today, or RAFT. It's audacious, proposing to put tens of thousands of people back to work cleaning up as much as $100 billion worth of liabilities in Alberta's oil patch — everything from leaking inactive wells to abandoned pipelines.

Both men come from the oil town of Grand Prairie and know what they are talking about. O'Neil has working in the patch since he was 14 and Boychuk, a roofer by trade, has been researching the troubled state of oil and gas royalties for more than decade.

Like most Albertans they have seen the province swing from bust to boom to bust again with nary a change in policy.

Neither wanted to be the centre of this story. They just want some important ideas and facts the media have mostly ignored to get a public airing.

So here goes.

RAFT is built on several premises. The first is that the time for fossil fuel extraction has ended in Alberta. The low fruit has been picked and nobody saved anything for the future.

The second is that climate change has become a clear and present danger. "We need to start making a real reduction in man-made emissions so our future generations have the same opportunities we once did" says the RAFT proposal.

The best way to respond to this emergency — as well as increasing oil price volatility — is to wind down the industry and re-employ people in a massive environmental clean-up, RAFT proposes. While industry has a legal obligation to clean up its inactive wells and abandoned pipelines, it probably won't spend the money unless government tackles some surprising legal obstacles.

Cleaning up has many economic benefits. It puts oil service companies back to work and would employ thousands throughout the province. The clean-up would last decades and fixing leaking wells would reduce methane pollution into the atmosphere.

The plan *(http://thetyee.ca/Documents/2016/11/03/RAFT-Doc.pdf)* would slowly erase the large and ugly footprint the industry has left in rural Alberta.

Current liabilities for the conventional sector, the plan notes, include 444,000 oil and gas wells (only 200,000 are actually pumping liquids), 430,000 kilometres of pipelines (the distance to the moon is 384,000 kilometres), 30,000 oil and gas facilities, 900 square kilometres of oil sands development, 220 square kilometres of tailing ponds and "a 11.2 million ton sulfur pile that dwarfs the great pyramids of Egypt." (The sulphur is another waste stream from bitumen upgrading.)

No one has argued about the environmental necessity of a clean-up.

Petroleum experts, for example, have warned *(http://thetyee.ca/News/2014/06/05/Canada-Leaky-Energy-Wells/)* that methane leaking from an estimated 500,000 wellbores in Canada represents "a threat to environment and public safety" due to groundwater contamination, greenhouse gas and radon emissions and explosion risks wherever methane collects in unvented buildings and spaces.

But the public record shows that neither government nor industry have taken these risks seriously. Some companies have proposed *(http://edmontonjournal.com/opinion/columnists/opinion-oil-and-gas-wells-cheaper-to-give-away-than-to-operate)* giving aging wells — and liabilities — to municipalities. Others continue to pump more water than oil from exhausted wells just to avoid reclamation costs. As oil and gas companies become more debt-laden thanks to oil price volatility, the threat to the public purse grows.

Consider the size of the environmental burden. Last month the Alberta Energy Regulator reported *(http://www.aer.ca/data/facilities/LLR_Report.pdf)* that the forecast cost of reclaiming inactive oil and gas wells and abandoned facilities now totalled more than $30.6 billion. (When I first reported on these liabilities nearly a decade ago they amounted to $9 billion.)

Incredibly, the regulator holds only $240 million in its clean-up fund. That potentially leaves taxpayers on the hook for a $29-billion clean-up bill if laws and policies don't radically change in the province and country.

It's widely agreed *(http://www.mcmillan.ca/Files/184873_nov2015_CAPLNegotiator.pdf)* the industry-funded regulator, directed by a former oil patch lobbyist, has failed to grasp the gravity of the situation or the inadequacy of its current policies.

Moreover the $30-billion figure is a gross underestimate of real remediation costs. Even the Petroleum Services Association of Canada (PSAC) calculates that it will cost on average between $100,000 to $300,000 to reclaim 75,000 inactive wells.

That means the final bill for just for 75,000 wells (not including 60,000 wells that pump less than 10 barrels of oil a day and are no longer economic) could be as high as $82 billion.

The oil sands add to these growing environmental liabilities.

Alberta's auditor general has already warned *(http://www.macleans.ca/news/canada/oilsands-cleanup-may-not-be-adequately-funded-alberta-auditor-general/)* that the province's clean-up fund of $1.6 billion is grossly inadequate to cover an estimated $21-billion clean-up liability for just eight oil sands mining sites and 19 coal mines. Treating the toxic water in the tailing ponds might cost *(http://www.aguanomics.com/2014/02/blame-regulators-for-tar-sands-tailings.html)* another $24 billion.

Industry and the Alberta government have known about these liabilities for years. And the principle that industry is responsible for cleaning up its polluted sites is widely accepted.

But that's where RAFT runs into some big challenges.

A 1991 court case established that petroleum companies couldn't walk away from aging wells and that clean-up costs were to be paid before any payments to creditors. At the time industry liabilities totalled almost $5 billion.

But ever since then industry and government have steadily eroded that principle like some foul wind.

On one front the industry repeatedly lobbied and secured lower royalties for oil and gas, among the lowest in North America, over the last 20 years. A succession of royalty cuts made Alberta a Third World state where companies boasted record profits and the public owners of the resource got robbed. Not surprisingly, the companies never saved their windfalls to fix up leaking or abandoned wells.

To assuage a troubled public, the industry and government set up an Orphan Well Association *(http://www.orphanwell.ca/)* to help clean up after oil and gas companies went bankrupt and walked away from their polluted well sites.

In the last 18 years the non-profit agency has cleaned up *(http://www.orphanwell.ca/OWA%202015-16%20Ann%20Rpt%20Final.pdf)* 702 wells at a cost of $214 million.

But it is now overwhelmed. Since February, the number of abandoned wells in its inventory has grown from 683 to 1285.

Another part of the problem results from small changes made to the federal

Bankruptcy and Insolvency Act that effectively made it legal for oil and gas companies to declare bankruptcy and walk away from unreclaimed wells. The changes basically ensured that other creditors got paid while the public got stiffed with the environmental bills.

One legal analysis noted *(https://tspace.library.utoronto.ca/bitstream/1807/33370/5/Chaput_Nicolas_201211_LLM_thesis.pdf)* the change created an "incentive for insolvent corporations to proceed to abandon worthless contaminated properties, a procedure by which environmental claims are more likely to be considered 'past claims' and thus characterized as simple monetary claims to be compromised in the restructuring proceedings."

This year an Alberta court proved how bizarre the situation has become. It ruled *(https://www.osler.com/en/resources/regulations/2016/implications-of-the-redwater-decision-where-does)* that the receiver for insolvent Redwater Energy could walk away from environmental liabilities, including 71 wells. At the same time the receiver sold 20 working wells to pay off Redwater's chief creditor — the Alberta Treasury Branch. Alberta's Chief Justice Neil Wittmann found the federal bankruptcy law outweighed provincial clean-up requirements.

The Alberta regulator and the Orphan Well Association have appealed *(http://www.dailyoilbulletin.com/article/2016/10/12/alberta-court-appeal-reserves-decision-redwater-en/)* the decision. But the writing is on the wall: it is legal to walk away from leaking and polluting energy and mining infrastructure in Canada.

In an article in University of Toronto Faculty of Law Review, Alexander Clarkson proposed *(https://www.thefreelibrary.com/In+the+red%3A+towards+a+complete+regime+for+cleaning+up+environmental...-a0350792484)* changing federal law to declare well reclamation a "super priority."

That would give clean-up costs priority over creditors who extended risky loans to the company.

More importantly, it would force bankers and other creditors to factor in environmental risks when lending to the highly indebted oil patch.

The law journal concluded: "The Canadian economy is founded upon extractive industries that pose constant environmental risks. Given the importance of the environment to Canadians, the current inability of the Companies' Creditors Arrangement Act (CCAA) and the Bankruptcy and Insolvency Act (BIA) to efficiently internalize the cost of reclamation to prevent environmental damage is unacceptable."

When the costs of reclamation take priority over the interests of the creditors (they now have loaned $107 billion in the oilpatch), financial institutions will have to pay more attention to Alberta's growing environmental risks and liabilities.

The bottom line is that oil and gas companies with more debts than revenue from producing wells need to be wound down. Their assets should be liquidated and all the money should be used for the clean-up. And it should be happening now.

But that means changing federal law to protect the environment and taxpayers.

Other potential sources of money to pay for Alberta's massive environmental clean-up include a levy on every barrel of oil or raising royalties for oil sands companies that are, contrary to industry propaganda, still making good profits thanks to low royalty rates. Which the Notley government, capitulating to threats from industry and the interests of their creditors, has just made even lower *(http://thetyee.ca/News/2016/02/02/Alberta-Royalty-Review-Disaster/)* .

Consider these revelations from a few quarterly corporate reports.

Cenovus, for example, paid *(http://www.cenovus.com/invest/docs/2016/Q2-2016-quarterly-report.pdf)* only $3 million in royalties on bitumen sales worth $1.1 billion in the first six months of 2016. That's less than a one per cent royalty.

CNRL Resources paid *(http://www.cnrl.com/upload/media_element/1037/01/q22016-interim.pdf)* $6 million on sales of $1.9 billion worth of bitumen.

Suncor paid *(http://www.suncor.com/investor-centre/financial-reports/quarterly-reports)* $48 million in royalties on $4.7 billion worth of gross bitumen sales. And on it goes.

Many of the oil sands companies making money tend to own refineries and are what industry calls "integrated producers." They include big oil sands players such as Suncor, Imperial, Husky and Cenovus.

Even when oil prices are low these integrated players make huge profits by buying low-priced bitumen, upgrading and refining it and then selling high-priced refinery products in the North American market. Oil prices might be low but gasoline prices *(http://www.nationalobserver.com/2015/09/18/opinion/canadians-get-ripped-pumps)* remain surprisingly high.

The Koch brothers know the game. Since the 1980s Koch Industries has been

buying Canada's low value garbage crude at discounted prices and turning it into high-value jet fuel and gasoline at its Minnesota-based Pine Bend refinery.

Koch Industries remains the largest buyer of Canada's dirty bitumen at approximately 300,000 barrels a day. According to Jane Mayer's *Dark Money*, a best-selling history of the Koch brothers and their radical right politics, bitumen refining profits have played a major role in funding much of the Koch brother's right wing political activism. No Canada pipeline proponent ever mentions how bitumen profits have destabilized U.S. politics.

But the Koch brothers know the truth. "Without Pine Bend, Koch Industries would be a different company." Charles Koch said *(https://www.youtube.com/watch?v=pHs68mB-VUE)* in 2015. "We'd be in a much smaller less successful company."

There is a bold solution to Alberta's problems. But it is not more extraction.

It involves directing the economy towards a massive clean-up while industry still has the money to fund most of the job.

The RAFT plan also requires that government establish a transparent commission to scope out the full scale of the liabilities "associated with oil and gas and bitumen infrastructure, their affect on Albertans' health and environment, and the cost and a financial mechanism to properly address them."

But there are major federal legal loopholes to be addressed before the liabilities grow even bigger.

It's time to start a conversation about RAFT and Alberta's massive liabilities.

The province's economic waters are about to become more turbulent. But two Albertans have proposed a bold solution that could lift the province above the storm.

Andrew Nikiforuk will be speaking Saturday at a conference *(https://www.facebook.com/events/1756005428000026/1775665686034000/?notif_t=plan_mall_activity¬if_id=1478198438444981)* ***on Alberta's Energy Future at the University of Alberta.***