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## **Liability Management Rating Program**

NEBC Producer's Society  
December 2010

## Liability Management Rating Program

The OGC committed to the development of an Liability Management Rating (LMR) program that requires permit holders carry financial risks from liability.

### LMR Implementation:

1. **Phase 1** – Interim LMR Program (underway)
2. **Phase 2** – Comprehensive LMR Program (mid 2011)
3. **Non-Producer Liability** (TBD)

# Liability Management Rating Program

## Background

- Former Drilling Deposit Framework
  - Drilling Deposit required under the former PNG Act.
  - Required deposit for new operators.
  - Initially \$7500.
  - More recently, deposit requests equal to site-specific cost estimate for abandonment and reclamation of one well.
  - Under OGAA, drilling deposits became Security Deposits.

# Liability Management Rating Program

## Phase 1 – Interim LMR Program

- Initial LMR System:
  - Similar to AB and SK LLR models.
    - Focus is to contain liability.
  - Database of existing B.C. permit holders.
  - Uses an LMR calculation:

$$\text{LMR} = \frac{\text{Deemed Assets}}{\text{Deemed Liabilities}}$$

# Liability Management Rating Program

## Phase 1 – Interim LMR Program (cont'd)

Asset Calculation (Production \* Netback \* Return Period)

- Production data as reported to the Ministry of Finance.
  - Oil Equivalent.
- Netback from CAPP.
- Return Period = three years.

# Liability Management Rating Program

## Phase 1 – Interim LMR Program (cont'd)

### Liability Calculation (SUM(Abandonment + Reclamation))

- Abandonment estimate = \$75,000 per well.
  - Based on average of site-specific estimates.
- Reclamation estimate = \$75,000 per well.
- Associated facility liability calculated as the sum of abandonment unit cost (\$15,000) and reclamation unit cost (\$75,000) multiplied by the well equivalency factor (WEF):
  - Plant sites (20 WEF)
  - Batteries (five WEF)
  - Compressor Stations (five WEF)
  - Other facilities (two WEF)

# Liability Management Rating Program

## Phase 1 – Interim LMR Program (cont'd)

- Complete LMR review when:
  - Assets transferred
  - New wellsite application
  - Amalgamations will be reviewed
- License transfers:
  - Post-Transfer Assets > Liabilities = Green Light
  - Liabilities > Assets = Deposit Review
  - Potential Deposit if LMR drops following transfer:
    - Deposit = amount required to return to pre-transfer LMR
- New well applications:
  - Assets > Liabilities = Green Light
  - Liabilities > Assets = No Approval w/out deposit
  - Deposit = One Wellsite Liability (\$150K, one-time)

# Liability Management Rating Program

## Phase 1 – Interim LMR Program (cont'd)

- Production Requirements in LMR Calculation:
  - One active well equivalent liability of \$150,000.
  - Production of 180 m<sup>3</sup> of annual oil production or 360 Km<sup>3</sup> of gas production sufficient to cover liability.
    - This is equivalent to ~ three bbl of oil per day or ~ 35,000 ft<sup>3</sup> gas per day.

# Liability Management Rating Program

## Phase 1 – Interim LMR Program (cont'd)

- Example:

- Company AAA to transfer three active and two completed wells to Company BBB.
- AAA – Assets of \$1.5MM, Liabilities of \$1MM.
  - LMR ratio prior to transfer is 1.5.
- BBB – Assets of \$1.2 MM, Liabilities of \$1.5 MM.
  - LMR ratio prior to transfer is 0.8.
- Transferred wells production asset = \$300K.
- Transferred wells deemed liability = \$750K.
- Calculation of post-transfer LMR's indicates that AAA's ratio remains above one; however, BBB's ratio dropped to 0.66.

# Liability Management Rating Program

## Phase 1 – Interim LMR Program (cont'd)

- Example

- Deposit (from post transfer conditions) = X

$$\text{If:} \quad \text{LMR (0.8)} = \frac{\$1.5\text{MM} + X}{\$2.25\text{MM}}$$

$$\text{Then:} \quad X = (0.8 * \$2.25\text{MM}) - \$1.5\text{MM}$$

$$X = \$300,000$$

\$300,000 deposit required from Company AAA prior to approval of application to transfer assets.

*Underlying theme.....contain liability.*

## Liability Management Rating Program

### **Phase 2** – Comprehensive LMR Program (mid 2011)

- Program will require security on liability over assets.
- Requires companies to carry full financial risk.
- Security requested when liabilities exceed deemed assets (LMR < 1.0).
  - Security deposit payment is phased, equal to full difference.
- Communicated to industry and stakeholders prior to implementation.
- Permit holder's with LMR's less than one can appeal decisions.

# Liability Management Rating Program

## Phase 2 – Comprehensive LMR Program (cont'd)

- Highlights of LMR:

- Further detail on facility liability, based on facility size/capacity.
- Stratified liability costing based on area/ecoregion.
- Address sites with higher risk for contamination (legacy).
- Include factors such as age, fluid type, production history, etc.
- Potential for additional indicator of permit holders disregarding liabilities (period of time that abandonment/reclamation not addressed).
- Address “problem sites” ~ those with compliance issues, complaints, spills, etc.

# Liability Management Rating Program

## Phase 2 – Comprehensive LMR Program (cont'd)

- Option for site-specific based LMR program:
  - System by which deemed liability is projected by the permit holder on a site-by-site basis.
  - The goods:
    - Potentially more accurate
    - Allows liability model to fluctuate more accurately
    - Provides marriage of Commission records
  - Potential challenges:
    - Many small producers without in-house expertise
    - Retention of third party to estimate can be costly
    - Unknown audit requirements

# Liability Management Rating Program

## **Phase 2 – Comprehensive LMR Program (cont'd)**

- LMR program evolving through early 2011.
- Communication and feedback program following draft framework.
- Information requests to industry to be delivered:
  - Feedback on liability costing
  - Site-specific assessment process
  - Dispute process
  - Inventory confirmation

# Liability Management Rating Program

## **Non-Producer Liability (NPL)**

- Currently no framework to rate companies without production.
- Dealt with on case-by-case basis.
- Need to address:
  - Waste disposal companies (disposal well or supporting facility)
  - Midstream companies (gas processors)

# Liability Management Rating Program

## Non-Producer Liability (cont'd)

$$\text{NPL} = \frac{\text{Assets (Volume x Netback x Return Period)}}{\text{Liabilities (Abandonment + Reclamation)}}$$

- Where:

- Input Volume = Annual facility throughput
- Netback = Revenue – cost of operations (facility specific)
- Return period (requires further analysis):
  - As per asset retirement forecast
- Liabilities = Site-specific assessment

# Liability Management Rating Program

## Non-Producer Liability (cont'd)

- NPL calculation required by Commission on annual basis and upon license transfer for facility.
- Netback to be provided by the licensee based on annual financial statement submitted to Commission.
  - If:
    - $\text{Assets} > \text{Liabilities} = \text{No Deposit}$
    - $\text{Liabilities} > \text{Assets} = \text{Deposit}$
- $\text{Deposit} = \text{Liabilities} - \text{Deemed Assets}$
- Deposit payment potentially phased.

**Thank You.**

**QUESTIONS?**

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