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Update on Directive 067: Eligibility Requirements for Acquiring and Holding Energy Licences and Approvals

Energy Bulletin

On December 6, 2017 the Alberta Energy Regulator ("AER") released an update to Directive 067 which stipulates the terms and conditions for a party obtaining or continuing to hold a licence for energy development. The changes stem from the AER's concern over a growing number of licensees abandoning wells in an unprofitable market in bankruptcy proceedings. The new Directive 067 allows the AER to better monitor and control those licensees who have a history, or a higher risk, of non-compliance.

Additional Information and Discretion

Directive 067 now requires applicants to submit additional information at the time an application is made. It also provides the AER greater discretion to reject applications where an applicant poses an unreasonable risk to ensure that licences are only granted to and retained by responsible parties. It should be noted that 'unreasonable risk' is not defined in Directive 067 which may result in uncertainty but does give the AER greater discretion when reviewing applications. Applicants for licence eligibility must complete the updated schedule 1 to Directive 067 which requires more fulsome corporate information. Before issuing a licence the AER must be of the opinion that the applicant does not pose an unreasonable risk based on the following criteria:

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- the compliance history of the applicant, including its directors, officers, and shareholders, in Alberta and elsewhere, including in relation to any current or former AER licensees that are directly or indirectly associated or affiliated with the applicant or its principals;
- the compliance history of entities currently or previously associated or affiliated with the applicant or its directors, officers, and shareholders;
- experience of the applicant, including its directors, officers, and shareholders;
- corporate structure;
- the financial health of the applicant;
- outstanding debts owed by the applicant or current or former AER licensees that are directly or indirectly associated or affiliated with the applicant or its directors, officers, or shareholders;
- involvement of the applicant's directors, officers, or shareholders in entities that have initiated or are subject to bankruptcy or receivership proceedings or in current or former AER licensees that have outstanding noncompliances; and
- naming of directors, officers, or shareholders of current or former AER licensees under Section 106 of the *Oil and Gas Conservation Act*.

The updated provisions in Directive 067 explicitly allow the AER to examine past regulatory compliance when issuing new licences to existing licensees for new activities. Furthermore, the AER now has the ability to require an applicant to address any outstanding noncompliance of current or former AER licensees that are directly or indirectly associated with the applicant or its directors, officers, or shareholders, which could have broad implications.

Material Changes

Within 30 days of a material change, all licensees must file notice thereof with the AER. Existing licensees with licence eligibility as of December 6, 2017 must provide an updated schedule 1 to Directive 067 by January 31, 2018. Failing to do so, gives the AER the right to restrict or revoke licence eligibility of such noncompliant party. Material changes include:

- changes to legal status and corporate structure;
- addition or removal of a related corporate entity;
- changes to directors, officers, or control persons (persons holding over 20% of the outstanding voting securities of the licensee or approval holder);
- appointment of a monitor, receiver, or trustee over the licensee's property;
- plan of arrangement or any other transaction that results in a material change to the operations of the licensee;
- the sale of all or substantially all of the licensee's assets; or
- cancellation of insurance coverage.



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If a licensee is uncertain about whether the AER would consider a potential material change to be an unreasonable risk, the licensee may request an advance ruling from the AER. Proceeding in this manner could avoid a finding that, as a result of the material change, the licensee poses an unreasonable risk and be subject to the AER revoking or restricting the licensee's eligibility by imposing additional terms and conditions such as:

- the types of licences or approvals that may be held;
- the number of licences or approvals that may be held;
- additional scrutiny required at the time of application for or transfer of a licence or approval;
- requirement to provide full or partial security at the time of application for or transfer of a licence or approval;
- requirements regarding the minimum or maximum working interest percentage permitted; or
- a requirement to address outstanding noncompliances of current or former AER licensees that are directly or indirectly associated with the applicant or its director, officers, or shareholders.

By imposing these restrictions, the AER gains additional discretion and control over a licensee to facilitate compliance in situations where it has deemed there is an unreasonable risk. Avoiding these restrictions through advanced rulings may be especially important from the perspective of lenders to confirm that no material change (and therefore no unreasonable risk) occurs as a result of a licensee borrowing funds from the lender or as a result of any other activity of the licensee. To protect a lender's interest, lending agreements may, as a condition precedent to funds being made available, stipulate that a licensee obtain an advanced ruling in each instance where a material change occurs to prevent restrictions from being imposed and affecting the lender's interest. Another application for an advanced ruling may be where a lender intends to take a pledge on shares over 20% of the outstanding voting securities of a private company to ensure no restrictions on the licensee would result from taking such pledge. In this respect, caution should be exercised by lenders when taking pledges of shares.

Streamlined Licence Types

The updates also streamline licence eligibility types to three categories of:

- (i) no eligibility - not eligible to acquire or hold licences to drill/construct wells, facilities or pipelines,
- (ii) general eligibility - eligible to hold licences for all types of wells, facilities, and pipelines, and
- (iii) limited eligibility - eligible to hold only certain types of licences and approvals, or eligibility is suspect to certain terms and conditions.

The following licence eligibility types are now converted to limited eligibility:

- Wells, facilities, or pipelines (all types) granted with conditions;
- Public educational institutions;
- Government;
- Water wells drilled deeper than 150 meters;



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- Farm gas well licences and gas wells licensed for domestic use (along with associated pipeline licences); and
- Mineral exploration test hole licences.

Conclusion

The changes to Directive 067 affect both current and prospective licensees and may impact those parties who are connected with such licensees through lending agreements. It remains to be seen how the AER will apply the broad language and powers of the new Directive 067. However, it is clear that licence holders and applicants have been given notice that the AER will examine former AER licensees that are directly or indirectly associated or affiliated with the applicant or its directors, officers, or shareholders which may incentivize licensees, and parties who they do business with, to approach new business ventures with greater caution and due diligence.

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