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Top Court Rules Bankrupt Corporations Can't Evade Environmental Obligations

In a landmark decision released on January 31, 2019, the Supreme Court of Canada (SCC) ruled in *Orphan Well Association v Grant Thornton Ltd.* that the environmental remediation obligations of a bankrupt oil and gas company must be fulfilled in priority over all other claims, including secured claims. In addition to immediate effects to creditors of Alberta oil and gas interests, creditors of all sectors will want to analyze the implications of this case.

Background

Under Alberta's regulatory regime, the licensing of active wells is directly related to the management of liabilities for closure and reclamation of inactive wells. Grant Thornton Limited (GTL), serving as bankruptcy trustee for Redwater Energy Corporation (Redwater), intended to take possession of Redwater's active wells for the purpose of selling such assets to pay secured creditors while disclaiming all inactive wells under section 14.06 of the *Bankruptcy and Insolvency Act* (BIA). It was GTL's position that by issuing disclaimers in respect of the inactive wells, GTL could not be compelled to fulfill any regulatory obligations associated with the inactive wells. The Alberta Energy Regulator (Regulator) did not recognize GTL's interpretation of the disclaimers and responded by issuing orders requiring closure and reclamation of the inactive wells (Abandonment Orders) and warning it would not authorize the transfer of licences for active wells without satisfactory measures to address inactive wells.

SCC Decision

At issue before the SCC was whether the Regulator's attempt to enforce compliance with the Abandonment Orders during bankruptcy conflicted with the BIA (i) to the extent that it sought to impose obligations on GTL in relation to the disclaimed properties, and (ii) because it was seeking to disrupt the scheme of priorities established by the BIA.

The majority of the SCC (Moldaver and Côté JJ dissenting) determined that the Regulator's use of its statutory powers does not conflict with the BIA. The Court found that a disclaimer under section 14.06(4) of the BIA insulates the trustee from personal liability but does not prevent the estate from having to comply with the Abandonment Orders. In enforcing Redwater's regulatory obligations, the Regulator was found to be acting in a bona fide regulatory capacity, did not stand to benefit financially and was therefore not a creditor. Accordingly, the SCC found that the obligations under the Abandonment Orders were not claims provable in the bankruptcy and, therefore, not subject to compromise under the priority scheme established by the BIA. The SCC went on to order that the proceeds of sale from the active wells should be used to satisfy the Abandonment Orders, with the result that there would be no proceeds available to Redwater's secured and unsecured creditors.

Impact

Inside Alberta, this decision will force Alberta oil and gas companies to internalize 100% of their expected closure and reclamation costs (including where the Regulator has required bonding for a portion of this liability).

Far more broadly, however, this decision appears to give any provincial regulator a powerful new argument for requiring insolvent companies to pay for their regulatory obligations prior to any other creditor being paid. This case could extend beyond the Alberta oil and gas industry and apply to any provincial statutory obligation required to be enforced by a regulator.

In *Orphan Well*, the assets owned by Redwater primarily comprised two types of properties: valuable producing oil wells and non-producing wells subject to environmental liabilities. It is unclear whether, in the absence of similar facts (i.e., a regulatory regime that tethers contaminated and uncontaminated assets), the courts would interpret this decision to mean that a regulator enforcing a public duty has

the authority to require that a debtor use *all of its assets* (or their proceeds) to remedy environmental contamination or any other type of regulatory obligation notwithstanding the existence of secured parties. In future cases, both the nature of the regulatory enforcement undertaken and the debtor's assets will be critical to assess whether insolvency priorities can, again, be avoided.

It is expected that Canadian credit markets will react to this case by reducing any existing credit availability of Alberta oil and gas companies by the full amount of their unbonded closure and reclamation costs and carefully considering whether the same needs to be done for any other borrower with outstanding statutory liabilities.

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