Environmental and Bankruptcy Law Collide: Redwater Energy Corporation

Authors: John Stefaniuk, K.C.

published 10/27/2016

Laws intersect. Laws run parallel. Sometimes they collide. What happens then?

On May 19, 2016 the Alberta Court of Queen's Bench released its decision in *Re: Redwater Energy Corporation*. Redwater was an oil and gas developer in Alberta. It held a number of development properties under the authority of the Alberta Energy Regulator (AER). Things did not go well for Redwater. Its primary lender, Alberta Treasury Branches (ATB) had called its loan. When Redwater was unable to repay the loan, ATB appointed Grant Thornton LLP (GTL) first as Receiver and subsequently as Trustee in Bankruptcy of the estate of Redwater.

The Trustee did what trustees do; it gathered up Redwater's assets for sale for the benefit of Redwater's creditors. ATB was first among them. In doing so, the Trustee examined the assets. It learned of environmental clean-up and site reclamation obligations that were associated with some of Redwater's non-producing or "shut-in" properties. The Trustee sought to realize on the 20 or so valuable, producing well properties and to disclaim the other 87 sites, leaving the reclamation of the latter sites to the Province of Alberta's orphan well reclamation program administered by the Orphan Well Association.

AER refused to permit the transfer of the valuable, productive licences, which would leave the remaining orphaned sites in the bankrupt corporation. AER had a policy that prevented cherry-picking of assets, preventing transfers unless licensees meet a solvency ratio or asset test. It issued abandonment orders requiring clean-up or posting security in relation to the disclaimed properties. The Trustee applied to the Court to set aside the orders. AER applied to the Court for an order preventing the Trustee from disclaiming the properties that required reclamation.

The Court had to deal with the conflict between the provincial oil and gas legislation that imposed reclamation obligations on licence holders (including a Trustee that takes control of properties) and the federal *Bankruptcy and Insolvency Act* (BIA). The Court held that the provincial legislation would frustrate the purpose of the section of the BIA that allows a

Trustee to disclaim unwanted assets and agreements (including environmental clean-up obligations). Under the *Constitution Act, 1867*, bankruptcy falls under federal jurisdiction. Where a conflict between any valid, federal legislation and provincial legislation crops up, and the conflict renders simultaneous compliance with both impossible, the federal legislation is considered “paramount” in that it trumps the inconsistent provincial legislation. Here the Court held that the provisions of the BIA that allowed the Trustee to disclaim assets took precedence over provincial law that otherwise prevented the transfers and the disclaimer.

Note that the test for federal paramountcy is one of “impossibility of dual compliance”, not just inconsistency. By way of example, the Supreme Court has upheld the validity of a Quebec municipal by-law that banned the use of “cosmetic pesticides” for residential weed control, notwithstanding that the products that were banned were federally approved as safe for use and that the lawn care companies that challenged the by-law held valid provincial pesticide application licences.

The *Redwate*r decision has implications outside of the realm of oil and gas properties. If the case is followed, then where a company that holds assets requiring environmental clean-up becomes insolvent, it will be open for a Trustee to disclaim those assets, resulting in greater recovery of proceeds for the benefit of creditors. The decision places greater pressure on provincial regulators to take steps to avoid orphan site liability. That could take the form of increased oversight while the operator is solvent, quicker calls for reclamation and the issuance of remediation orders and the requirement for increased financial assurance at the licence stage. All of this could impact the ability of a company to carry out its business and to undertake new developments.

The result of the case also creates greater potential exposure to directors and officers of corporations that have environmental liabilities. It is becoming more and more routine for Canadian regulators to name directors and officers in compliance and cleanup orders issued against a defaulting corporation. Those directors and officers may be relying upon the overall financial assets of the corporation to satisfy its environmental legal obligations. If a Trustee in Bankruptcy is able to disclaim the assets that have associated environmental liabilities, leaving them while taking the valuable assets to satisfy creditor claims, the resulting shortfall may fall upon the shoulders of the directors and officers.

In turn, individuals will want to consider whether and in what circumstances they are prepared to serve as directors or officers of corporations that are exposed to significant environmental liability. It may not be safe for those individuals to assume that they may rely upon the asset cushion on the books of the corporation as a buffer that will satisfy the corporation's remediation obligations. Those directors and officers will want to ensure that environmental obligations are appropriately managed during their tenure and that adequate, dedicated financial assurance is in place to address remediation obligations should the corporation fall short in its ability to deal with them. It might also affect the timing of

insolvency protection, encouraging directors and officers to act more quickly while greater assets are available to satisfy claims.

Governments, typically the Provinces, may find themselves faced with higher numbers of orphaned sites, as those are disclaimed and the valuable assets of insolvent corporations are used to first satisfy creditor claims.

The *Redwater* decision is under appeal. In the meantime, AER has amended its rules to attempt to limit the impacts of the ruling.

This article was written for, and published in Mid-Canada Forestry & Mining magazine and is reproduced with permission.
