By Frank Spizzirri and Sheldon Title

SCC's Final Word in the *Redwater Energy Corp.* Bankruptcy

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The question of who pays for the environmental clean-up of a bankrupt company is one that has dogged Canadian insolvency practitioners for years. Should the "polluter pay" — meaning, should the estate of the bankrupt (*i.e.*, the creditors) bear the burden — or should the bankruptcy trustee be able to walk away from environmentally damaged property and any associated clean-up liability, and effectively leave the government (*i.e.*, the taxpayer) to clean up? These hotly contested questions were thought to have been settled largely in favor of creditors at the expense of taxpayers by the Supreme Court of Canada (SCC) in 2012 in *AbitibiBowater Inc*.[1] However, the SCC reconsidered these questions in its recent ruling in the bankruptcy and receivership of *Redwater Energy Corp.*[2] This time, the SCC ruled that the estate of the polluter would have to pay, and provided along the way a few nuances to the three-part test it first set out in *AbitibiBowater*.

Background

Redwater was a publicly traded junior producer that held a number of oil and gas-producing properties licensed under provincial legislation: the Oil and Gas Conservation Act[3] and the Pipeline Act[4] (collectively, the "Provincial O&G Statutes"). Among other things, these statutes imposed end-of-life obligations for oil and gas operating assets and wells, and they required regulator approval for the transfer of licenses. In 2015, Redwater found itself the subject of both a receivership order and a bankruptcy order with Grant Thornton Ltd. (GTL) appointed as receiver, then bankruptcy trustee.

After its appointment as receiver, GTL conducted a review of Redwater's business and assets, and decided to only take control of and sell a small portion of the wells/licenses (namely, the economically viable ones), then disclaim and abandon the rest. In response, the Alberta Energy Regulator (AER) issued closure and abandonment orders, which required GTL to comply with Redwater's provincial statutory obligations in relation to the abandoned wells under the Provincial O&G Statutes. In effect, GTL had to deal with the end-of-life/abandonment and clean-up costs before being able to sell the more marketable wells/licenses and distribute the proceeds to creditors.

The legal dispute centered around whether the end-of-life/abandonment and clean-up obligations under the Provincial O&G Statutes ran afoul of both the limitation on trustee obligations and liabilities set out in § 14.06,[5] and of the priorities regime set out in § 136 of the Federal Bankruptcy and Insolvency Act (BIA).[6] In Canada, the doctrine of paramountcy provides that where a provincial law is otherwise *intra vires* but is in conflict with an equally *intra vires* federal law (*i.e.*, the two laws are both valid but mandate different actions or result in different outcomes), the federal law trumps provincial law. GTL argued that the provincial environmental clean-up obligations were in conflict with the BIA.

The matter ended up in court, with the AER, together with the Orphan Well Association (OWA),[7] seeking to have the "polluter pay"[8] by compelling GTL to comply with the AER's orders. GTL sought to abandon assets at its discretion and without the obligation to comply with the AER orders or pay for the associated costs. The motions judge and a majority of the Alberta Court of Appeal agreed with GTL and held that the AER's proposed use of its statutory powers conflicted with the BIA in that (1) it imposed on GTL the obligations of a licensee in relation to the assets disclaimed by GTL, which were contrary to § 14.06(4) of the BIA; and (2) it upended the priority regime established by the BIA by requiring that the claims of the AER, an unsecured creditor, be paid ahead of the claims of Redwater's secured creditors.[9] The case was then appealed to the SCC.

The SCC Decision

The SCC, in a split 5-2 decision, overturned the Alberta Court of Appeal. The question of who would have to pick up the cost of environmental clean-up was examined by the SCC in 2012 in

1 *AbitibiBowater Inc., Re* (2012), 95 C.B.R. (5th) 200 (SCC) ("*AbitibiBowater*").
2 *Orphan Well Ass'n v. Grant Thornton Ltd.*, 2019 SCC 5 ("*Redwater*").
3 R.S.A. 2000, c. 0-6, *as amended*.
4 R.S.A. 2000, c. P-15, *as amended*.

5 Under § 14.06 of the BIA, trustees and receivers are afforded certain protections from personal liabilities for environmental clean-up costs.
6 R.S.C. 1985, c. C-36, *as amended*.
7 The OWA is a nonprofit organization unique in the province of Alberta. Its mandate is to manage the abandonment of upstream oil and gas orphan wells, pipelines and facilities, and the remediation and reclamation of their associated sites. It operates under the delegated legal authority of the AER.
8 The regulator did not seek to hold GTL liable for these obligations beyond the assets remaining in the *Redwater* estate.
9 The lower court decisions, *AbitibiBowater* and the doctrine of paramountcy are discussed in greater detail in a previous article. *See* Frank Spizzirri and Sheldon Title, "*Redwater Energy*: Environmental Clean-Up Costs in Canada," XXXVII *ABI Journal* 1, 54-55, 85, January 2018, *available at* abi.org/abi-journal.

AbitibiBowater, where the SCC looked at the question from the perspective of whether the clean-up obligation under the provincial law was regulatory or monetary in nature.

If the obligation was monetary in nature, then it would be an ordinary monetary claim within the proceeding and the trustee would not be compelled to do the clean-up work. If the obligation was regulatory in nature, the trustee would have to comply with the obligation, thereby effectively giving the clean-up costs a superpriority over other creditors. In determining whether an environmental obligation was monetary, the Supreme Court set out a three-part test: (1) There must be a debt, liability or obligation to a creditor; (2) the debt, liability or obligation must be incurred as of a specific time; and (3) a monetary value must be attachable to the debt, liability or obligation.

The net result of the *AbitibiBowater* decision and the application of the three-part test by subsequent courts was that governmental clean-up orders were reduced to monetary claims and environmental clean-up effectively became the problem of provincial governments or their regulators. In applying the test in *AbitibiBowater* to the facts in *Redwater*, however, the majority took a slightly different approach: nuancing two of the three parts of the test. With respect to the first part of the *AbitibiBowater* test, the majority stated that part one of the test should not be taken as standing for the proposition that a regulator is always a creditor when it exercises its statutory enforcement powers against a debtor. A regulator exercising a power to enforce a public duty was not a creditor.

Here, the majority found that the AER was acting in a *bona fide* regulatory capacity, acting in the public interest and for the public good, and it did not stand to benefit financially from the obligation imposed. Since it was not benefiting financially, its claim was not monetary in nature.

With respect to the third part of the test, the majority commented that a court must determine whether there are sufficient facts indicating the existence of an environmental duty that will ripen into a financial liability owed to a regulator. In determining whether a non-monetary regulatory obligation is too remote or too speculative to be included in the bankruptcy proceeding, the court must apply the general rules that apply to future or contingent claims: It must be sufficiently certain that the contingency will come to pass.

In this case, the SCC concluded that it was not certain that the AER and/or the OWA would have to pay for any clean-up in the end. The majority concluded that the AER was therefore not asserting a monetary claim but instead a regulatory claim. Therefore, the priority scheme in the BIA was not upended. Moreover, the majority also found that while trustees are afforded protection from personal liability (in § 14.06 of the BIA), that did not mean that trustees were empowered to simply walk away from the environmental liabilities of the estate.

The minority came to the opposite conclusion, arguing that the majority overly narrowed the first and third parts of the test. The minority concluded that the AER's claim was monetary in nature and that therefore the obligations imposed by the Provincial O&G Statutes were trumped by the doctrine of paramountcy. The minority also found that the restriction on the ability to disclaim certain wells/licenses by GTL directly ran afoul of § 14.06 of the BIA and that the doctrine of paramountcy also applied there.

The Decision's Practical Impact

There are a number of implications from the SCC's decision in *Redwater* — not only for the oil and gas industry in Canada, but also across all industries in Canada that face environmental challenges and regulatory bodies that seek to contain taxpayer risk to clean-up costs. In its reasoning, the majority has clearly reopened the ability of regulators to successfully seek to have an estate cover the costs of remediation and spare taxpayers. For governments and taxpayers, this is good news. However, it is not good news for the secured creditors of polluters.

The impact on the Alberta oil and gas industry is clear: The cost of end-of-life well management will now have a clear priority over secured creditors. This means that secured creditors (along with unsecured creditors and equity stakeholders) will need to factor these costs into their decisions of whether to loan, invest or extend credit to an oil and gas company.

The impact on borrowing capacity will most likely be felt in the short term as lenders re-evaluate their borrowers in light of the decision. Junior and intermediate companies are more vulnerable to the liquidity squeeze, which might force these companies to turn to more expensive secondary sources of financing or to become a target of an acquisition by a larger industry player, thereby leading to further consolidation within the Canadian energy industry. Moreover, lenders might now play a more active role in ensuring that borrowers are compliant by inserting customized environmental covenants in bank loan agreements to manage the enhanced risk. As a result, borrowers' cost of borrowing will likely rise. Companies with revolving loans, which typically factor the cost of end-of-life and remediation into calculating their borrowing base, might now face lenders who are less willing to accept these costs at face value, but rather shrink the borrowing base to reflect the additional risk from the *Redwater* decision.

With respect to insolvency proceedings initiated for the purposes of restructuring a business or facilitating the conveyance of economically valuable assets, this might not be good news. Debtors had previously looked to restructure their businesses by using insolvency proceedings as a means of renouncing interest in licensed wells, facilities and pipelines. The *Redwater* decision effectively takes that off the table.

Moreover, lenders might now be less inclined to appoint receivers to sell operations as going concerns in situations where the value of the debtor's assets is insufficient to satisfy the related end-of-life obligations. Receivers might also be reluctant to accept appointments, as there might be no funds available to pay the administrative costs. This might lead to situations where banks walk away from enforcing their security or debtors might simply abandon their assets without engaging in insolvency proceedings, thereby effectively eliminating a mechanism for redistributing the assets.

Foreign investment might also be negatively affected. If the cost of borrowing goes up and/or the return on investment decreases as a result of rising operational costs, foreign investors might simply invest in other parts of the world. While the domestic energy industry appears to support the majority decision on the ground that it reinforces the polluter-pay principle, it remains to be seen how it will influ-

continued on page 101

from page 37

ence the perceptions of foreign investors and impact foreign investment in 2019 and beyond.

Going forward, in all likelihood, regulators across Canada will be reviewing their own laws and regulations and considering how to align them to the decision in order to prevent polluters (and their creditors) from avoiding valid provincial clean-up obligations by going insolvent or bankrupt. While the regulators in the energy sector might welcome the polluter-pays principle, it is critical that these regulators also recognize the need to work collaboratively with oil and gas debtors, insolvency practitioners and lenders to ensure that their actions are consistent with promoting a viable and competitive energy industry. Moreover, provincial governments might well look beyond environmental clean-up costs as they seek to act in the public's interest and for the public good in other areas of the economy, and might push back against insolvency proceedings being used to avoid provincial obligations.

As the majority so succinctly put it, "Bankruptcy is not a license to ignore rules, and insolvency professionals are bound by and must comply with valid provincial laws during bankruptcy."[10] And so the SCC (well, the majority at least) has spoken, for now. abi

10 *Redwater, supra* at ¶ 160.