ENVIRONMENTAL OBLIGATIONS CANNOT BE IGNORED EVEN IN BANKRUPTCY: *ORPHAN WELLS ASSOCIATION V GRANT THORNTON LTD.*

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With the growing concern over the environmental impacts of commercial activity, provinces have enacted and expanded environmental legislation in order to hold companies accountable for the costs of remediating the environmental harm they cause. However, regulators have struggled with how to hold companies accountable for environmental harm when they become insolvent. For many years, clean-up obligations have been treated as unsecured claims lacking priority over secured claims.

On January 31, 2019, the Supreme Court of Canada (the "**SCC**") released its much anticipated decision in *Orphan Well Association v Grant Thornton Ltd.*, 2019 SCC 5 ("***Redwater***") in which the Court considered the interplay between federal insolvency law and provincial environmental regulation. The SCC upheld the Alberta environmental regulatory scheme allowing it to circumvent established priorities in the federal *Bankruptcy and Insolvency Act* (the "***BIA***") with potentially wide ranging implications for both insolvency and environmental law.

***Redwater* Decision**

This case involved the bankruptcy and receivership of Redwater Energy Corporation (the "**Company**"), which operated in the oil and gas industry in Alberta, and a dispute between the Alberta Energy Regulator (the "**Regulator**") and the company's receiver and trustee, Grant Thornton Ltd. (the "**Receiver**"), over who was responsible for the clean-up costs of the Company's abandoned oil wells. The Company operated various wells and pipelines in the province.

Under Alberta's regulatory scheme, companies operating in the oil and gas field are assigned a Liability Management Rating ("**LMR**"). The LMR is a ratio between the value of the assets that are licensed to the company against the costs of cleaning up those assets at the end of their economic life. Companies must maintain a ratio above 1.0 to avoid paying a security deposit and will be prevented from transferring licenses if it would cause the ratio to fall below 1.0 (or in some cases 2.0). In order to ensure that companies do not escape environmental liability by declaring bankruptcy, the Alberta scheme includes "trustee" and "receivers" in the

definition of "licensee" in the context of end-of-life closure and clean-up responsibilities.

In *Redwater*, the Company experienced financial difficulties and was put into receivership and eventually bankrupt. The Regulator notified the Receiver that as trustee it was required to fulfill the Company's clean-up obligations prior to distributing any assets to creditors. The Receiver took the position that it would only be taking control of certain of the Company's assets and would renounce the Company's remaining assets, thus avoiding liability for their associated clean-up.

In court, the Receiver argued that it should not be held liable under the provincial regulatory scheme as doing so would conflict with the *BIA*. It argued that if it were held liable, this would conflict with the priority order under the *BIA*, thus rendering the provincial regulation inoperative based on the legal doctrine of federal paramountcy. While both the chambers judge and a majority of the Alberta Court of Appeal sided with the Receiver, the SCC rejected both of these arguments and held that the doctrine of federal paramountcy need not be applied as it was possible to interpret Alberta's environmental regulatory scheme in a manner that did not conflict with the *BIA*:

> "[w]hen a federal statute can be properly interpreted so as not to interfere with a provincial statute, such an interpretation is to be applied in preference to another applicable construction which would bring about a conflict between the two statutes."[1]

The Court found that there was no operational conflict between the two statutes and that the Receiver remained responsible for the end-of-life obligations of all of the Company's assets.

The SCC also considered whether the Regulator was asserting a claim "provable in bankruptcy" which would be covered by the *BIA*'s collective priority scheme. In such instance, the rule that provincial law will be inoperative when it conflicts with federal law would apply.

The test for when an environmental claim is provable in bankruptcy was previously set out by the SCC in the case of *Newfoundland and Labrador v. AbitibiBowater Inc.*, 2012 SCC 67 ("***Abitibi***") as follows:

1. there must be a debt, a liability or an obligation to a creditor;
2. the debt, liability or obligation must be incurred before the debtor becomes bankrupt; and
3. it must be possible to attach a monetary value to the debt, liability or obligation.[2]

Accordingly, not all environmental obligations enforced by a regulator will be claims provable in bankruptcy. In *Redwater*, the Court found that the first part of the test was not met as the Regulator was acting in the public interest and did not stand to benefit financially in the same way a creditor would benefit. As a result, the environmental claim was not provable in bankruptcy and therefore did not conflict with the priority scheme set out in the BIA.

Implications for Environmental Law

Prior to *Redwater*, regulators have struggled to uphold environmental clean-up obligations when a company becomes insolvent. Under the *Abitibi* test, environmental clean-up orders that are provable in bankruptcy are unsecured claims, making the likelihood of recovery low as against secured creditors. Because of this difficulty, regulators have turned to other methods to try to ensure that contamination left behind by a bankrupt party will be addressed.

In *Northstar Aerospace Inc.*, Re, for example, the Ontario Ministry of Environment was unable to enforce a clean-up order against a bankrupt company on the basis that once bankruptcy proceedings had begun, the Ministry could not enforce what was a payment obligation against the company. Instead, the Ministry had to file a claim against the company along with other unsecured creditors. As a result, the Ministry chose instead to go after the company's directors personally, ultimately settling with them for a fraction of what the Ministry had originally been seeking against the company.[3]

Redwater signals the SCC's willingness to resolve conflicts between environmental and insolvency law on the side of attempting to protect the environment. Depending on the specific wording of the provincial environmental statute, *Redwater* strengthens the ability of provincial regulators to enforce compliance with environmental remediation orders in situations where such a claim is not provable in bankruptcy. We should expect regulators to potentially become more aggressive in the enforcement of clean-up obligations in circumstances where the company is insolvent or claims to be in financial distress. Further, Redwater will make it more difficult for companies to abandon their environmental obligations when insolvent and, at least in theory, less likely that directors will be asked to cover the company's obligations when they do.

From the policy perspectives of protecting the environment and upholding the polluter-pays principle, Redwater is arguably a positive development. However, there will undoubtedly be concerns raised as to whether the SCC in deciding the case as it did has made it more difficult for federal bankruptcy law to achieve its purposes and for companies to obtain adequate funding. For the implications for lenders of Redwater please read: Supreme-Court-of-Canada-Allows-Redwater-Appeal-Regulator-entitled-to-super-priority-for-abandonment-and-reclamation-costs.

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[1] Redwater at para 78, citing Canadian Western Bank v Alberta, 2007 SCC 22 at para 75.
[2] Abitibi at para 26.
[3] Former Northstar directors, officers reach deal with Ontario over cleanup.

A Cautionary Note