June 2015

PROPERLY ASSESSING LIABILITIES FOR A&D

Historically, the Oil & Gas Industry has done a poor job of quantifying the liabilities associated with assets held for sale and the ramifications have become more apparent in recent years because of the increasingly stringent regulatory environment. From our experiences, very few producers or investors even made considerations for liabilities until after the LLR increases in 2013. In a recent Level 1 Liability Review performed for a potential purchase, Kriedo calculated the decommissioning liability as 7.25x higher than as stated on the balance sheet. On the flip side, we have identified an arbitrage opportunity in another purchase that will benefit the buyer for millions of dollars because the seller has overstated the liability due to a regulatory technicality. The result is that companies are overvaluing opportunities, missing arbitrage opportunities, and not maximizing the marginal return of their investments. Essentially, people are not choosing the right dance partner.

A common remark is that the Oil & Gas Industry has functioned for decades without this at the forefront, so what has changed to make this relevant now? And the answer is a combination of things:

Age
The Oil & Gas Industry, particularly in Alberta, has reached an age where wells and infrastructure from decades past have reached the end of their life and no longer have the capability to be active sites.

Provincial Regulations
Provincial Regulators have steadily increased liability management regulations in recent years, including updated LLR liabilities and the Inactive Well Compliance Program. These changes have created an environment in which most companies are now realizing expenses related to liability management and must budget capital to these processes.

Commodity Prices
The drop in commodity prices has resulted in companies shedding non-core assets, increasing acquisition opportunities. However, buyers cannot afford to incur unaccounted expenses, resulting in the need for thorough due diligence of potential purchases.

Even when companies and investors recognize that they need a thorough liability evaluation, quantifying a reasonable value is very convoluted and requires a life-cycle understanding of Oil & Gas. A proper evaluation needs to consider environmental regulations, production history, decommissioning practices, and financial drivers. When we examine financial models commonly used in the Industry to evaluate opportunities, there are numerous factors that we often notice mis-evaluated or unaccounted for:

- Reliance on LLR Values
- Pipeline Liabilities
- Base Cost of Environmental Assessments
- Earlier Realization of Abandonment Expenses Due to IWCP
- Access Costs
- Time Frame Required to Achieve Reclamation Certification
- Cherry-Picking & Exclusion of Outliers
- Amortization Periods
- Phantom/Overstated Facilities

Kriedo is committed to delivering adaptable solutions in order to properly evaluate liabilities and calculate the yearly negative cash flows associated with a group of assets. For more information, please contact Don Keith at 587 586 7898

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NEW WETLANDS GUIDELINES

Alberta has recently implemented new guidelines for wetland management as outlined in Alberta Wetland Policy (September, 2013). These policies are currently being brought into effect in a phased approach, with the new requirements for White Areas taking effect as of June 1. The principles of the Alberta Wetland Policy are avoidance and minimization where possible, and when permanent wetland loss does occur, replacement will be required based on an assessment of the wetlands value. The new policies will incorporate wetlands of all classes and help to provide regulatory clarity and predictability, which will help developers to plan accordingly.

Under the new guidelines, practitioners of Wetland Science will be required to formally meet new requirements for the new designation of Qualified Wetland Science Practitioner (QWSP) by May 31, 2016. Until then registration as an Interim Wetland Science Practitioner (IWSP) is required. Industry should ensure any personnel completing wetland applications carry the correct designation.

Application submission consists of three steps: Planning and Legislative Alignment, Wetland Assessment and Impact Report, and Application Submission. In keeping with the core principles of the Alberta Wetland Policy, a new tool to assess the value of the potentially impacted wetlands has been released. The Alberta Wetland Rapid Evaluation Tool – Actual (ABWRET-A) requires a site survey to input data into a model which compares a site to other known wetlands to make a rapid assessment of the value based on the functions the wetland provides, including water storage, water quality improvement, providing habitat for diverse animal or plant life, and human use.

The new tools will provide a regional context for wetland management. The wetlands of the highest value based on the results of the new tools are to be protected long term. In addition in areas where there has already been significant wetland loss there is a high priority placed on conserving the wetlands that remain, and restoring wetlands where possible. Plans should be developed to avoid wetlands where possible and minimize overall impact. Where wetland loss is permanent and necessary, the value of the lost wetland will be required to be replaced. This value will be calculated with the new tools and will require the replacement of the functionality of the lost wetland, and will not require replacement based solely on the area of impacted wetland. A wetland replacement matrix has been provided to determine the area of wetland to be replaced based on the value category of the impacted wetland and the value category of the replacement wetland. The restoration of previously impacted wetland will also be encouraged and will reduce the amount of wetland replacement required. In addition an in-lieu fee payment will be allowed based on the average cost of wetland restoration work, monitoring, land value and an administrative fee. Ephemeral water bodies are not subject to replacement, however they remain subject to the Water Act.

The new guidelines are designed not only to provide clarity and accountability to industry, but to protect the future of Alberta's water resources for all Albertans.

June 2015

THE HISTORY OF AN INTER-PROVINCIAL PIPELINE

As the raging debate between pro and anti-pipeline groups continues in the media, with seemingly every group on the right and the left distributing their own agenda pieces, we at Kriedo wanted to explore the history of an established pipeline, The Trans Mountain Pipeline, and look objectively at its contributions since it has been built.

- The Trans Mountain Pipeline was built in 1953 and it transports petroleum products from Edmonton to Burnaby and 90% of the proposed new pipeline is being expanded on existing corridors, and is NOT actually a completely new pipeline project.
- The Trans Mountain Pipeline carries 80% of the crude oil that is refined into gas, diesel, & jet fuel which is currently used in British Columbia, and without the Trans Mountain petroleum supply, British Columbia would have to import crude oil products from California and international sources.
- In 60 years of operations, the pipeline has experienced one major incident when a Burnaby worker punctured the pipeline.
- From 1998 to 2014 the owners of the pipeline paid $320 Million dollars in municipal taxes to areas along the pipeline corridor.
- The last time the pipeline was expanded, in 2006 under the Anchor-Loop expansion, the project won the Emerald Award from the Alberta Emerald Foundation, which recognizes and awards "the excellent environmental initiatives undertaken each year by large and small corporations, individuals, not-for-profit associations, community groups and governments." Past recipients include the Alberta Conservation Society, The Biosciences department at The University of Calgary, and The Solar Energy Society of Alberta.

The incident record of this Canadian pipeline (Found Here) is important to consider when determining the merits of these types of home-grown projects. Environmental records of companies south of the border are often used as objective evidence against the construction of pipelines in Canada and we have to consider that as comparing "Apples to Oranges". In Canada, we have different regulatory bodies, methods of inspections, and environmental controls, and the overall record of the Trans Mountain Pipeline indicates that our regulatory system has in fact worked to protect our sensitive areas.

Another contested topic for discussion, is the number of permanent jobs that will be created from the pipeline, although the exact number is difficult to pin down, and varies greatly from study to study. The job contribution to any local economy is not nearly as significant in comparison to the $320 Million paid to local governments in municipal taxes by Trans Mountain owners over a decade and a half. The tax revenue gained, is money that can be used in ways that improve the local government initiatives and is not distributed by the unreliable spending habits of those employed by the project. It would seem that the municipal tax contribution is a far better indicator of the economic impact of the pipeline then actual number of jobs created, although both of these contribute to an overall economic benefit to the local economies.

Kriedo hopes this information is able to provide a little better understanding of the impact of an existing pipeline expansion project in Canada, and supplies knowledge to discuss the overall merits of future expansion projects.

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