Alberta Court of Appeal clarifies application of Redwater to oil and gas assets

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The Alberta Court of Appeal released its decision in *Manitok Energy Inc (Re)*, in which the Court clarified how the principles in *Redwater*[1]ought to be applied to insolvent oil and gas producers that become subject to regulatory enforcement orders after some of the insolvent company's assets have been sold. This important case is the first time that the Alberta Court of Appeal has considered a priority dispute between regulatory claims and secured creditors in an oil and gas insolvency since *Redwater* was decided in 2019.

Background

Manitok Energy Inc. (Manitok) was an oil and gas E&P company that entered receivership proceedings in 2018. Manitok held licenses for numerous oil and gas assets. Like most insolvent oil and gas companies, some of Manitok's assets were productive and valuable, while others were not.

Through Manitok's receivership proceeding, certain assets were sold to a third party, pursuant to a court-approved sale transaction (the Sale Transaction and the Purchased Assets). Under the terms of the Sale Transaction, the purchaser assumed all abandonment and reclamation obligations (ARO) of the Purchased Assets, and the Order of the Court approving the Sale Transaction provided that the sale proceeds would stand in the place and stead of the Purchased Assets with regard to any claims against Manitok's estate.

Shortly after the Sale Transaction closed, the Alberta Energy Regulator (AER) issued abandonment orders (the Orders) regarding certain of Manitok's assets. The Orders did not apply to any of the Purchased Assets. The cost of complying with the Orders exceeded the realization value of the assets to which the Orders applied. Consequently, the Receiver sought to disclaim those assets, due to their negative value.

The AER asserted that the costs associated with complying with the Orders enjoyed first priority over the proceeds from the Sale Transaction, pursuant to the Supreme Court of Canada's decision in *Redwater*. However, two oilfield service companies had filed builders' liens against certain of the Purchased Assets prior to Manitok's receivership, and contested the AER's position and asserted first priority over the sale proceeds.

The Chambers decision

The Chambers judge ruled in favour of the lien-holders and stated that *Redwater* did not apply in the circumstances. The Chambers judge reasoned that because the sale proceeds arose from the sale of the Purchased Assets, and the Orders did not apply to the Purchased Assets, the sale proceeds were "unrelated" to the environmental condition or damage that was being remediated by the Orders. Relying on an excerpt from *Redwater* in which the Supreme Court suggested that assets that are "unrelated to the environmental condition or damage" should not be used to fulfill ARO for the disclaimed assets, the Chambers judge held that the sale proceeds could not be applied toward the AER's claim.

Further, the Chambers judge held that, since the AER had not issued the Orders at the time the Sale Transaction was completed, the proceeds arising therefrom could not be subject to the AER's claim for first priority.

The Alberta Appeal Court decision

In overturning the Chambers decision, the Court of Appeal rejected the Chambers judge's determination that the Supreme Court's commentary in *Redwater* creates a separate class of "unrelated" oil and gas assets based on whether those assets are subject to abandonment and reclamation orders. The Court of Appeal noted that the facts before it were very similar to those in *Redwater*, and that if the Chamber's judge's ruling was accepted, it would render *Redwater* "meaningless", as there would never be any proceeds available to perform abandonment and reclamation obligations. The Court of Appeal explained that, assets overwhelmingly encumbered by ARO obligations would, by definition, never generate sale proceeds.

Further, the Court of Appeal remarked that in *Redwater* the Supreme Court of Canada did not treat Redwater's assets as falling into different pools. Rather, all of the oil and gas assets were treated collectively as being contaminated, and therefore the proceeds of any valuable assets must be applied toward the abandonment and reclamation obligations attached to the disclaimed assets.

Finally, the Court of Appeal noted that the timing of the Orders is inconsequential with regard to asserting priority to the proceeds because reclamation and abandonment obligations are "inherent" in oil and gas assets from the time those assets come into existence. The Court stated that abandonment and reclamation obligations are not contingent on enforcement action taken by the AER; but rather, the public duty on the Receiver to use proceeds of the Sale Transaction to discharge Manitok's abandonment and reclamation obligations exists independently of any enforcement action taken by the AER. The Court summarized by stating: "neither the existence of enforcement orders nor the sequence in which enforcement action is taken is relevant to the Receiver's duty to discharge public environmental obligations."

Outlook

The Court of Appeal's approach confirms the broad reach of the principles set out in *Redwater. Manitok* similarly builds on some of the Court of Appeal's other recent

decisions, arising from the Sequoia Resources Corp. bankruptcy, in which the Court has held that ARO have to be "discharged even in priority to paying secured creditors".[2]

Ultimately, *Manitok* serves to clarify the application of *Redwater* in oil and gas insolvencies, and provides greater certainty to insolvency professionals regarding the administration of insolvent estates of oil and gas companies.

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

[2] *PricewaterhouseCoopers Inc v Perpetual Energy Inc*, 2021 ABCA 16, para 95.

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