

# THE NEGOTIATOR

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## **The Extreme Operating Procedure Makeover Is Complete – Part II**

Further Improvements introduced in the 2015 CAPL Operating Procedure

## **Do We Really Need Stricter Regulation on A&D Activity in This Market?**

Changes to the AER License Transfer Process and impact on industry

## **Red Water or Murky Water?**

AER vs Grant Thornton, as Receiver for Spyglass





# Do We Really Need Stricter Regulation on A&D Activity in This Market?

(AER Bulletin 2015-34 – Pipeline Records and LTA)

IN ALBERTA, WE COULD, UNTIL NOW, SORT OF, KIND OF, IGNORE SMALL PIPELINE TRANSFERS IN A&D TRANSACTIONS. This is because the Alberta Energy Regulator (AER) pipeline licenses for flowlines

and gathering systems are transferred as part of wells, facilities and pipeline license transfer application (LTA) process.

We could ignore the pipe because the pipeline portion of the LTA does not attract a licensee liability ratio (LLR) calculation. Small pipelines currently have no assigned asset value or liability value. All is good. You simply list the pipeline

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licenses, or segments of the license on a partial pipeline transfer, and move onto the more onerous aspects of the LTA process, such as trying to figure out how to transfer the well and facility licenses without triggering a massive LLR Security Deposit.

Well, those stress free days are over my friends. And really, thank goodness, because the cozy life of \$30 oil and \$2 gas was making me sort of fat and lazy anyway. Probably a good time to add one more little rule change, and possible costs, to A&D deals. I bet all of our international competitors are adding lots more rules and costs to their processes too.

The changes were announced in a very brief AER Bulletin (Bulletin 2015-34) on December 17, 2015. The changes will be incorporated into the AER digital data submission (DDS) online LTA form effective April 1, 2016. You need to be aware of these changes prior to pushing the LTA button on any deals submitted after April 1.

### Same Rules, So Why Worry?

The Bulletin begins rather innocuously:

Effective April 1, 2016, the Alberta Energy Regulator (AER) is amending its pipeline licence transfer application process to require *written confirmation* that records required by CSA Z662: *Oil and Gas Pipeline Systems and Part 4 of the Pipeline Rules* have been *maintained by the seller (transferor)* of the pipeline licence and have been *transferred to the purchaser (transferee)* of the licence as of the effective date of the licence transfer. [emphasis mine]

Oil and gas companies must already follow CSA Z662 and the Pipeline Rules when constructing and maintaining pipelines. So really, nothing is new. Right?

Just in case you are suspicious of the benign effect of the Government action on your business, the Bulletin goes out of its way to let you know that you are being paranoid, by stating:

Confirmation by the transferor and transferee of an AER pipeline licence of the transfer of records does not impose any new or additional requirements since pipeline licensees are already required to maintain the records mandated under the Pipeline Rules and CSA Z662.

Well thank goodness. Please only read on if you fear the AER doth protest too much.

### Required Pipeline Records on Transfer

Let's start with the pipeline records a vendor must locate, organize and pass over to a purchaser:

Under existing regulatory requirements, AER pipeline licensees are required to conduct activities such as inspections, testing, monitoring, and assessments to manage pipeline integrity and safety and maintain records of these activities. AER pipeline licensees must also retain records of pipeline incidents and failure investigations. Whenever a pipeline is sold, all records that exist for that pipeline must be transferred to the new owner.

We are not simply talking about locating and cross-referencing the relevant surface files (surface leases, rights of way, road use, etc.) pertaining to sold pipelines. This is the minimum requirement. You must have access to your pipe or you are noncompliant. Incidentally, this seemingly basic task is sometimes difficult to complete in complex transactions with short timelines. Some vendors cut corners in their surface tenure transfer due diligence. But I digress.

You must also locate, deliver and cross-reference all of the other non-land files and other materials, such as: construction files, surveys, maintenance files and environmental and safety records and compliance reports. Are you sure all those items are properly set up in your record management systems? Can they be easily cross referenced and packaged for delivery to the purchaser on sale?

Under current practise, a vendor delivers all such documents it can locate to purchaser, in due course, using reasonable efforts, at or shortly after closing. Now, a vendor needs to locate all such documents, cross referencing same back to all sold pipelines, and has real issues if there are any document deficiencies.

Reasonable efforts are not enough. Missing or incomplete documentation is a non-compliance event.

### Written Confirmation – LTA Statutory Declaration

All of this pipeline document due diligence needs to be completed prior to submission of the LTA. The Bulletin is clear on timing:

... the confirmation is intended to ensure that the transfer of all required records to the new licensee occurs *before* the pipeline licence transfer application is processed and approved by the AER. [emphasis mine]

To ensure compliance, the AER will now make you promise that you have complied with the pipeline due diligence requirements at the time you submit and concur a LTA.

### Transferor Declaration

When the vendor (transferor) completes the draft LTA and pushes the DDS LTA submission button, someone, on behalf of the transferor, needs to swear a statutory declaration that all



is good. I assume that someone will be an officer of the vendor. The specific wording of the declaration is as follows:

Transferor statement: The transferor hereby confirms that it has collected and retained all records required under the Pipeline Rules and CSA Z662. The transferor confirms that it has provided these records to the transferee by the effective date of the licence transfer.

### Transferee Declaration

But wait, there is a kicker. The Bulletin paragraph above continues with the following additional statutory declaration requirement:

Transferee statement: The transferee hereby confirms that it has received all records required to be collected and retained under the Pipeline Rules and CSA Z662 from the transferor. The transferee is responsible for producing these records on request by the AER. Failure to do so constitutes a noncompliance of AER requirements.

Ergo, both the transferor and the transferee are required to swear all is good. It seems tough enough for the vendor (transferor) to make such a declaration. I would really, really, not want to be the poor dude working for the purchaser (transferee) who makes the declaration and pushes that button on a large LTA for a deal that closes, in like, you know, 60 days.

Pitter-patter. Pipeline due diligence must now be done by both sides, before submitting the LTA, and completed in a manner sufficient to allow an officer of the vendor and purchaser to swear that you got everything covered. Hope your whole surface department didn't get let go in the last round of cuts.

### Engineering Assessment if Deficient

The real impact of the Bulletin may be in the unforeseen costs associated with becoming compliant enough to allow the LTA to be processed. The Directive states:

... If relevant records are lost, damaged, destroyed, or incomplete, the pipeline must be proven to be fit for service through an *engineering assessment*. [emphasis mine]

The requirement of an "engineering assessment" is what concerns me the most. I hope I am making a mountain out of a molehill. However, my experience with the costs and delays related to the BCOGC "as built" requirement on pipeline license transfers makes me leery.

If the AER is zealous in the pipeline compliance process, it could easily find deficiencies in the documentation required to allow the transfer of many pipelines. In short, the failure to have all the old paper could trigger a full engineering assessment

to establish that the pipe meets the reporting requirements. This could easily create significant new costs in LTA approvals.

### Pipeline Suspension on Audit

Further, document deficiencies can lead to pipeline suspension:

The AER will conduct compliance monitoring to ensure that these records have been transferred. Licensees who fail to produce these records are considered to be in noncompliance with AER 2 Bulletin 2015-34 requirements. Depending on the situation, the AER may suspend operation of the pipeline pending completion of an engineering assessment that demonstrates that the pipeline is fit for its intended purpose and service.

It is unclear whether these audits would occur during the LTA process or under a random AER pipeline compliance audit. If the former occurs, closing may be at risk. For the latter, a company could see revenue affected due to production being shut-in until engineering assessments are completed and approved by the AER.

### A Note On PSA Considerations

Under a typical purchase and sale agreement (PSA), the vendor already agrees to provide all documents and records to purchaser. However, it may now be prudent to specifically consider this Bulletin in PSA drafting (much like I do in BCOGC "as built" situations). Issues may include:

- A vendor representation regarding pipeline records sufficiency.
- A purchaser condition precedent for conducting pipeline records due diligence.
- Who pays the engineering assessment costs to become compliant if a LTA audit requires engineering assessments prior to the LTA transfer? What about a post-closing audit?
- How do the parties govern themselves if there is LTA limbo during the engineering assessment process? Can you close on the assets and leave the LTA for post-closing?
- Be ready to add a transitional services agreement if this becomes a live issue near closing.
- Can we still rush to close deals without all surface paper being completed?
- How about closing prior to boxing up and delivering files to purchaser?

Again, I hope I am overreacting. Only time will tell. 📖