Shifting Environmental Liabilities After The Redwater Decision

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The Court considered whether the Alberta Energy Regulator can restrict a trustee's powers to sell or disclaim uneconomic assets subject to AER licences, in particular assets subject to costly environmental abandonment, reclamation and remediation obligations.

Summary

In a recent decision of the Alberta Court of Queen's Bench, the Court considered whether the Alberta Energy Regulator (the "AER") can restrict a trustee's powers to sell or disclaim uneconomic assets subject to AER licences, in particular assets subject to costly environmental abandonment, reclamation and remediation obligations. The Court held that a trustee can sell or renounce such properties, relying on federal paramountcy rules to hold that the AER's ability to restrict or impose conditions on the transfer of AER licences by a trustee conflicts with a trustee's granted authority under the federal bankruptcy regime, rendering the provincial legislation inoperative to the extent of the conflict or inconsistency.

This decision helps clarify what has been referred to as the "untidy" interplay between environmental legislation and insolvency legislation in Canada and has widespread implications in Alberta. While the decision itself is not policy based and is largely a straightforward analysis of federal paramountcy rules, it calls into question key foundational policy issues about who should bear environmental abandonment, reclamation and remediation costs of insolvent debtors and how Alberta's "polluter-pays" regulatory model should function in the bankruptcy and insolvency context.

The results of this decision on actors in Alberta's economy are mixed. Creditors will benefit from a more certain risk profile which will likely assist already struggling oil and gas companies in securing funding. However, the decision will likely increase the risk of directors and officers being found personally liable for potentially huge environmental costs. Further, the decision will have large impacts on Alberta's orphan well fund which will likely increase costs for oil and gas companies and potentially shift more financial responsibility for environmental costs to the public purse.

Facts

In *Redwater Energy Corporation (Re)*, 2016 ABQB 278, Redwater Energy Corporation ("Redwater") was a publically listed oil and gas corporation which held a number of oil and gas properties in Alberta licensed by the Alberta Energy Regulator (the "AER") pursuant to the *Oil and Gas Conservation Act*, RSA 2000, c O-6 (the "OGCA") and the *Pipeline Act*, RSA 2000, c P-15 (the "Pipeline Act").

In May of 2015, Grant Thornton Limited ("Grant Thornton") was appointed as a Receiver of Redwater pursuant to section 243 of the *Bankruptcy and Insolvency Act,* RSC 1985, c B-3 (the "BIA") after Redwater's principal lender, Alberta Treasury Branches, called Redwater's loans.

Grant Thornton advised the AER that it was only taking possession and control of the AER licenses, permits and approvals relating to approximately 20 of the 127 AER licensed properties which were the most valuable assets of Redwater. In response, the AER issued abandonment orders with respect to those assets which Redwater refused to pay for. Subsequently, Redwater was petitioned into bankruptcy and Grant Thornton was appointed as Trustee.

The AER then brought an application for an order that the Trustee's actions to disclaim those properties were unenforceable and that the Trustee was required to comply with the abandonment orders and statutory duties of a licensee in respect of abandonment, reclamation and remediation. Grant Thornton brought a cross application to approve a sales process for the assets.

Decision

The decision involved a detailed analysis of federal paramountcy rules. The doctrine of federal paramountcy provides that if federal and provincial legislation covers the same or similar subject matter, but the legislation conflicts or is inconsistent or the operational effects of the provincial legislation are incompatible with federal legislation, the federal legislation prevails and the provincial law is rendered inoperative to the extent of the conflict or inconsistency with the federal law.

The Court held that there was an operational conflict between the provincial and federal legislation and that the provincial legislation frustrated the purpose of section 14.06 of the BIA. The Court found that under the BIA, a trustee or receiver can disclaim assets at its discretion but that same power is not provided for under the provincial legislation. The Court held that so long as a trustee renounces the affected property in accordance with section 14.06(4), the AER cannot attempt to impose on a trustee the obligation to remediate the renounced property by performance or posting security. The Court also held that forcing a licensee to comply with the AER orders frustrates the purpose of section 14.06 in limiting the liability of receivers and trustees for the environmental condition of or environmental damage to property of the debtor and also frustrates the BIA's purpose of equitable distribution of those assets.

Implications

a. Creditors

This decision protects the interest of creditors who will benefit from a trustee's ability to renounce assets and remove liabilities for properties with environmental issues. This provides greater certainty to creditors and will likely have a positive influence on the ability of oil and gas companies to attract debt financing.

However, this result also calls in question the "polluter pays" principle, which is one of the foundational principles of Alberta's environmental regulatory model. The result of this decision is that creditors benefit from environmentally risky operations without bearing the corresponding risk.

b. Directors and Officers

Directors and officers of oil and gas companies are potentially exposed to much greater personal liability as a result of this decision. Environmental legislation provides that environmental liabilities extend to directors and officers. In an insolvency scenario, if a trustee or receiver renounces properties, the AER has another mechanism to recover abandonment, reclamation and remediation costs: the strict liability approach that allows the AER to recover personally from management.

In Canada, regulators have increasingly named directors and officers personally in environmental orders. The AER released a bulletin on April 8, 2016 (Bulletin 2016-10) reminding licensees and their directors and officers that they may be personally responsible for the statutory obligations of a licensee when it enters insolvency proceedings or otherwise ceases operations. Recent cases in both Ontario and Alberta have affirmed a regulator's ability to order current and/or former officers and directors to recover remediation costs. For example, in *Baker v Ministry of the Environment,* 2013 ONSC 4142 officers and directors of Northstar Canada were named personally in an environmental cleanup order. The directors and officers ended up paying $4.75 million to be released from the cleanup order as part of a settlement with the Ontario Minister of the Environment.

This is a potentially enormous liability for directors and officers and is likely not in proportion to the compensation received by management in the course of their employment (particularly as in an insolvency or bankruptcy scenario management has also likely lost their employment). This result may make it difficult for oil and gas companies to attract highly qualified directors and officers.

Further, pursuant to the OGCA the AER may make a declaration setting out the names of directors and officers of a licensee that has outstanding debts to the account of the orphan fund, in respect of the suspension, abandonment or reclamation obligations. Such a declaration grants the AER the ability to, among other things, restrict the rights of a director or officer to transfer future licences or approvals or require deposits for future transfers. This may have the further detrimental impact on directors and officers of making it difficult to find new employment after an insolvency or bankruptcy event.

In order to protect themselves against personal liability for environmental affairs, directors and officers should be diligent in monitoring and assessing environmental concerns. A cautious director or officer should make sure that adequate insurance is maintained to cover historic and future environmental liabilities. The shifting liabilities

post-Redwater may also influence a company's timing in declaring insolvency as directors and officers should ensure that sufficient funds are available for abandonment which may require declaring insolvency earlier by taking into account reclamation costs in balance sheets.

c. Orphan Well Fund

The decision will also undoubtedly impact the orphan well fund as the fund will be required to cover the costs of assets renounced by a trustee. The fund is currently funded by industry which will put a further stain on solvent oil and gas companies who are already facing a difficult economic environment in Alberta. To the extent the industry is unable to cover the increased costs, the Alberta public will be left to cover the costs of abandoning, reclaiming and remediating sites.

While there is a high likelihood that this decision will be appealed, if that appeal is unsuccessful, industry participants should be aware of how this decision shifts environmental liability for abandonment, reclamation and remediation costs.

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