

June 18, 2013

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Dear Ms. Johnson,

**Re: Draft Financial Viability and Financial Responsibility Guidelines for the *Canada Oil and Gas Operations Act***

I am writing to you on behalf of Ecojustice to comment upon the Draft Financial Viability and Financial Responsibility Guidelines (“Draft Guidelines”) for the *Canada Oil and Gas Operations Act* (“*COGOA*”).<sup>1</sup>

Ecojustice is Canada’s largest public interest environmental law charity, with a mission to defend Canadians’ rights to a healthy environment. Our lawyers and scientists have been involved in litigation and law reform matters pertaining to oil and gas exploration and drilling for the past two decades. We have considerable expertise in the area of offshore spill liability (see attached article recently published in the McGill Journal of Sustainable Development Law and Policy), and hope to bring this to bear with a view to strengthening the Draft Guidelines.

*COGOA* plays an important role in regulating the protection of the environment and conservation of oil and gas resources in relation to the exploration of oil and gas. It is critical that entities carrying on work related to the drilling, production, conservation, processing and transportation of oil and gas be authorized under section 5(1)(b) in such a manner that the polluter pays principle is achieved and risk-averse behaviour is maximized. The regulator’s role in ensuring both financial responsibility and financial viability of authorized entities is crucial to achieving this.

With a view to clarifying the application criteria for those applying for an authorization, the NEB has published these Draft Guidelines. However, Ecojustice has some concerns and believes they can be strengthened to better enable the *COGOA* to fulfill its legislative purpose. Below we set out these concerns and provide our recommendations.

For the reasons outline below, **Ecojustice recommends that:**

- **Recommendation #1: The purposive section of the Draft Guidelines<sup>2</sup> should include a provision acknowledging that the implementation of the polluter-pays principle is a primary objective of the liability regime. While the polluter-pays**

<sup>1</sup> *Canada Oil and Gas Operations Act*, RSC 1985, c O-7.

<sup>2</sup> National Energy Board, Draft Financial Viability and Financial Responsibility Guidelines (2013) at 1.

principle is implicitly suggested within the Guidelines, making this objective explicit clearly places responsibility on the applicant.

- **Recommendation #2:** The Draft Guidelines fail to provide a detailed list for applicants to consider when creating their Financial Viability estimate. This is a concern as responsive actions should be secondary. The focus should be on preventative measures. A more specific list of criteria, similar to those listed under Financial Responsibility should be included.
- **Recommendation #3:** The Draft Guidelines provide a list of factors to be considered when preparing an estimate for Financial Responsibility. These are: the costs associated with containing the incident, costs of cleaning up the environment and costs of compensation. While this is beneficial some of the factors would be improved by increased clarity. Under the “cost of cleaning up the environment” the sub-factor “Net Environmental Benefits Analysis outcome for considered spill countermeasures” should be revised to provide more clarity regarding its meaning and intent.
- **Recommendation #4:** Under Financial Responsibility, “cost of cleaning up the environment”, it is unclear to what extent applicants are responsible for restoring the environment and damaged resources to their pre-spill condition. Three types of restoration exist: (i) emergency restoration where time is of the essence, (ii) primary restoration which is intended to return damaged natural resources to their baseline, and (iii) compensatory restoration, which quantifies the interim damage that occurred.<sup>3</sup> For instance if 5000 adult birds were killed, it is not sufficient to replace the adults but also provide for the production foregone or the impact on future generations due to the loss of those adults. The Guidelines would be significantly strengthened, if it was clearly stated that applicants are responsible for all three stages, rather than just cleaning up damage associated with the spill. Thus, restoration must refer to the cost of restoring, rehabilitating, replacing/acquiring the equivalent of the damaged natural resources.
- **Recommendation #5:** Under Financial Responsibility, the damage and loss to public ecological goods and services should be included as a factor. For instance, many flora and fauna provide water filtration services. The public will lose the use of these resources. This damage should be included as a factor in Financial Responsibility. The criteria could also include the diminution in value of natural resources pending their restoration. When considering ecological goods and services, non-economic benefits should also be considered. Scientists use a variety of methods in calculating a reduction in ecological goods and services, and these methods are highly dependent on the resource being assessed.<sup>4</sup> Often, the concept of total economic value (“TEV”) is employed. TEV is the sum of use values (e.g., direct use, indirect use, preserving use for future) and non-use values (e.g., satisfaction derived from knowing that water filtration exists and will exist for future generations). TEV can be used to capture non-market aspects of ecological

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<sup>3</sup> National Commission on the BP *Deepwater Horizon* Oil Spill and Offshore Drilling, Natural Resources Damage Assessment: Evolution, Current Practice and Preliminary Findings Related to the *Deepwater Horizon* Oil Spill (Staff Working Paper No 17) at 5.

<sup>4</sup> *Ibid.*

services.<sup>5</sup>

- **Recommendation #6:** The Draft Guidelines should also require that when estimates are submitted, they be increased by a certain percent before the NEB will accept the estimates. This would reflect the reality, that the costs of accidents are almost always more expensive than the originally estimated.
- **Recommendation #7:** The Draft Guidelines should also mandate that Financial Responsibility and Viability cost estimates receive independent third party verification. For instance, under Ontario's Greenhouse Gas Reporting program, independent third parties must verify emissions reports submitted. This would help to ensure veracity and minimize bias before cost estimates are submitted to the NEB.<sup>6</sup> It also acts to verify quantification methodologies and ensures that cost estimates are compliant with the established criteria.<sup>7</sup>
- **Recommendation #8:** Although six months seems reasonable for the NEB to do a thorough review of offshore cost estimates, the two month period for onshore applications should be extended. A longer review time for onshore activities will enable the NEB to complete a thorough investigation of cost estimates.
- **Recommendation #9:** The Draft Guidelines should also provide more detail regarding what constitutes a worst-case scenario. How will a worst-case scenario be defined and who will determine when there is a worst-case scenario? It seems inappropriate that applicants are able to determine what constitutes a worst-case scenario. Perhaps this is another scenario where third party verification should be implemented. At the very least, the criteria for determining the worst-case scenario should be transparent, and accessible to the public. It is also unclear whether in a worst-case scenario whether an operator must cover the full costs of such a scenario, or merely up to the maximum absolute liability limit.
- **Recommendation #10:** More detail should be provided as to what constitutes a "material change." This should not be left to the discretion of the applicant.
- **Recommendation #11:** The Draft Guidelines should clearly outline the role of the NEB in monitoring the Financial Viability and Responsibility of operators throughout the life of the project. The responsibility should not solely be on the operator to notify the NEB. Instead, the Draft Guidelines should make it clear that the NEB needs to have access to all the operator's financial records throughout the lifetime of the project.

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<sup>5</sup> Credit Valley Conservation and Pembina Institute. (2009). *Credit Valley Conservation – Natural Credit: Estimating the Value of Natural Capital in the Credit River Watershed*, online: Credit Valley <<http://www.creditvalleyca.ca/wp-content/uploads/2011/06/Natural-Credit-Estimating-the-Value-of-Natural-Capital-in-the-Credit-River-Watershed.pdf>>.

<sup>6</sup> Enviro Access. Why validate a greenhouse gas (GHG) emissions reduction project? What is validated? (2013), online: Enviro Access <<http://www.enviroaccess.ca/audit-carbone/en/services-ac/greenhouse-gas-validation/why-validate-a-greenhouse-gas-ghg-emissions-reduction-project-what-is-validated/>>.

<sup>7</sup> *Ibid.*

- **Recommendation #12:** Serious consequences for failing to report material changes in Financial Responsibility and Viability should be incorporated into the *COGOA*. Consequences for failing to report will help to ensure compliance.
- **Recommendation #13:** It is concerning that the NEB has full discretion over the proof of financial responsibility that an applicant must implement. Perhaps, more detailed criteria should be outlined to establish consistency across applicants. The Guidelines also appear to suggest, that the NEB could seek to obtain proof of Financial Responsibility in an amount less than the statutory maximum absolute liability limit. Ecojustice recommends that the maximum liability limit should be the minimum value of any irrevocable letter of credit provided to the NEB.
- **Recommendation #14:** While an audited financial statement and irrevocable letter of credit are important and positive steps, it is again important to highlight the importance of having the Financial Responsibility and Financial Viability estimates independently audited. Please see recommendation #7.
- **Recommendation #15:** It is concerning that the Draft Guidelines allow applicants to propose self-insurance. Instead, only independent third parties or parent companies should be able to provide an insurance guarantee. Third party insurance or parent company guarantees provide more stability for liability costs.
- **Recommendation #16:** It is troublesome that beyond the irrevocable letter of credit, worst-case scenario costs can be covered through “any other arrangement that is acceptable to the Board.” Instead, options for coverage should be standardized for all operators.
- **Recommendation #17:** The Draft Guidelines should provide more detail as to what constitutes inadequately responding to a spill. Guidance needs to be provided as to the reasonableness of measures taken. This will provide certainty and hold both the operator and the NEB accountable. As the term “reasonable measures” has not been considered in a judicial context, this underscores the importance of the Guidelines providing increased guidance.
- **Recommendation #18:** It is highly troublesome that limits are imposed on absolute liabilities. This provides an inadequate measure of protection. In the alternative, if limits continue to be imposed, Ecojustice recommends more appropriate maximum liability limits. Higher limits would reflect the true costs associated with clean-up measures. Ecojustice also recommends instituting a cap to the exception, where operators intentionally contravene the law.
- **Comment #19:** While there is no way to ensure that this concern can be addressed satisfactorily, Ecojustice would like to highlight that there is no guarantee that any security posted by operators will be large enough to meet all potential absolute liability claims.

## Purpose

Under section 5(1)(b) of *COGOA*, applicants seeking authorization must demonstrate their Financial Viability and must demonstrate how they will meet their Financial Responsibility pursuant to subsection 27(1). The purpose of the Draft Guidelines is to provide clarity with regards to these concepts. The Draft Guidelines describes “Financial Viability” as:

the extent to which an Applicant is financially capable of conducting the applied-for activity safely and in an environmentally responsible manner. The Applicant must provide an estimate of the costs of doing so, and demonstrate its ability to pay for these costs.<sup>8</sup>

Financial viability is described as including the actions applicants take to reduce the likelihood and consequences of an event occurring. Actions include “implementing an effective management system, and the safety, environmental protection, contingency, [and] emergency response plans”<sup>9</sup> implemented to support the activity. The Draft Guidelines requires applicants demonstrate their financial ability to pay for their activities to be completed safely, pursuant to any regulatory requirements.

Financial responsibility is described as:

the extent to which an Applicant is financially capable of implementing its worst case scenario spill contingency plan. For the purposes of these Guidelines, the worst case scenario is a severe event with extreme and significant effects and consequences...The Applicant must provide an estimate of all costs associated with control of the incident, clean-up of the environment and compensation to affected parties, and demonstrate its ability to pay for these costs.<sup>10</sup>

Financial responsibility is described as taking into consideration the actions an applicant would take in response to an event occurring, such as implementing a spill contingency plan. The Draft Guidelines requires that an applicant must demonstrate that they have sufficient funds available to quickly and effectively address worst-case scenarios.

**Recommendation #1: The purposive section of the Draft Guidelines<sup>11</sup> should include a provision acknowledging that the implementation of the polluter-pays principle is a primary objective of the liability regime. While the polluter-pays principle is implicitly suggested within the Guidelines, making this objective explicit clearly places responsibility on the applicant.**

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<sup>8</sup> National Energy Board, Draft Financial Viability and Financial Responsibility Guidelines (2013) at 1.

<sup>9</sup> *Ibid.*

<sup>10</sup> *Ibid.*

<sup>11</sup> *Ibid.*

## Cost Estimates

Pursuant to the Draft Guidelines, an applicant for a *COGOA* authorization must provide two cost estimates. The first is for the cost of completing the applied-for activity in a safe and environmentally responsible manner (Financial Viability). The second estimate is for the total cost of implementing a spill contingency plan in a worst-case scenario (Financial Responsibility).

The Draft Guidelines provide a very detailed list of criteria to consider when creating an estimate for Financial Responsibility. The spill contingency plan must include the cost of containing the spill, cleaning up the environment and compensating affected third parties.

Applicants must explain how they arrived at their estimates, and provide supporting documentation. Applications for authorizations for onshore activities need to be filed at least two months prior to the time the decision is requested, and offshore activities need to be filed at least six months prior.

**Recommendation #2: The Draft Guidelines fail to provide a detailed list for applicants to consider when creating their Financial Viability estimate. This is a concern as responsive actions should be secondary. The focus should be on preventative measures. A more specific list of criteria, similar to those listed under Financial Responsibility should be included.**

**Recommendation #3: The Draft Guidelines provide a list of factors to be considered when preparing an estimate for Financial Responsibility. These are: the costs associated with containing an incident, costs of cleaning up the environment, and costs of compensation. Under the “cost of cleaning up the environment”, the sub-factor “Net Environmental Benefits Analysis outcome for considered spill countermeasures” should be revised to provide more clarity regarding its meaning and intent.**

**Recommendation #4: Under Financial Responsibility, “cost of cleaning up the environment”, it is unclear to what extent applicants are responsible for restoring the environment and damaged resources to their pre-spill condition. Three types of restoration exist: (i) emergency restoration where time is of the essence, (ii) primary restoration which is intended to return damaged natural resources to their baseline, and (iii) compensatory restoration, which quantifies the interim damage that occurred.<sup>12</sup> For instance if 5000 adult birds were killed, it is not sufficient to replace the adults but also provide for the production foregone or the impact on future generations due to the loss of those adults. The Guidelines would be significantly strengthened, if it was clearly stated that applicants are responsible for all three stages, rather than just cleaning up damage associated with the spill. Thus, restoration must refer to the cost of restoring, rehabilitating, replacing/acquiring the equivalent of the damaged natural resources.**

**Note: Both in relation to Recommendation #4 and Recommendation #5, Ecojustice acknowledges the lack of explicit statutory provision for “non-use” damages under *COGOA*. However, such damages could be claimed by the Crown pursuant to the common law (see *British Columbia v. Canadian Forest Products Ltd.*, [2004] 2 S.C.R. 74,**

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<sup>12</sup> *Supra* note 3 at 5.

2004 SCC 38), and we therefore recommend that the NEB amend its draft guidelines to reflect this. We further note that the federal government has indicated it will table legislative amendments allowing for the pursuit of “environmental damages” (ie. including non-use damages), so at the very least, the NEB should be prepared to release finalized Guidelines that reflect this change (see <http://www.nrcan.gc.ca/media-room/news-release/2013/7202>).

**Recommendation #5: Under Financial Responsibility, the present and future potential damage and loss to public ecological goods and services should be included as a factor. For instance, many flora and fauna provide water filtration services, which may be lost to the public. The criteria could also include the diminution in value of natural resources pending their restoration. When considering ecological goods and services, non-economic benefits should also be considered. Scientists use a variety of methods in calculating a reduction in ecological goods and services, and these methods are highly dependent on the resource being assessed.<sup>13</sup> Often, the concept of total economic value (“TEV”) is employed. TEV is the sum of use values (e.g., direct use, indirect use, preserving use for future) and non-use values (e.g., satisfaction derived from knowing that water filtration exists and will exist for future generations). TEV can be used to capture non-market aspects of ecological services.<sup>14</sup>**

**Recommendation #6: The Draft Guidelines should also mandate that Financial Responsibility and Viability cost estimates receive independent third party verification. For instance, under Ontario’s Greenhouse Gas Reporting program, independent third parties must verify emissions reports submitted. This would help to ensure veracity and minimize bias before cost estimates are submitted to the NEB.<sup>15</sup> It also acts to verify quantification methodologies and ensures that cost estimates are compliant with the established criteria.<sup>16</sup>**

**Recommendation #7: Although six months seems reasonable for the NEB to do a thorough review of offshore spill cost estimates, it should be considered that such estimates may require bilateral/multilateral discussions with other sovereign nations (e.g. the United States, in the context of a prospective Beaufort spill).**

**Recommendation #8: The Draft Guidelines should also provide more detail regarding what constitutes a worst-case scenario. On what basis will a worst-case scenario be defined and who will determine when there is a worst-case scenario? It is inappropriate for applicants/operators to define a “probable” worst-case scenario. If the NEB does not have the resources or capacity to project such a scenario, then another option would be for a third party to assess, based on a set of informational criteria (anticipated flow rate, pipe diameter, length of potential loss of well control, etc) provided by the operator, and baseline ecological characteristics provided by the NEB and other relevant departments. At the very least, the criteria for determining the worst-case scenario should be transparent, and accessible to the public.**

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<sup>13</sup> *Supra* note 3 at 5.

<sup>14</sup> *Supra* note 5.

<sup>15</sup> *Supra* note 6.

<sup>16</sup> *Ibid.*

## Financial Responsibility and Viability Requirements

The Draft Guidelines require that Financial Viability and Responsibility be maintained throughout the life of the project. The Draft Guidelines also require that applicants inform the NEB of a material changes that ill Financial Responsibility or Viability.

**Recommendation #10: More detail should be provided as to what constitutes a “material change.” This should not be left to the discretion of the applicant.**

**Recommendation #11: The Draft Guidelines should clearly outline the role of the NEB in monitoring the Financial Viability and Responsibility of operators throughout the life of the project. The responsibility should not solely be on the operator to notify the NEB.**

## The Draft Guidelines: Proof of Financial Statements

The NEB has full discretion over the proof of Financial Responsibility an applicant must submit. The NEB also has full discretion to impose any amount for Financial Responsibility. The Draft Guidelines state that in demonstrating coverage for Financial Viability, audited financial statements and the applicant’s most recent credit rating reports (an investment grade of at least a B) is required. An applicant must also provide the NEB with unfettered access to the funds provided as proof of coverage of Financial Responsibility, in the form of an irrevocable letter of credit. The NEB also requires that the applicant hold at minimum, spill and pollution insurance.

**Recommendation #12: The Guidelines appear to suggest that the NEB could seek to obtain proof of Financial Responsibility in an amount less than the statutory maximum absolute liability limit. Ecojustice recommends that the maximum liability limit should be the minimum value of any irrevocable letter of credit provided to the NEB.**

**Recommendation #13: While an audited financial statement and irrevocable letter of credit are important and positive steps, it is again important to highlight the importance of having the Financial Responsibility and Financial Viability estimates independently audited. Please see recommendation #6.**

**Recommendation #14: It is concerning that the Draft Guidelines allow applicants to propose self-insurance. Instead, only independent third parties or parent companies should be able to provide an insurance guarantee. Third party insurance or parent company guarantees provide more stability for liability costs.**

**Recommendation #15: It is concerning that beyond the irrevocable letter of credit, worst-case scenario costs can be covered through “any other arrangement that is acceptable to the Board.” Instead, options for coverage should be standardized for all operators.**

## Unsatisfactory response by applicant

In the event of a spill incident not appropriately addressed by the operator, the Draft Guidelines



provide that the NEB may take over the spill response and pay out any outstanding claims. It should be noted that the NEB's Chief Conservation Officer can authorize anyone to take control the management of an emergency response if it believes the operator is not responding adequately to a spill.

**Recommendation #16: The Draft Guidelines should provide more detail as to what constitutes inadequately responding to a spill. Guidance needs to be provided as to the reasonableness of measures taken. This will provide certainty and hold both the operator and the NEB accountable. As the term "reasonable measures" has not been considered in a judicial context, this underscores the importance of the Guidelines providing increased guidance.**

On behalf of Ecojustice, we would like to thank you for considering our concerns. Please contact us if you have any questions regarding our concerns or any other matter.

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