AER rejects Shell/Pieridae asset transfer: implications for insolvency matters

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This article considers potential implications of the Alberta Energy Regulator's (AER) recent decision to reject joint applications by Shell Canada Limited (Shell) and Pieridae Alberta Production Ltd. (Pieridae) relating to the transfer of ownership of certain sour gas assets.

Legal background

In January 2019, the Supreme Court of Canada issued its landmark decision in *Orphan Well Association v Grant Thornton Ltd*[1] (also known as *Redwater*) and confirmed that a trustee in bankruptcy cannot disclaim environmental liabilities of the bankrupt estate. This decision had significant implications for the oil and gas industry, as it introduced changes to the credit risk assessment in a changing economic and political climate.[2]

After *Redwater,* the Government of Alberta indicated that it would prioritize legislative responses to address the consequences of *Redwater*. In April, the government passed Bill 12, *Liabilities Management Statutes Amendment Act*, 2020, providing additional tools for the Orphan Well Association (the OWA) and the AER to manage and remediate orphan wells. However, this legislation remains untested to date. The AER made its decision in the Shell/Pieridae transaction in this unique legal context.

AER's decision on the Shell/Pieridae transfer of sour gas assets

On May 13, 2020, the AER issued a decision refusing joint applications by Shell and Pieridae with respect to the sale of Shell's sour gas processing plants to Pieridae.[3] In the application, the companies had sought approvals under a number of statutes. The crux of the AER's decision concerned the *Environmental Protection and Enhancement Act* (EPEA) applications, in which Shell and Pieridae proposed they split regulatory liabilities. Under the proposal, Shell would remain liable for historic regulatory liability for sulfinol and certain other substances, while Pieridae would be liable for all other remediation and reclamation costs. The AER rejected this proposal for several reasons, including:

- The scope and extent of contamination at the sites was unclear. This created practical uncertainty as to how to distinguish between contamination from historic operation of the assets and ongoing operations for the purposes of apportioning liability, as well as regulatory uncertainty arising from the proposed partial obligations of each party;
- The EPEA does not distinguish reclamation or remediation liabilities by substance;
- The proposal was contrary to the polluter-pays principle that guides the EPEA. Shell, as the current operator, has remediation and reclamation obligations relating to the two sour gas plants. If the proposed approval was granted, Shell, as polluter, would be relieved from costs associated with decommissioning, remediating and reclaiming the plants (except for the liability associated with historic sulfinol contamination); and
- The proposal diminished the AER's ability to enforce obligations under the EPEA. First, the proposal was contrary to the concept of joint and several liability for environmental obligations. Second, the AER would have fewer enforcement tools to incentivize Shell to discharge its liability for historic sulfinol contamination, as Shell would not be benefiting from the continued activities at the plants.

The AER's decision was without prejudice to the parties' ability to submit further applications in respect of the proposed transaction.

Potential implications

The AER's decision means there are challenges ahead for oil and gas transactions, as commercial parties regularly separate environmental liabilities by contract. The decision reflects concerns with ensuring sufficient regulatory certainty and oversight for remediating and reclaiming oil and gas facilities, continuing the theme previously seen in *Redwater* of emphasizing redress for environmental liabilities in commercial transactions. Together with enacting Bill 12, these developments suggest that the AER will take a more active role in overseeing oil and gas transactions, as the costs of satisfying the environmental obligations associated with oil and gas assets is a growing concern in all transactions requiring regulatory and judicial approval.

The AER's decision also demonstrates how the existing regulatory framework may affect in the future transactions concerning the purchase and sale of oil and gas assets. In particular, the regulatory restraint on vendor and purchaser abilities to limit contractually environmental liabilities will likely affect a potential purchaser's willingness to purchase an asset. At minimum, it will affect the terms of the deal. It will also affect parties' decisions to enter formally into insolvency proceedings. To the extent that the subject assets constitute the only viable assets of a debtor company, the debtor should consider the possibility that court approval of a proposed transaction may not satisfy AER's requirements for the appropriate distribution of liabilities, and the relative costs of realization in a formal proceeding or by other means.

As financial impacts of the COVID-19 measures and the federal and provincial governments' responses become clearer, the balance of the proposed "suite of policies" will hopefully provide further insight for issues that are yet to be addressed in Alberta's liability management framework and provide helpful guidance for the oil and gas insolvency proceedings following *Redwater*.

[1] *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5, [2019] 1 SCR 150 [Redwater].

[2] Read BLG's previous article on the implications of Redwater

[3] Alberta Energy Regulator, Shell Canada Limited Transfer of Ownership Including the Waterton Sour Gas Plant EPEA Application No 021-258 and Jumping Pound Sour Gas Plant EPEA Application No. 015-11587, Decision dated May 13, 2020.

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