

# ENVIRONMENTAL PRIORITIES IN INSOLVENCY PROCEEDINGS AND THE IMPACT ON LENDERS: ALBERTA COURT BROADENS REDWATER PRINCIPLES

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A recent Alberta case continues the development of a line of cases at the intersection of environmental protection and bankruptcy and insolvency law in Canada. The Alberta Court of King's Bench decision in *Qualex-Landmark Towers v 12-10 Capital Corp* ("**Qualex**")<sup>[1]</sup> opens the door for private citizens to try to establish a "super priority" over registered mortgagees where environmental remediation obligations are at issue. The decision has important implications for financial institutions and other lenders who loan against the value of real property.

The *Qualex* decision relies and builds on the Supreme Court of Canada's ("**SCC**") landmark decision in *Orphan Well Association v. Grant Thornton Ltd.* ("**Redwater**").<sup>[2]</sup>

## A Review of Redwater

In *Redwater*, the SCC considered how environmental remediation obligations should be prioritized in bankruptcy. Pursuant to Alberta's regulatory regime, a company is required to obtain a license in order to extract oil and gas resources.<sup>[3]</sup> Specific environmental obligations are imposed on license holders, including end-of-life obligations to ensure the environmental security of a well.<sup>[4]</sup> Such obligations may persist through and after insolvency proceedings pursuant to Alberta statutes, such as the *Oil and Gas Conservation Act*,<sup>[5]</sup> the *Pipeline Act*,<sup>[6]</sup> and the *Environmental Protection and Enhancement Act*.<sup>[7]</sup>

The principal issue in *Redwater* was that the associated costs of the insolvent company's end-of-life obligations with respect to its abandoned oil wells would exceed its asset sale proceeds in the insolvency proceeding.<sup>[8]</sup> The company's receiver and trustee posited that these remediation obligations conflicted with the provisions of the *Bankruptcy and Insolvency Act* (the "**BIA**"),<sup>[9]</sup> particularly section 14.06,<sup>[10]</sup> but the SCC concluded otherwise.<sup>[11]</sup>

The Court then applied the test set out in *AbitibiBowater Inc., Re*<sup>[12]</sup> to determine whether the environmental claims at issue were provable in bankruptcy and ultimately concluded that the company's environmental

remediation obligations did not conflict with the *BIA*'s priority scheme.

In issuing the decision in *Redwater*, the SCC signaled a trend toward heightened environmental responsibility of debtors and their receivers and trustees as well as the creation of a "super priority" for certain environmental obligations. A more detailed discussion of the *Redwater* decision and its implications can be found in our earlier bulletins [here](#) and [here](#).

### **Earlier Applications of *Redwater* in Alberta**

Two recent decisions that build on and consider *Redwater* are the Alberta Court of Appeal's 2022 decision in *Manitok Energy Inc (Re) ("Manitok")*<sup>[13]</sup> and the Alberta Court of King's Bench decision in *Orphan Well Association v. Trident Exploration Corp. ("Trident")*.<sup>[14]</sup>

In *Manitok*, the receiver was tasked with determining priority between two builders' liens and the oil and gas well abandonment and reclamation obligations of the insolvent company.<sup>[15]</sup> The Court applied *Redwater*, finding that the assets in the estate should have been made available to discharge the abandonment and reclamation obligations regardless of the fact that the assets were sold by the trustee and converted to cash.<sup>[16]</sup>

Similarly, the Alberta Court of King's Bench, relying on *Redwater* and *Manitok*, determined in *Trident* that the application of the now established super priority principles required that the abandoned oil and gas well reclamation obligations be given precedence over municipal tax obligations.<sup>[17]</sup>

### **Application of *Redwater* to Private Interests**

The reasoning in *Qualex* potentially broadens the reach of super priority principles. In that case, 12-10 Capital Corp ("**Capital Corp**") owned contaminated real property (the "**12-10 Lands**"). This contamination had migrated onto and impacted the adjacent property owned by Qualex-Landmark Towers Inc. ("**QLT**")<sup>[18]</sup> and Alberta Environment and Parks ("**AEP**") had directed Capital Corp to complete an environmental remediation plan to address it.<sup>[19]</sup> Upon discovery of Capital Corp's insolvency (despite not yet subject to insolvency proceedings) and its intention to sell the 12-10 Lands, QLT brought a claim against Capital Corp seeking an order requiring Capital Corp to complete the remediation as directed by AEP and a finding that Capital Corp's environmental obligations took priority over its outstanding mortgages. Given that there would be insufficient net proceeds from the sale of the 12-10 Lands to complete the environmental obligations after the mortgages were re-paid, QLT sought an attachment order to hold any sale proceeds of the 12-10 Lands in trust for the purpose of the environmental remediation work pending the outcome of its claim. <sup>[20]</sup>

In keeping with *Redwater*, *Manitok* and *Trident* and in line with the polluter pays principle, the Court recognized that it would be inappropriate to permit an insolvent corporation that caused or was responsible

for the contamination at issue to escape environmental remediation obligations while simultaneously paying its secured lenders.<sup>[21]</sup> The Court held that, subject to hearing full argument on the matter at trial, a super priority could apply against Capital Corp with QLT as a likely beneficiary.

Of note to lenders, the super priority would displace the priority that would otherwise be held by the mortgagees.

The Court also confirmed that QLT was not required to be a “regulator” for the purposes of benefitting from a super-priority claim, stating that regardless of if an acting body is a “regulator” or not, a polluter is vested with an obligation to remediate.<sup>[22]</sup>

### **Qualex and Future Implications**

This line of case law emphasizes the need for prospective lenders to exercise thorough due diligence with respect to any real property involved in financing transactions. As environmental issues may remain hidden for years and often their complete scope is not fully known at the time of a transaction, such due diligence may identify previously unknown environmental conditions, risks and obligations associated with the property. This information will assist a lender in making an informed decision based on the possibility of such environmental obligations being granted priority over the secured assets in the event of an insolvency proceeding or civil dispute.

[1] *Qualex-Landmark Towers Inc v 12-10 Capital Corp*, 2023 ABKB 109 [*Qualex*].

[2] *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 [*Redwater*].

[3] *Ibid* at para 12.

[4] *Ibid* at paras 16 - 17.

[5] *Oil and Gas Conservation Act*, RSA 2000, c O-6.

[6] *Pipeline Act*, RSA 2000, c P-15.

[7] *Environmental Protection and Enhancement Act*, RSA 2000, c E-12.

[8] *Redwater*, *supra* note 2 at para 50.

[9] *Bankruptcy and Insolvency Act*, RSA 1985, c B-3.

[10] *Redwater*, *supra* note 2 at para 53.

[11] *Ibid* at para 114.

[12] *AbitibiBowater Inc, Re*, 2012 SCC 67.

[13] *Manitok Energy Inc (Re)*, 2022 ABCA 117 [*Manitok*].

[14] *Orphan Well Association v Trident Exploration Corp*, 2022 ABKB 839 [*Trident*].

[15] *Manitok*, *supra* note 13 at para 2.

[16] *Ibid* at paras 30, 32.

[17] *Trident*, *supra* note [14](#) at para 17.

[18] *Qualex*, *supra* note [1](#) at para 12.

[19] *Ibid* at para 16.

[20] *Ibid* at para 8.

[21] *Ibid* at paras 87-88.

[22] *Ibid* at para 94.

by [Talia Gordner](#), [Adam Maerov](#) and [Ryan Johnson](#) (Articling Student)

### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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