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Implications of the Redwater decision – Where does the buck stop?

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Introduction

On May 17, 2016, the Alberta Court of Queen's Bench released its eagerly awaited decision in *Redwater Energy Corporation (Re)*, 2016 ABQB 278 regarding the intersection between the provincial oil and gas regulations and the federal bankruptcy and insolvency regime. At issue was whether the provincial regulatory regime under the *Oil and Gas Conservation Act* [1] (OGCA) and the *Pipeline Act* [2] (PA) operationally conflicted with the *Bankruptcy and Insolvency Act* [3] (BIA) or frustrated its purposes.

In particular, the Court was concerned with: (a) whether a receiver and trustee (together, a Trustee) who renounce licensed oil and gas assets in the context of a bankruptcy or receivership proceeding is required to take possession and control of all licensed assets – including abandoned or non-producing wells; (b) whether a Trustee is required to fulfill the statutory obligations of the debtor under the OGCA and the PA to abandon, reclaim and remediate a debtor's licensed assets; and (c) whether the Alberta Energy Regulator (AER) can refuse applications to transfer licences of retained assets by a Trustee as a result of a debtor's liability management rating (LMR) in the context of a bankruptcy.

The Court held that the provisions of the BIA permitting a Trustee to renounce assets it deemed uneconomic was paramount to any obligations of the Trustee under the OGCA and the PA as a "licensee" of the debtor's licensed assets. Considering section 14.06 of the BIA, the Court held that a Trustee is permitted to make rational economic assessments of the costs of remedying environmental conditions and must have the discretion whether to comply with orders to remediate property affected by these conditions. Accordingly, the Court held inoperative the provisions of the OGCA and the PA to the extent such provisions would have the effect of requiring a Trustee to comply with or provide security in respect of abandonment orders regarding renounced licensed assets.

The decision has far-reaching implications for an industry that has been hammered by low commodity prices, devastating wildfires, and now the prospect of increased levies to fund the efforts of the Orphan Well Association (OWA) to assume the obligations of bankrupt participants. For the boards of directors who serve companies with operations in the oil patch, the AER has also made it clear that it has extensive statutory rights.

Facts

Redwater Energy Corp. (Redwater) was a publicly listed junior oil and gas producer in Alberta. Its principal secured lender, Alberta Treasury Branches, demanded repayment of its indebtedness and applied to the Court for an order appointing a receiver. On May 12, 2015, the Honorable Mr. Justice Jones granted an order appointing a receiver of the assets, undertakings and property of Redwater under section 243 of the BIA.

Upon appointment, the receiver conducted an assessment of Redwater's licensed assets and advised the AER that of the 91 wells for which Redwater held licences, it would only be taking possession of 20 wells, facilities and associated pipelines.

Shortly thereafter, the AER issued closure and abandonment orders in respect of the licensed assets renounced by the receiver and filed an application to compel the receiver to comply with the closure and abandonment orders and to fulfill all statutory obligations of Redwater in relation to abandonment, reclamation and remediation of the licensed assets.

On October 28, 2015, the Honourable Madam Justice Romaine granted an order adjudging Redwater bankrupt and appointing the receiver as trustee of Redwater's estate.

Decision

Chief Justice Wittmann first considered the doctrine of federal paramountcy. He reviewed the two branches of the paramountcy test established by the Supreme Court of Canada, namely: (a) whether it is possible to apply the provincial law while complying with the federal law; and (b) whether the provincial legislation is incompatible with or frustrates the purpose of the federal legislation.

Under the first branch of the paramountcy test, the Chief Justice reviewed section 14.06(4) of the BIA which permits a Trustee to renounce assets and not be responsible for environmental abandonment and remediation work. He also reviewed numerous provisions of the OGCA and the PA which expressly include a Trustee as a "licensee." Neither provides any means for "licensees" to renounce licensed assets. Accordingly, as the BIA permits the Trustee to renounce and not be liable for the costs of abandonment, remediation and reclamation, while the OGCA and the PA continue to hold a Trustee liable for such obligations, the Chief Justice held that dual compliance under the OGCA, the PA and the federal insolvency regime under section 14.06(4) is not possible.

He then looked at the second branch of the federal paramountcy test, holding that the fundamental purposes of section 14.06 of the BIA are to: (a) limit the liability of insolvency professionals so that they will accept mandates despite environmental issues; (b) permit a Trustee to make rational economic assessments of the costs of remedying environmental conditions; and (c) equitably distribute the assets of the debtor.

In determining the purpose of the abandonment orders issued under the OGCA and the PA, the Chief Justice reviewed the decision of the Supreme Court of Canada in *AbitibiBowater* [4] and cases that followed. He found that based on the principles defined in that case, the abandonment orders constituted provable claims within the meaning of the BIA and were therefore subject to federal insolvency legislation.

As a result, the provisions of the OGCA and the PA were held to be inoperative to the extent such provisions conflict with federal legislation requiring a Trustee to comply with or provide security in respect of abandonment orders regarding renounced licensed assets.

The Chief Justice also held that the purpose of section 14.06 of the BIA was frustrated by the AER's requirements to pay security deposits and perform abandonment orders as conditions of its approval of applications to transfer Redwater's AER licences as this required the Trustee to: (a) address those conditions prior to the payment of fees and disbursements or any secured or unsecured creditors; and (b) pay or rectify those conditions as costs of administration regardless of the fact that the conditions relate to renounced assets.

Impact

As a result of the Court's decision, a Trustee in Alberta is permitted to renounce assets pursuant to the terms of the BIA, will not be considered a licensee under the provincial regulatory regime in relation to renounced assets, will not be required to assume any liabilities and will not be bound by any abandonment orders issued by the AER relating to renounced assets in seeking approval of the sales process to market and sell assets remaining under its possession and control.

Similarly, the AER will not be permitted to consider renounced assets in calculating the LMR of a company when approving or refusing to approve a transfer of licences to a purchaser within a bankruptcy or receivership under *Directive 006*.

The implications of this decision for the Alberta oil and gas industry are far-reaching. On the one hand, the Court's decision provides certainty to secured lenders that priority is maintained over their security (subject to costs of administration and other super priorities under the BIA). This certainty should result in continued access by the oil and gas industry to readily available credit.

On the other hand, it could result in a dramatic increase in the number of wells renounced by Trustees and determined to be "orphaned" by the AER, which will undoubtedly increase pressure on industry to fund the completion of work to abandon, reclaim and remediate such wells, and on the boards of directors who serve companies in the industry.

For directors and officers of bankrupt companies, the decision could potentially restrict their ability to act in the capacity of director or officer for oil and gas companies in the future. Pursuant to section 106 of the OGCA, the AER is permitted to make a declaration setting out the names of one or more directors or officers (among others) of a licensee that has outstanding debts to the OWA in respect of suspension, abandonment or reclamation obligations. Such a declaration permits the AER to: (a) refuse to consider an application for a licence or approval from an applicant under the OGCA or the PA; (b) refuse to consider an application to transfer a licence or approval under the OGCA or the PA; (c) require the submission of abandonment and reclamation deposits in an amount determined by the AER prior to granting any licence approval or transfer to an applicant; or (d) require the submission of abandonment and reclamation deposits in an amount determined by the AER from any wells or facilities of any licensee or approval holder. The remedies in section 106 follow the director or officer beyond the termination of his or her employment with the licensee. Further, depending on the nature of the renounced environmental obligations, directors and officers of non-compliant companies could also potentially be held personally liable and subject to fines, imprisonment or both under sections 228 and 232 of Alberta's *Environmental Protection and Enhancement Act*. [5]

For an already strained oil and gas industry, the costs of performing the expected increase in renounced obligations will not be insignificant. Individual companies already fund not only the costs to abandon, reclaim and remediate their own wells, but through the collection of a levy by the OWA, also fund such costs for orphan wells where there is no legally responsible or financially able party to deal with such obligations. The OWA operates under the direction

of the AER and its other members – the Canadian Association of Petroleum Producers (CAPP) and the Explorers and Producers Association of Canada (EPAC). Since the added cost associated with higher levies could have severe economic implications for some companies in the current environment, it remains to be seen what response will be provided by the industry members of CAPP and EPAC regarding proposals to increased levies.

If the OWA is unable to increase its funding for abandonment, reclamation and remediation of orphan wells, such wells could become the responsibility of the Alberta public if the provincial and/or federal governments are required to assume a greater share of the obligations associated with a Trustee's renouncement of licensed assets. The public policy debate around who should bear the environmental remediation costs of insolvent debtors has positioned banks and accounting firms opposite the oil and gas industry, and while this match was decided in favour of the banks as secured creditors and accounting firms as trustees, it may be premature to call the matter concluded.

The Court acknowledged that the public interest is at stake if a licensee does not fulfill its environmental duties and that the financial and environmental repercussions of a licensee's failure to do so are very real. The Chief Justice recognized that "this case raises several issues of importance to the energy industry, the financial industry and the Alberta public, in terms of the potential environmental and financial repercussions when abandoned wells or a bankrupt energy company are renounced by a trustee or receiver in bankruptcy." However, the Court held that Parliament balanced a number of competing considerations in enacting section 14.06 of the BIA and that it would require a reassessment by Parliament to effect a different result. This reassessment is in Parliament's jurisdiction to determine – not the Court's.

Only time will tell whether Parliament chooses to respond to the decision and whether an appeal will be forthcoming. Undoubtedly the complex social, financial and environmental issues raised in this case, including the public policy debate about where the buck should stop between the energy industry and Canadian banking institutions given the underlying purposes of the Canadian bankruptcy framework, demand a broad and thoughtful analysis by Parliament, the Legislature, the banking industry, and the oil and gas industry in Alberta.

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[1] *Oil and Gas Conservation Act*, RSA 2000 c. O-6.

[2] *Pipeline Act*, RSA 2000, c. P-15.

[3] *Bankruptcy and Insolvency Act*, RSC 1985 c. B-3.

[4] *Newfoundland and Labrador v. AbitibiBowater Inc.*, 2012 SCC 67.

[5] *Environmental Protection and Enhancement Act*, RSA 2000, c. E-12.