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Re: **Request for Comment – Proposed Amendments to NI 51-101 *Standards of Disclosure for Oil and Gas Activities*, Form 51-101F1 *Statement of Reserves Data and Other Oil And Gas Information*, Form 51-101F2 *Report on Reserves Data by Independent Qualified Reserves Evaluator or Auditor*, Form 51-101F3 *Report of Management and Directors on Oil and Gas Disclosure* and Companion Policy 51-101CP *Standards of Disclosure for Oil and Gas Activities***

We are writing in response to the Canadian Securities Administrators' (CSA) request for comments on its proposed amendments to National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities*, and its companion policies[1].

[1] http://www.osc.gov.on.ca/documents/en/Securities-Category5/rule_20091218_51-101_rfc-pro-amd.pdf

With S4.3 billion in assets under management, Northwest & Ethical Investments L.P.'s approach to investing incorporates the thesis that companies integrating best environmental, social and governance (ESG) practices into their strategy and operations will provide higher risk-adjusted returns over the long term. We pay particular attention to the oil and gas sector, because it makes a major contribution to the total market capitalization of the TSX Composite Index, and because it is associated with significant risks from an ESG perspective. Through our company evaluations, our active engagement with the companies in our funds, and our issues research, we have developed considerable insight into good practices and weaknesses in corporate ESG disclosure in the industry, which we endeavour to share in the context of consultations on policy and standards.

Northwest & Ethical Investments L.P. commends the CSA for its timely effort to enhance corporate disclosure in the oil and gas sector, and for seeking input in this process. In the following pages we set out our general response to the proposed amendments, as well as our specific comments and recommendations on the CSA consultation documents.

Changing disclosure needs for a changing oil and gas industry

A growing number of investment institutions are seeking to integrate material environmental, social and governance (ESG) factors into their decision making. According to research by the Social Investment Organization, assets managed under socially responsible investment (SRI) mandates in Canada reached over C$609 billion in 2008, representing almost 20% of total assets under management[2]. Internationally, 538 institutions managing assets in excess of US$18 trillion have become signatories to the UN Principles for Responsible Investment[3], while the Carbon Disclosure Project is supported by 534 investors with assets under management of US$64 trillion[4]. To be able to integrate ESG considerations, investors need access to consistent data, allowing them to compare the systems and performance of companies across sectors. This suggests that enhancing ESG disclosure requirements will be an important factor in maintaining the future competitiveness of Canadian exchanges. We note that the Ontario Securities Commission (OSC) will be conducting activities this year to enhance environmental and governance disclosure requirements. We hope that other members of the CSA will participate in this work, and that it will be opened up to wide consultation.

Against this background of change in the disclosure needs of investors, the oil and gas industry is also undergoing a transformation, in Canada and internationally. Today's oil and gas industry looks very different from that of 20 years ago, and 10 years from now the industry will be different again from that of today. At present conventional oil and gas exploration and production remains the dominant revenue generator in Canada, but this is being outpaced by growth in exploitation of unconventional assets. Oil sands, shale gas, coal-bed methane, offshore oil, enhanced oil recovery and other relatively new production streams form an increasingly significant proportion of production and reserves. These unconventional assets bring a suite of benefits, costs and risks that differ from those associated with conventional oil and gas. As a result, investors require greater clarity both on the extent to which a company's strategic positioning depends on specific types of unconventional assets, and on the unique risks associated with those assets.

In Companion Policy 51-101CP, the CSA acknowledges that the present policy drafts make few specific references to unconventional oil and gas, and encourages issuers engaged in these areas of activity to

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2 http://www.socialinvestment.ca/documents/caReview2008.pdf
3 http://www.unpri.org/files/PRI%20Annual%20Report%2009.pdf
4 https://www.cdproject.net/en-US/WhatWeDo/Pages/overview.aspx

supplement prescribed disclosure with information that will help investors to understand the business (p10570). In our experience, while some Canadian oil and gas companies are showing leadership in recognizing the changing expectations of investors and acknowledging the specific risks and opportunities of unconventional oil and gas, not all issuers have been so responsive in meeting these new disclosure needs. Over the past year we have conducted comparative research into ESG disclosure among companies operating in the Alberta oil sands, highlights of which were published in the report *Lines in the Sands: Oil Sands Sector Benchmarking* (http://www.ethicalfunds.com/SiteCollectionDocuments/docs/lines_in_the_sands_full.pdf). We found that many of the companies were failing to provide information on what we believe to be material issues with potential to affect investment decision-making.

Drawing on our recent research, in the following sections we will focus in particular on disclosure issues relating to oil sands assets. We note, however, that the unique characteristics of other types of unconventional oil and gas activity may generate other sets of unique disclosure needs. The CSA is ideally placed to set minimum expectations for disclosure on unconventional oil and gas issues through national instruments such as NI 51-101, pushing all issuers to adapt to emerging disclosure needs. We believe the role of the CSA, in providing guidance and creating a level playing field, is crucial.

National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities*

Section 1.1(v) Definition of 'Product Types'

We recommend that issuers be required to specify the bitumen extraction method in disclosure on oil sands product types.

The draft recognizes that investors need to understand the extent to which a company is exposed to various aspects of oil and gas activity. This is indeed essential, as different activities are associated with distinct risks and opportunities. Section 1.1(v) provides a fairly comprehensive breakdown of product types for which companies should be providing disaggregated disclosure. However, we believe further clarification is required regarding 'synthetic oil' and 'bitumen'.

Bitumen can be extracted through two radically different approaches, in situ extraction and mining. There appears to be an assumption in the Companion Policy that the product of oil sands mining is invariably upgraded to synthetic oil, while the product of in situ extraction is always 'raw' bitumen (p10570). This is not always the case: there are examples of in situ producers upgrading bitumen, and recent changes in demand and price differentials have encouraged miners with upgrading facilities to ship 'raw' bitumen instead.

The significant differences between in situ and mining extraction create differing risks and opportunities, warranting disaggregated disclosure. Mining and in situ extraction involve differing technology, skills, and equipment. For example, a forecasted shortage of the massive tires used on oil sands dump-trucks could impact severely on a mining operation, but would have little effect on an in situ operation. In such a case, clarity on the relative exposure of the company's assets to oil sands mining or in situ extraction would be material information for investors.

The environmental challenges and impacts associated with the two types of oil sands extraction also vary. Although in situ has its own set of environmental challenges, much of the public controversy about current and potential environmental impacts of the oil sands industry relates to aspects that are specific to mining, such as the creation of tailings ponds. We note that in situ operators have created the In Situ

Oil Sands Alliance (IOSA), which devotes considerable effort to emphasising for the public and investors the distinction between in situ and mining operations.

The product type 'shale gas' is essentially similar to 'natural gas', but the CSA has rightly recognized the need to differentiate production and reserves estimates between these two forms of gas based on differing methods of extraction. In the same way, we believe investors need to be able to distinguish the extent of a company's exposure to the risks and opportunities of different methods of bitumen extraction.

<u>Section 5.16 Prohibition Against Addition Across Resource Categories</u>

We support the addition of Section 5.16, prohibiting addition across resource categories. This will help to prevent the disclosure of misleading reserves estimates and as such is an enhancement to the instrument.

<u>Section 5.17 Disclosure of High and Low Case Estimates of Reserves and Resources other than Reserves</u>

We support the addition of Section 5.17, particularly the requirement to disclose both the high and low case estimates. We believe that this requirement will also help to prevent misleading estimates, and that it represents an enhancement to the instrument.

Form 51-101F *Statement of Reserves Data and Other Oil and Gas Information*

The proposed amendments to Form 51-101F represent an improvement, but to enable investors to more completely assess the profitability of a company's future reserves, we recommend the following additions relating to costing.

<u>Item 2.1 *Reserves Data (Forecast Prices and Costs)*</u>

We recommend that oil sands miners be directed to disclose more information about reclamation and abandonment costs, and that all issuers be directed to disclose forecast costs of compliance with greenhouse gas emissions pricing regulations.

Investors need to understand the material assumptions that have been made about the profitability of future reserves. This is the basis for the current sound requirement for issuers to provide adequate disclosure on the forecast prices and costs that impact the evaluation of reserves and future net revenues. Forecast prices and costs used should be "generally accepted as being a reasonable outlook of the future" (p10569). This implies that factors that are inevitable or highly likely to emerge in the near term should be taken into consideration. We consider two such factors in the following sections. Specifically, the table referenced to Item 2.1.3(b) would be an appropriate place to include additional cost factors.

Section 2.1.3 (b) Abandonment and Reclamation Costs – Tailings Ponds

Abandonment and reclamation costs are included in the list of costs issuers are required to forecast against future revenues, recognizing that the reclamation obligation is an inevitable consequence of exploitation of a resource. However, our experience of studying current disclosure among companies operating oil sands mines suggests these issuers may not be providing a complete picture on reclamation and abandonment costs. With current technology, oil sands mining creates a unique reclamation obligation in the form of tailings ponds. Given the unresolved technical challenges surrounding tailings reclamation, and the large scale of the problem, the costs are likely to be significant, and therefore should be considered material. We are concerned that companies with active or proposed tailings ponds may be not be including the potential costs of tailings reclamation when calculating future net revenue.

The following example illustrates the potential problem. According to its reporting for financial year 2008, a large-cap company involved primarily in oil sands mining (and therefore exposed to the obligation to reclaim tailings ponds) had allocated 0.15% of proved gross revenue towards abandonment costs. By way of comparison, a small-cap oil and gas company operating conventional assets (the reclamation of which might be assumed to present a lesser challenge) had allocated 0.77% of proved gross revenue towards abandonment costs.

Companies operating oil sands mines point to various factors to justify what appear to be low estimates of reclamation costs in their public disclosure. These include the distant horizon for reclamation of such long-lived assets, and the fact that recycled water from the tailings ponds forms part of the operational water balance. But if the purpose of disclosure is to allow investors to understand the reserves status and future net revenues from an oil sands mine, it seems misleading to downplay an unavoidable future cost that is potentially significant, even if it will not materialize in the short term. Indeed, if there is a real risk that the costs to reclaim the ponds might exceed the revenues generated, arguably these resources should not be considered as economically viable reserves.

Furthermore, mine operators now face the prospect of having to take action on tailings ponds in the near term. The Alberta government's new tailings directive specifies requirements on tailings reduction and reclamation progress, and will begin apply to operations as early as June 2011[5]. This implies that tailings reclamation costs are not merely a distant prospect, but will generate actual costs well within the forecasting timeframe commonly used for public disclosures. The Alberta regulator has indicated that this is the first of several directives focused on driving forward tailings management performance, with the eventual goal of eliminating the tailings ponds.

Tailing ponds are a significant environmental, reputational, and financial risk to the companies concerned, worthy of special attention within the context of NI 51-101

Section 2.1.3 (b) - Cost of Carbon

The list of costs to be considered against revenue includes royalties and income tax expenses. We believe that, in addition, carbon costs are likely to be increasingly material to the calculation of future net revenues. Oil and gas producers already recognize that they are likely to be exposed to impacts from current and future regulations relating to climate change. Carbon pricing is no longer a theoretical concept: it already applies in several jurisdictions, including in Alberta, where heavy emitters currently face an intensity-based cost of $15/tonne CO_2 equivalent for emissions above their regulated allowance[6].

Although Canadian federal and global carbon pricing frameworks remain uncertain, it seems likely that carbon costs will increase and be applied more widely in future. Prudent companies should be incorporating a price for carbon into their reserves estimates, but currently there is no disclosure on how future carbon prices could impact net revenues from reserves. Issuers should therefore be asked to disclose current and potential carbon costs to investors.

[5] http://www.ercb.ca/docs/documents/directives/directive074.pdf
[6] This regulation currently only applies to facilities that have annual GHG emissions of over 100 kilo tonnes.

Item 2.2 Supplemental Disclosure of Reserves Data

Under this item, issuers are allowed to supplement reserves disclosure under Item 2.1 with disclosure according to US requirements. When conducting our oil sands research, we observed that companies reporting under Canadian regulations provided better disaggregated disclosure than those reporting under US Securities and Exchange Commission (SEC) guidelines. We have no objection to supplemental disclosure, but note with concern that some issuers are avoiding the obligations under Item 2.1 entirely by requesting a complete exemption from the CSA reporting requirements in favour of disclosure under SEC requirements. We do not see value for investors in securities regulators granting such exemptions, as issuers reporting to SEC are not providing comparable disclosure.

Item 3.2 Forecast Prices Used in Estimates

We believe oil and gas companies should be asked to disclose the carbon pricing forecasts they are using in their estimates.

As noted earlier, greenhouse gas emissions costs are already a reality for companies operating in some jurisdictions, and there is reason to believe carbon pricing will become more common within the forecasting period that issuers currently report on. We note that in general issuers currently provide their forecast prices and costs in a table format that discloses forecast prices over 10 years – a window within which carbon pricing is likely to become an increasingly material issue. Item 3.2 guides companies on disclosure of pricing assumptions for each product type, including assumptions on inflation and exchange rates. If companies are to be asked to disclose carbon costs in the context of reserve estimates, it would seem logical to disclose assumptions regarding the future price of carbon here. Ideally we would like to see companies disclose forecast costs for carbon on a unit of oil equivalent basis (e.g. per barrel).

Carbon price forecasting is complicated by current regulatory uncertainty, but there is also great uncertainty about the future price of crude oil, which issuers are nevertheless expected to forecast. Investors need to know how companies are accounting for the future cost of carbon in their planning. As active owners, we know from engagement discussions that leading companies are already including carbon pricing as a factor in their capital investment planning. Some companies in the oil and gas industry already include this pricing in their public disclosures – a practice we would like to see adopted by all companies in high-emissions sectors.

Item 5.2 Significant Factors or Uncertainties Affecting Reserves Data / Item 6.2.1 Significant Factors or Uncertainties Relevant to Properties with No Attributed Reserves

Under Item 5.2, the reference in the Instructions to "the need to build a major pipeline or other major facility before production of reserves can begin" has been deleted. We would question the value to investors of this change. In light of the increasingly remote locations of some oil and gas exploration activities, disclosure on the potential barriers to future production (e.g. unusually high development costs or the need for pipeline infrastructure) is extremely relevant to investors. The need to build pipelines and other major facilities is included in Item 6.2.1 as an example of a factor or uncertainty relating to properties with no attributed reserves; it is not clear why this guidance is relevant here and not in the former case. If the intention behind the deletion is to highlight the fact that assets should not be booked as reserves if there is uncertainty about relevant facilities such as pipelines to distribute the product, this is a sensible change, but this intention could be specified more clearly.

Item 6.4 Additional Information Concerning Abandonment and Reclamation Costs

It is under Item 6.4 that oil sands mining companies generally choose to discuss the potential impacts of tailings pond reclamation costs on future net revenues. However, disclosure is generally limited to a boilerplate statement that reclamation costs for tailings ponds are potentially material, but have not been incorporated because the costs are undetermined. This disclosure is a welcome starting point, but does not provide robust information that investors can use to determine the long-term viability of a company's strategy. As noted earlier, investors need to understand the actual cost estimates associated with the final reclamation of tailings ponds, and the near-term costs of compliance with the Alberta Government's new tailings directive.

If reclamation and abandonment costs for tailings ponds are not being included under Item 2.1, then Item 6.4 should provide for more informative disclosure of the liability. Specifically, we would like to see an estimate of the future volume and extent of tailings ponds that will be created or sustained by exploitation of the reserves, as well as high and low estimates of the potential costs of reclamation. The latter disclosure could take the form of an aggregated estimate, or be provided on a $/unit basis.

Conclusion

We commend CSA's continuing commitment to review and enhance disclosure standards. Robust disclosure equips investors with the information necessary for prudent decision making. At a time when investors are taking increasing interest in environmental, social and governance indicators, when carbon pricing is becoming a reality, and when the focus of the oil and gas industry is shifting towards exploitation of unconventional assets, it is timely to consider enhancements to disclosure requirements that could provide investors with a clearer picture of the differing risks and opportunities associated with emerging aspects of oil and gas production. In this context, we believe disclosure on oil sands operations could be enhanced by disaggregation of data according to the bitumen extraction approach used, and by addition of further detail on oil sands mine tailing pond reclamation; and that all oil and gas disclosure would be enhanced by disclosure of carbon costing assumptions.

Should you have any questions regarding this submission, please do not hesitate to contact Bob Walker, Vice President, Sustainability (bwalker@northwestethical.com, 604-742—8320).

Sincerely,

Northwest & Ethical Investments L.P.

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