Court applies Redwater principles outside formal bankruptcy proceedings

April 10, 2023

In a recent decision, 2023 ABKB 109, Justice D. B. Nixon of the Alberta Court of King's Bench applied the tenets of Canadian environmental law, reiterating that a polluter cannot walk away from its contaminated land and determining that a private landowner has a reasonable likelihood of establishing a super priority to mortgagees for a claim for environmental remediation. The Court's decision is based on its consideration of principles espoused in *Redwater* and other recent cases in the insolvency context.

Justice Nixon granted QL Towers Inc. (QLT) an attachment order for the proceeds of the sale of the defendant's property for over $2 million.

Background

The parties each own properties in Calgary's Beltline. For the purpose of the application for an attachment order, the defendant, 12-10 Capital Corp. (Capital Corp), conceded that QLT had a reasonable likelihood of establishing its claim on the merits. It was conceded that:

1. Capital Corp owns real property that is contaminated (the 12-10 Lands).
2. The contamination is migrating from the 12-10 Lands to the real property of QLT (the QLT Lands).
3. The contamination is at concentrations exceeding the applicable Tier 1 Guidelines of Alberta Environment and Parks (AEP).
4. Capital Corp has failed to remediate to prevent further spread of the contamination.

The crux of the issue before Justice Nixon was that Capital Corp's only valuable asset was the contaminated 12-10 Lands, the value of which is likely not sufficient to cover the outstanding mortgages registered against the 12-10 Lands, let alone the further cost of undertaking environmental remediation.

As found by Justice Nixon, the contamination of the 12-10 Lands was revealed as early as 2006, before Capital Corp purchased the 12-10 Lands in 2009. Capital Corp completed some subsurface investigation of the 12-10 Lands between 2012 and 2015,

including some groundwater pumping and vapour testing, at the direction of AEP: at paras 13-14.

As found by Justice Nixon, Mr. Riaz Mamdani controls the Strategic corporate group (the Strategic Group), which includes Capital Corp: at para 15. Justice Nixon noted that, in an April 2018 letter from AEP to Mr. Mamdani, Capital Corp was directed to submit an environmental site assessment (ESA) for the 12-10 Lands by June 1, 2018: at paras 15-16. The ESA proposal was to include a complete delineation and a remediation action plan or risk management plan (collectively, the Risk Management Plan): at para 16. Almost four years later, in a letter to the Strategic Group, dated February 2022, AEP advised that it still had not received the Risk Management Plan or further soil and groundwater investigation updates from Capital Corp: at para 20.

At the forefront, was the fact that, in January 2022, Capital Corp entered into an Agreement of Purchase and Sale to sell the eastern portion of the 12-10 Lands for the amount of approximately $13.3M, but the sale did not close (Sale): at paras 18-19. At this time, QLT learned that the proceeds from the Sale, or any future sale, were likely not sufficient to cover the outstanding mortgages. The Court noted that there were three mortgages on title. Capital Corp has only made one payment on the most recent mortgage, which was registered after the first direction of AEP to address the contamination.

Decision

The Court held there is a reasonable likelihood of success that QLT will be able to establish a super priority to the mortgagees for its environmental remediation claim because:

- The underlying nature of the claim (environmental remediation) and the fact that Capital Corp is insolvent engages the principles of *Redwater*, *Manitok*, *Perpetual* (2021), *Perpetual* (2022), and *Trident Exploration*.
- If there were formal bankruptcy proceedings, the environmental obligations imposed by Alberta Environment and Parks would likely foist a super priority that may apply absent formal bankruptcy proceedings. Justice Nixon wrote: "*Given the development of the common law in this area, I do not agree that the super priority charge would apply only if an insolvent corporation with environmental remediation obligations enters formal insolvency proceedings. As I read the appellate direction, the super priority charge over the real property of the corporation to remediate likely arises coincidental with the Contamination and will hang over the real property like an umbrella until the environmental remediation obligation is satisfied*."
- It would be inappropriate to allow a corporation to avoid formal insolvency proceedings so that it can sell its property to satisfy its secured lenders and walk away from its environmental remediation obligations. This is even more inappropriate where a corporation has mortgaged the underlying real property in circumstances where the loan-to-value ratio is excessively high. Any such loophole needs to be filled using the common law, perhaps by giving priority to private claims for environmental remediation by displacing the traditional priority to secured lenders.
- Under Canadian environmental law, Capital Corp has a duty to take remedial measures, even absent involvement from the regulator, and QLT has a right to

live free of the nuisance of contamination from neighbouring property. Therefore, QLT need not be a "regulator" to advance its claim that environmental remediation ranks in priority to the mortgagees.
- Though an application for an attachment order, to draw a parallel to bankruptcy proceedings, an application of the *Abitibi* test shows QLT's claim is not a claim provable in bankruptcy.
- Given the super priority of environmental remediation obligations in the bankruptcy context, there is a viable argument that Capital Corp should not be able to walk away from its environmental obligations.

Takeaways

The polluter-pays principle is a tenet of Canadian environmental law. There is a public duty to remediate, which arises independent of a regulator's enforcement. The appellate authority is clear: one cannot walk away from environmental remediation obligations.

This case is a novel application of these principles outside the context of a formal bankruptcy proceeding, and by a private landowner as the beneficiary of the public duty. While this case is a novel application of a super priority outside of a formal bankruptcy, the Court of Appeal of Alberta, in the *Perpetual* cases, has already considered the propriety of transactions prior to formal insolvency proceedings. As Justice Nixon commented, there is a gap that the common law needs to fill because "it would be inappropriate to allow a corporation to avoid formal insolvency proceedings so that it can sell its property to satisfy its secured lenders and walk away from its environmental remediation obligations."

The Alberta jurisprudence is clear that environmental liabilities form part of a balance sheet test, and commercial lenders should already be accounting for a borrower's potential environmental remediation requirements when assessing a mortgage application in light of the lender's own risk.

Standard mortgages require that a borrower warrant that it has disclosed any known environmental contamination. In Alberta, reports regarding environmental contamination are disclosed publicly online on the Government of Alberta's Environmental Site Assessment Repository, which is a searchable database. The simplest of due diligence will put a lender on notice of the environmental remediation obligations of the landowner or borrower. This case serves as a reminder to commercial lenders to complete their due diligence.

The authors of this article acted as counsel for QLT.

By

Matti Lemmens, Taylor Kemp

Expertise

Disputes, Environmental, Commercial Litigation

BLG | Canada's Law Firm

As the largest, truly full-service Canadian law firm, Borden Ladner Gervais LLP (BLG) delivers practical legal advice for domestic and international clients across more practices and industries than any Canadian firm. With over 800 lawyers, intellectual property agents and other professionals, BLG serves the legal needs of businesses and institutions across Canada and beyond – from M&A and capital markets, to disputes, financing, and trademark & patent registration.

blg.com

BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749