What Are the Implications for Boards of Directors in Light of the Redwater Decision?

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Introduction

From the public policy standpoint, there has been a shift towards more environmental stewardship in Canada, evidenced by heightened media attention on environmental issues and by an expanded legal framework relating to the management of environmental liabilities. For example, directors may be personally liable for violation of environmental statutes[1] and may face reputational harm if the corporations they manage are found to have breached environmental rules or norms. The case of *Redwater Energy Corporation (Re)* ("Redwater") is a new example where directors and officers have been opened up to the potential of greater personal liability for environmental costs.[2] How does this trend towards environmental sustainability affect the actions of the board of directors?

Redwater Background and Implications

In 2016, the Alberta Court of Queen's Bench released its decision on Redwater. In this decision, the Court determined that a trustee in bankruptcy could disclaim uneconomic assets which were subject to Alberta Energy Regulator (the "AER") licenses. In particular, the Trustee of Redwater Energy Corporation disclaimed assets which were subject to environmental abandonment, reclamation and remediation obligations. The AER then sought an order to compel the Trustee to comply with the provincial requirements. This case determined that the requirements of a trustee under the *Bankruptcy and Insolvency Act* take precedence to the remediation requirements of the *Oil and Gas Conservation Act* (the "OCGA") and the *Pipeline Act*.[3] As such, the Trustee was not obligated to comply with the provincial requirements and could disclaim the assets and absolve itself of any responsibility for the environmental liabilities associated with those assets. This decision has been appealed and there has yet to be a decision at the appeal level.

As a result of Redwater, there has been a large impact on Alberta's orphan well fund — a fund governed by the Orphan Well Association which is used to cover the costs of

abandoned assets. By allowing trustees in bankruptcy to disclaim assets, there has been an increase in the amount of orphan wells in the orphan well fund.

The Redwater decision is expected to shift more environmental risk onto directors and officers, as the AER will likely use other mechanisms in its power to recover environmental costs when it cannot enforce them directly against an insolvent corporation.

On April 8, 2016, the AER released Bulletin 2016-10 which reminded licensees and their directors and officers of their statutory responsibilities when a corporation enters insolvency proceedings or ceases operations. The AER has the power to restrict the ability of directors and officers to act in the capacity as a director or officer in the future for oil and gas companies in the event that a licensee has outstanding abandonment, reclamation or remediation debts to the Orphan Well Association.[4] This power extends even after the termination of the director or officer.

Another mechanism that can be used to recover environmental costs is the statutory regime that allows directors and officers to be personally named in environmental protection orders. Directors and officers can be held personally liable for environmental obligations and as such may be subject to fines and/or imprisonment if reclamation costs are not paid.[5] While this mechanism has not been used frequently in Alberta, in a recent case in Ontario, the directors and officers of a corporation personally paid over $4 million after being named personally in an environmental cleanup order.[6]

Board of Directors' Duty Generally

A board of directors of a corporation has a duty to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances".[7] This duty is codified in legislation and has been expanded on in the common law. In the case of *People's Department Stores Ltd. (1992) Inc., Re,* the Court looked at the legislative provisions encompassing the duty of the board of directors.[8] The Court determined that a contextual approach is required when determining the duty of care of a board of directors, factoring in prevailing socio-economic conditions in the analysis.[9] Pursuant to this case, decisions of a board of directors will be considered based on the business judgment rule — a rule in which courts will look at whether the decision of the board was reasonable in light of the circumstances in which the decision was made.[10] A board of directors has multiple factors to balance when making decisions on behalf of a corporation and Courts will take these factors into consideration when determining if a board of directors acted in a reasonably prudent and informed basis.

How Should the Board of Directors Move Forward?

With the release of the Redwater decision, board of directors for oil and gas companies in Alberta must be aware of their potential heightened exposure to personal liability in insolvency proceedings or in ceasing operations. Their actions in these circumstances will be defended by statutory standards set out in legislation or common law. For directors of oil and gas companies it is even more imperative that they are proactive in understanding and overseeing their corporation's practises, plans and potential risks for environmental contamination, as there are potential implications for them if they do not.

[1] *Canadian Environmental Protection Act, 1999*, SC 1999, c 33, s. 95.

[2] *Redwater Energy Corporation (Re)*, 2016 ABQB 278.

[3] *Oil and Gas Conservation Act*, RSA 2000, c O-6, *Pipeline Act*, RSA 2000, c P-15 and *Bankruptcy and Insolvency Act*, RSC 1985, c B-3.

[4] *OGCA*, s. 106.

[5] *Environmental Protection and Enhancement Act*, s. 228 and s.232.

[6] *Baker v Ministry of the Environment,* 2013 ONSC 4142.

[7] *Alberta Business Corporations Act*, RSA 2000, B- 9 ("ABCA"), s. 122(1)(b).

[8] *People's Department Stores Ltd. (1992) Inc., Re* 2004 SCC 68 [*Peoples*]. The Court looked at s. 122 of the *Canadian Business Corporations Act*, RSC 1985, c C-44 which is substantially the same as s. 122 of the ABCA.

[9] *Peoples* at para 64.

[10] *Peoples* at para 64.

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