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Once Upon a Time in the West: Redwater, its Trustee, and the Environmental Arm of the Law

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In a decision handed down on January 31, 2019, the Supreme Court ordered that a bankrupt oil and gas company fulfil its obligation to reclaim abandoned oil wells before paying any creditors. This decision has since sparked conflicting reactions across the country: first, because it gives clear precedence to environmental protection in the event of bankruptcy, and second, because of the influence it will likely have over business decisions in industries where environmental risks are involved. Moreover, the concrete impact this decision will have in Quebec, where environmental laws have recently undergone major reforms, remains to be seen.

Background

Redwater Energy Corp. is a publicly traded Alberta oil and gas company that obtained financing for part of its operations from Alberta Treasury Branches ("ATB") in 2013. The latter held a security interest over Redwater's assets. In 2014, Redwater experienced financial difficulties which resulted in its inability to fulfil its obligations to ATB, its primary secured creditor. In 2015, Redwater was placed under receivership.

At that time, Redwater's assets consisted of 127 oil and gas properties—wells, pipelines and facilities—and their corresponding licences obtained in 2009. Said licences were granted by the Alberta Energy Regulator ("AER"), subject to an obligation to reclaim wells and facilities as prescribed to make them environmentally safe.

However, at the time Grant Thornton was appointed as its receiver, 72 of Redwater's licensed wells and facilities were depleted and burdened with environmental liabilities in terms of abandonment and land reclamation, such that Redwater's liabilities exceeded the value of the wells and facilities that were still producing.

Upon being advised that Redwater was placed under receivership, the AER notified Grant Thornton

that despite the receivership, it was under the legal obligation to fulfil abandonment and reclamation obligations for all licensed assets prior to distributing funds or finalizing any proposal to creditors. Grant Thornton replied that it was not taking possession and control of Redwater's valueless facilities and that it therefore had no obligation to fulfil the environmental obligations associated with these renounced assets (the "Environmental Obligations").

In the summer of 2015, in response to Grant Thornton's reply, the AER issued abandonment orders under two Alberta laws directing Redwater to suspend the operation of the renounced assets, abandon them in accordance with the AER's rules and regulations, and obtain the reclamation certificates required by law.

In the fall of 2015, a bankruptcy order was issued for Redwater and Grant Thornton was appointed as trustee.

The AER filed an application to order Grant Thornton to comply with its Environmental Obligations before making any distribution to Redwater's creditors, but the application judge and the majority of the Alberta Court of Appeal agreed with Grant Thornton and refused to issue the orders sought. In their view, agreeing with the AER would be tantamount to ignoring the orderly and equitable distribution scheme set out in the *Bankruptcy and Insolvency Act* ("BIA").

The AER appealed the judgment to the Supreme Court. On January 31, 2019, in a 5-2 majority decision, the Supreme Court allowed the AER's appeal.

1- The trustee's personal liability

The first question the Court reviewed was whether section 14.06(4) of the *BIA* allows a trustee to escape the obligations imposed by Alberta law with respect to the reclamation of oil and gas facilities. Essentially, this question raises the fundamental issue of whether the *BIA* is in operational conflict with provincial laws.

Section 14.06(4) of the *BIA* provides that the trustee is not personally liable for any failure to comply with any order to remedy any environmental condition or damage affecting a bankrupt property if the trustee abandons or renounces any right to the property in question.

The majority of the Court interpreted this provision in a restrictive manner and concluded that, even if the trustee is not held *personally* liable, the bankrupt estate's *assets* remain subject to the order to remedy any environmental damage. Thus, the value of the bankrupt's assets must be used to fulfil its Environmental Obligations.

2- The notion of "provable claim"

Grant Thornton further argued that, even if the bankrupt's assets were to be used to fulfil Environmental Obligations, these should be paid as "provable claims" of an ordinary creditor, in other words, neither a secured nor a preferred creditor. Thus, the question of whether the AER could demand that Redwater's Environmental Obligations be fulfilled before the value of the assets could be distributed to its creditors involves the concept of "claims provable in the bankruptcy" as defined by the *BIA*.

One of the objectives of the *BIA* is to ensure the equitable distribution of the bankrupt's property among creditors who have a "provable claim." Said distribution is done according to a very precise order, established by law. However, if a claim is not "provable" within the meaning of the *BIA*, it nonetheless continues to be binding on the bankrupt and must be paid regardless of the distribution scheme provided for under the *BIA*.

According to the Supreme Court in the 2012 *AbitibiBowater*[1] decision, a “provable claim” exists if three requirements are met:

1. There must be a debt, 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.

If any one of these requirements is not met, there is no “provable claim.” Applying this analytical framework to the situation at hand, the majority of the Court determined that the AER is not a “creditor” within the meaning of the first requirement. According to the Court, the people of Alberta would ultimately benefit if Redwater and other companies like it met their Environmental Obligations: the province itself would not be gaining a financial advantage. Thus, the AER, when seeking to enforce Redwater’s public duties, is not a creditor within the meaning of the law. This was sufficient to conclude that its claim was not a “provable claim” subject to the distribution scheme provided for under the *BIA*[2].

The result, according to the Supreme Court, is that compliance with Environmental Obligations prevails over the payment of any provable claims of secured, preferred and unsecured creditors in the form of a first charge[3]. This conclusion does not conflict with the priority scheme under the *BIA*, nor does it contradict the goal of maximizing the realizable value of the assets, because all of Redwater’s valuable assets were subject to Environmental Obligations in any case.

Such a decision raises several questions. First, as Justice Côté points out in her dissenting reasons, it may sometimes be difficult to know when the regulator is *not acting* in the public interest, suggesting that such a regulator can never be a creditor within the meaning of the law. Second, the adopted interpretation is likely to have consequences, in particular on the financing industry for companies exploiting natural resources. Faced with the existence of first charges that could remain unknown for a long time, lenders that finance the activities of such companies may have to reconsider the conditions under which they agree to finance them because of the increased risk of having the value of their investment or guarantees reduced.

3- What about the effects of this judgment in Quebec?

It is particularly difficult to say with certainty what the effects of this decision will be in Quebec given the current legislative context in the areas of activity in question. Quebec legislation has undergone major reforms recently (in mid-2017 for the environment and at the end of 2018 for petroleum ressources) both in terms of environmental protection and the management of natural resources. The structure of the law, the conditions for obtaining operating licences and drilling authorizations and the powers of public authorities (in particular those of the ministers) have been changed to such an extent that we believe caution should be exercised before drawing hasty conclusions.

In the case analyzed by the Supreme Court, the legislation in question, which made site remediation an obligation under the licenses issued, defined remediation to include decontamination.

While this conclusion can apparently be drawn from the legislative structure applicable to mining operations, it is less obvious to do so with respect to petroleum resources development in Quebec.

Moreover, although Quebec has legislative provisions to ensure that soil decontamination work is carried out in certain situations under division IV of the *Environment Quality Act*, the obligations to produce a characterization study, prepare a rehabilitation plan and carry out decontamination work do not apply in all cases.

Although solely the production of a characterization study and a rehabilitation plan are required in

some cases (cessation of activities), decontamination is only mandatory for the resumption of other activities, unless ordered by the Minister.

Therefore, in cases where land decontamination is not a mandatory condition under the law, we must consider whether or not decontamination work otherwise performed may or may not qualify as “provable claims” within the meaning of the *Bankruptcy and Insolvency Act*.

Thus, we should be careful before affirming that the Supreme Court’s decision in this case will automatically apply to Quebec in all situations.

Analyzing situations on a case-by-case basis (as the Supreme Court said, incidentally) is the way forward, and understanding the Supreme Court's decision in the *Redwater* case properly will certainly be key.

4- Conclusion

The *Redwater* decision raises diametrically opposed reactions depending on the audience. Some welcome the Supreme Court's effort to support provincial authorities responsible for overseeing environmental matters by adopting an interpretation of federal and provincial legislation that is broad, flexible and imbued with cooperative federalism. The Court's message that bankruptcy is not a licence to ignore environmental rules and that trustees are bound by valid provincial laws is also appreciated.

Others, however, object to the business consequences that could result from this decision for companies operating in areas of activity that involve environmental risks, because access to financing may be more difficult. Where the full value of the assets is likely to be used to ensure compliance with environmental obligations, insolvency professionals who rely on the value of the assets to cover their own professional feess may be discouraged from accepting mandates when environmental issues are involved. Some are also concerned that companies in difficulty will abandon their assets to governments rather than attempting to restructure, thereby increasing the social burden of these problematic assets - a result that the majority decision seemed to want to avoid.

In Quebec, as we pointed out above, the powers exercised and orders issued will require careful review to determine their immediate or potential regulatory or monetary nature. In the first case, *Redwater* suggests that a trustee would be forced to comply in accordance with the value of the assets, while, in the second case, the provincial authority's claim would be considered subordinate to the rights of secured and preferred creditors in the distribution scheme provided for in the *BIA*.

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1. *Newfoundland and Labrador v. AbitibiBowater Inc.* [2012] 3 SCR 443, 2012 SCC 67 (CanLII)
2. However, the Court analyzed the third requirement set out in *Abitibi* and concluded that it is not possible to attach a monetary value to the debt in question, as it was not sufficiently certain that the organization would perform the work or claim its reimbursement. The dissenting judges concluded the contrary on this point.
3. Which the Court equates with the one under section 14.06(7) of the *BIA* that the organization could not avail itself of in this case.