



CANADIAN ASSOCIATION
OF PETROLEUM PRODUCERS

October 31, 2013

(via email: finrespguidelines@neb-one.gc.ca)

Mr. Gaétan Caron
Chair & CEO
National Energy Board
444 Seventh Avenue, SW
Calgary, AB T2P 0X8

Dear Mr. Caron:

RE: Draft Financial Viability and Financial Responsibility Guidelines

The Canadian Association of Petroleum Producers (CAPP) appreciates the opportunity to comment on the National Energy Board's (NEB) Draft Financial Viability and Financial Responsibility Guidelines. CAPP believes in regulation that balances robust safety and security while maintaining attractive investment climates and industry competitiveness. CAPP supports the underlying principles of the draft guidelines namely the "polluter pays" principle and that explorers/producers must have the technical and financial prowess to properly manage risks, operate in a safe manner, and satisfy financial obligations regarding liability.

However, we believe the current draft will present unnecessary and unintended prohibitive barriers to exploration activity in the NWT, which is a regulatory environment already fraught with uncertainty, unpredictability, and risk. Specifically, concerns related to duplicative processes, (on the regulatory, consultation, and financial assurance fronts) lacking differentiation between onshore and offshore activity risk profiles, unclear notions of "worst-case" scenario definition, and potentially onerous financial instrument requirements.

The North: Opportunities and Obstacles

Canada's North has resource potential for oil and natural gas but is competing with other regions in Canada, and around the globe for investment capital. Industry invested about \$600 million in the North over the past three years and is committed to spend \$650 million based on land acquisitions alone. Clearly, the North is an area of interest to industry, and one of the areas of vast potential in Canada. Plans to improve the North's regulatory processes for natural resource projects will cascade benefits throughout the North, and throughout Canada at large.

In these early stages of exploration in the North, regulations that encourage exploration are crucial as the North is already systemically a very high cost environment. First, being a frontier area, naturally there is a lack of infrastructure. Whether it be workforce, service sector, community infrastructure (housing, recreation) or physical infrastructure (roads, pipelines, and facilities), these missing pieces add to the cost and challenge of Northern development. This underscores the crucial importance of a

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regulatory regime in the North that delivers the security and safety Canadians have come to expect, while simultaneously maintaining the investment attractiveness of the region. Capital is very fickle and flows to jurisdictions and regulatory regimes that provide clarity, timeliness and efficiency whilst maintaining robust environmental protection. For example, the most recent land sale in the North garnered very little interest from industry, in part due to the uncertainty surrounding the regulatory process in the NWT.

The need for differentiation:

Much of the concern from industry is the draft inherently does not differentiate for the wide variety of exploration activity that occurs north of 60. The “*one size fits all*” nature of the draft is the primary issue at this time. First, the document provides little guidance and only reiterates the broad powers of the NEB under COGOA, namely section 27 amongst others. Specific procedures and parameters inserted to reflect the diversity of exploration activities would alleviate member concerns.

In that vein, onshore vs. offshore differentiation is lacking within the draft. While CAPP appreciates that a call for the guidelines emanated from the Arctic Offshore Drilling Review (AODR), the draft is lacking the explicit delineation between onshore and offshore scenarios and applications. Onshore and offshore exploration activities possess extremely contrasting traits to explore, develop and eventually produce. The environmental implications of a spill between onshore and offshore are in stark contrast therefore the risk and consequence with respect to severe event scenario factors are very diverse.

Accordingly, this should dictate very different demonstrations of financial viability and responsibility should a worst case scenario occur, which unfortunately is not built into the draft at this juncture. As a solution, CAPP would support either a separate document being drafted to properly reflect the two different activity and risk profiles of onshore and offshore, or removing the applicability of the draft to onshore and ancillary activities such as seismic shooting, altogether. Onerous, pre-emptive financial litmus tests not commensurate with the risk profile of the exploration activity will be a barrier to companies exploring onshore. As in any frontier area, entrepreneurial operators/explorers are a key, vital component to a successful resource exploration strategy.

An entrepreneurial approach has been very successful in other jurisdictions, such as the UK and Norwegian North Seas in acting as a catalyst to exploration and development. This model can equally be applied to Northern Canada, where smaller companies must recognize their limitations as operators beyond the seismic acquisition stage. The ability of large companies to support the financial requirements for drilling operations dictates that it is these companies the entrepreneurs must rightly partner with in order to drill in the Northern offshore. While a pre-emptive financial litmus test is more justifiable for such offshore drilling endeavors given the increased risk profile, and one that most companies can measure up to given the inherent critical mass of most offshore companies, applying parallel rigidity to the onshore is disproportionate, and not commensurate with the probability of risk inherent in such operations. The risk factors are vastly different as are the potential mitigation costs, consultation requirements, amongst others.

Smaller, junior oil and gas companies have already experienced a retraction following several years of challenging conditions, very tight oil pipeline capacity, and challenging markets amongst other factors. According to the National Post, “*the once thriving sub-sector has shrunk to half its size from the middle of the last decade, when juniors were such a force.*”¹ The junior oil and gas sector in Canada has been a key catalyst over the years responsible for various innovations, dynamism, and general entrepreneurship. A robust junior sector will be crucial for Northern Canada’s potential. Fraught with potential but also significant challenges, the region is ripe for frontier entrepreneurship many of these juniors bring. In

summary, CAPP asks that the NEB realize that the draft's financial measures could inhibit, and in some cases preclude the possibility of their market entrance, in a market that desperately needs them.

Demonstration of Financial Viability & Financial Responsibility:

Section six of the guidelines presents a very comprehensive suite of required financial proof/risk management instruments. However, the guidelines must recognize the financial safeguards and security that are in place already by virtue of a company's own robust internal protocols, safeguards, and financial assurance tools. Member companies both onshore and offshore operate under a comprehensive insurance regime already found to be acceptable in other jurisdictions around the globe.

For example, an audit of a company's insurance program by an external third party would add additional cost, and be potentially redundant given the world class risk management infrastructure member companies already have in place. Section 6 also requires to be included in applications, the most recent credit rating reports "*which need to be investment grade or above.*" Of the roughly 100 upstream companies listed on the TSX and TSX Venture exchange, only approximately seven have an investment grade rating or above, not to mention the variety of private companies, and Aboriginal owned companies that would fall into the same category. This provision could result in the inability of many companies besides the large US and Canadian firms, to enter the market. CAPP encourages the Board to re-consider these provisions, and the unintended consequences they could inflict.

Definition of "Worst Case Scenario"

Currently, the guideline's definition of "*worst case scenario*" (WCS) would be better served with clear parameters, and contextual criteria. Further, it is unclear whether the WCS implies a scenario that would cover absolutely *every* potential scenario in the critical path or is it meant to cover a more restricted band of scenarios, within upstream exploration activity. Accordingly, since the concept is somewhat vague in the draft, it could result in uncertainty as to what the letter of credit requirements would be. This will be of increased significance for smaller to medium size companies, as the amount of the letter of credit will be an important factor when determining to bid on land, and to drill.

Any modicum of relative clarity and predictability is crucial in the early exploration stage in the North as it is inherently, already a very complex and costly environment. The draft guidelines as they stand are vague in their definition and extended reach of the WCS. In determining a WCS, it should be based on the intrinsic risk profile of the activity while track record and experience of the particular operator involved should also be considered.

If removing the applicability of the draft to onshore activity is not an option, CAPP believes it would be preferable for not only onshore activity, but also offshore activity, that the amount of the letter of credit be determined up front via defined amounts, or even a system of banding so that all parties know as activity commences, what will be required. To facilitate this, we would like to see NEB consultation with CAPP and industry to determine an appropriate value of security, whereby there is a predetermined category/amount reflective of the different types of activity and risk profile.

With regards to the concept of a worst case scenario for offshore seismic surveys, it is clear the vast majority of this risk can be categorized as being related to general marine operations, as opposed to seismic acquisition *per se*. The guidelines must separate these two aspects as it would be inappropriate for the seismic vessel to be subject to a financial guarantee when other maritime traffic is not. For regulatory

equity, we would ask that the guidelines not impose financial guarantee requirements for seismic vessel general marine risk if this is not required for all other vessels operating in the same waters.

Consultation:

There are several other consultation requirements in place in the North through existing levels of government and regulation. By adding another layer, in addition to the most recent consultation requirements detailed in the NEB's Filing Requirements for Hydraulic Fracturing, there may be a point of diminishing returns on consultation, not to mention potential for consultation fatigue.

Member companies exploring and operating in the NWT have built a solid reputation following several years of work and consultation to inform stakeholders about safe and responsible operations. However, the guidelines stipulate the requirement to consult on a highly *unlikely* worst case scenario. This has the potential to stoke fear, and unnecessarily damage member company reputation, and the reputation of the industry at large. This could in turn negatively affect industry social license to operate in an already challenging environment. CAPP recommends the allowance of confidentiality for the worst case scenario cost estimates in order to maintain public confidence in the petroleum industry, and mitigate unnecessary public fear and alarm.

Conclusion:

CAPP's recommendations on the draft are aimed at ensuring safety, increasing clarity and predictability for explorers, mitigating potential investor uneasiness, and maintaining public confidence that the financial resources are in place to rectify the consequences of an incident.

In summary, CAPP would like to see explicit differentiation, clarity, and context built into the document to properly reflect the diversity of activities and their respective risk profiles. This could come in the form of a separate draft for the onshore; a clause(s) inserted into the draft to dictate/define differentiation; the removal of the applicability of the draft to the onshore; and avoiding potentially duplicative and prohibitive financial assurance and insurance requirements for both the onshore and offshore. These solutions would give rise to precedents and protocols that would help govern the application of the draft and ease industry and stakeholder concern. Using the respective industry and stakeholder positions as primers for further discussion, we look forward to subsequent dialogue and discussion immediately following the submission process.

Sincerely,



Aaron M. Miller
Manager, Northern Canada

ⁱ National Post, October 4, 2013