SUPREME COURT OF CANADA ALLOWS REDWATER APPEAL: REGULATOR ENTITLED TO SUPER-PRIORITY FOR ABANDONMENT AND RECLAMATION COSTS

Posted on January 31, 2019

Categories: Insights, Publications

A five judge majority of the Supreme Court of Canada has allowed an appeal brought by the Alberta Energy Regulator ("**AER**") and the Orphan Well Association from the decision of the Alberta Court of Appeal in *Orphan Well Association v Grant Thornton Limited*, 2017 ABCA 124 ("***Redwater***"). The case has been one of the most closely watched by the Canadian oil and gas industry in decades.

The dispute in *Redwater* centred on the renunciation of uneconomic oil and gas wells, pipelines and facilities that are subject to provincial abandonment and remediation liabilities.

The case concerned the receivership and bankruptcy of Redwater Energy Corp. The company's receiver (and later trustee in bankruptcy) challenged the applicability of the provincial regulatory regime administered by the AER. It argued, among other things, that the provincial regulatory regime frustrated the legislative purposes of the federal *Bankruptcy and Insolvency Act* ("**BIA**") and that dual compliance with federal and provincial legislation was not possible. It also argued that preventing receivers from renouncing uneconomic assets, including oil and gas wells, would result in receivers and trustees refusing to take on such mandates and would frustrate statutorily mandated efforts to realize on oil and gas assets of insolvent companies.

The Queen's Bench and Court of Appeal agreed with the trustee and the result has been that receivers and trustees operating under the BIA have been renouncing uneconomic oil and gas properties without liability for abandonment and remediation.

The Supreme Court of Canada overturned the Court of Appeal decision.

Specifically, the Supreme Court of Canada determined that:

- The BIA does not conflict with the provincial legislation and Alberta's regulatory regime can coexist with the BIA.
- The regulator was not asserting claims provable in bankruptcy. Instead, the regulator's claims for remediation costs were to be paid despite the consequences for the insolvent estate and its creditors.

- A trustee cannot be held personally liable for environmental liabilities of the insolvent company (barring gross negligence or wilful misconduct), but liability remains with the insolvent company or its estate despite the trustee renouncing or disclaiming assets.

A dissenting decision expressed the view that:

- There is a conflict between the provincial legislation and the BIA as receivers and trustees cannot disclaim assets under Alberta's regulatory regime that could otherwise be disclaimed under the BIA.
- A fundamental objective of the insolvency regime is to maximize recovery for creditors by realizing the estate's valuable assets. The BIA furthers this objective by allowing a trustee to disclaim uneconomic assets for the benefit of the estate.
- The regulator was asserting claims provable in bankruptcy. These claims must be subject to the BIA's priority of payment scheme.

The background to the *Redwater* QB Decision is set out more fully in our May 2016 bulletin, New Rules of Asset Sales by Insolvent Producers (at least for now).

Implications

An important implication of this decision is that a provincial regulator may require that remediation costs be paid out of the estate of a bankrupt company ahead of any of its creditors, including secured creditors. Although the majority found that the Alberta legislation does not impair the operation of the BIA, the practical effect of this decision arguably alters the priority payment scheme under the BIA.

This decision marks a return to the uncertainty that characterized the oil and gas insolvencies before the *Redwater* QB decision. Receivers and trustees who consider accepting mandates relating to oil and gas companies will be forced to negotiate with the AER on an *ad hoc*, case by case basis, to determine whether the AER will consent to the sale of a bankrupt company's oil and gas assets. For an example of such a situation, please see our January 2016 bulletin, Compromise with the Alberta Energy Regulator: Navigating a Receivership in Alberta's Oil Patch.

This decision may also have profound effects on lending to oil and gas companies at a time when the industry is experiencing severe setbacks. Secured lenders may be reluctant to advance funds to any oil and gas company for fear that the regulator may in effect confiscate the secured lenders' interest in their borrower's assets.

Receivers and trustees may also refuse to accept mandates relating to oil and gas companies in some circumstances resulting in more oil and gas assets being transferred to the Orphan Well Association. Amendments to the BIA are also possible.

McMillan represented the Canadian Association of Insolvency and Restructuring Professionals, which intervened in opposition to the appeal.

by: Adam Maerov, Kourtney Rylands and Preet Saini

A Cautionary Note