

## Legal update

### Expanding *Redwater* beyond oil and gas: can other regulators enforce orders in an insolvency?

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Bankruptcy, financial restructuring and insolvency

Energy

Environmental law

The Supreme Court of Canada recently released its decision in *Orphan Well Association v Grant Thornton Limited*, (*Redwater*). The majority ruled that a bankrupt oil company's estate remained liable for well closure and environmental obligations in priority to the company's creditors, including its secured creditors.

Although *Redwater* dealt with the Alberta Energy Regulator's (AER) powers to order a bankrupt oil company to close oil and gas wells, the decision can likely be used by regulators in other industries to ensure compliance with environmental and other laws.

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#### Provable claims

The concept of a provable claim is central to Canadian insolvency law. Once insolvency proceedings start, a regulator trying to enforce a compliance order that is considered a provable claim against the insolvent company is typically stayed by the court (i.e. stopped) from enforcing it. Conversely, a non-provable claim is not stayed and can be enforced.

In *Redwater*, the company entered receivership proceedings and the AER ordered the company to abandon and permanently close various wells by pumping cement down the well bore, cutting and capping the top of the well and removing surface equipment so as to leave the well in a safe state in perpetuity. The receiver argued the abandonment orders were stayed and sought to sell a package of Redwater's assets to a third party and use the proceeds to pay the secured creditor.

The matter ended up in the Supreme Court, which considered the historical test of what constituted a provable claim by a regulator in an insolvency set previously by it in *Newfoundland and Labrador v AbitibiBowater Inc.*, namely that there must be a debt, liability or obligation to a creditor, that it be incurred before the bankruptcy and that it must be possible to attach a monetary value to the debt, liability or obligation.

The Supreme Court in *Redwater* noted that although a regulator can be a creditor with a provable claim, a regulator exercising an enforcement power is not always one. The court noted the AER's abandonment orders did not require the company to pay the AER, but instead to do something, namely to permanently close the wells. It was not sufficiently certain that the AER would itself perform the well abandonments if the company failed to do so and then

advance a claim for reimbursement of the costs. Indeed, the AER was not in the business of abandoning wells and had no statutory duty to do so.

The Supreme Court distinguished *AbitibiBowater* by noting in that case the provincial government had expropriated a number of AbitibiBowater's properties without compensation. The company entered creditor protection and responded to the expropriation by filing a NAFTA claim for compensation. The province then issued environmental clean-up orders that the government hoped to use to set off against the NAFTA claim.

The court clearly saw the province as seeking a direct financial benefit from the clean-up orders. It pointed out the orders' timelines were not realistic, showing the province did not intend the orders to be complied with. The company also could not access some of the properties to undertake the work due to the expropriation. The court felt the ultimate purpose of the clean-up orders was not to have the properties remediated, but to create a set-off in response to the NAFTA compensation claim. Hence, the company owed a debt to the province to which monetary value could be attached.

In *Redwater*, the court found the regulator was acting in a *bona fide* regulatory capacity and did not stand to benefit financially from the abandonment orders. Unlike in *AbitibiBowater*, the AER had no ulterior motives in issuing the orders. It was acting in the public interest and for the public good. It was not enforcing a debt but was instead enforcing a general law of the province.

The court found that bankruptcy was not a license to ignore the rules, and the bankruptcy trustee was bound by and must comply with valid provincial laws. Hence, the abandonment orders were not provable claims in the bankruptcy and were not stayed. The court ordered the proceeds of sale of Redwater's assets in the bankruptcy proceeding be used to pay for the well abandonment costs to the preference of the company's secured and other creditors.

### **Other regulators are likely paying attention**

Regulators in other industries trying to enforce environmental protection legislation against insolvent companies are undoubtedly paying attention and considering if they can enforce their legislation in preference to an insolvent company's creditors. It appears many have the power to do so.

For instance, Alberta Environment and Parks (AEP) has the authority to issue environmental clean-up orders in response to a spill under Alberta's *Environmental Protection and Enhancement Act*. Such orders can require the company to investigate, take any action specified, minimize and remedy the effects of a spill and restore the environment. Although AEP can in certain instances claim costs incurred in enforcing the legislation, there is no requirement for it to do so.

Similarly, in British Columbia the director under the *Environmental Management Act* can issue a pollution abatement order in response to a spill event to any of the person who controlled the substance that caused the spill, the person who owns or occupies the land on which the substance was located prior to the spill, or a person who caused or authorized the pollution. The director may also issue a remediation order against one or more responsible persons for a site to undertake remediation.

Likewise, under Ontario's *Environmental Protection Act* a director with the Ministry of the Environment, Conservation and Parks may order a person who discharges a contaminant into the environment to repair injury or damage to land, water, property, animal life, plant life or human health. The order can include requiring the person to construct and install devices, equipment and facilities, and to develop and implement plans to remediate contamination. Although the ministry may require a polluter to pay the ministry's costs and expenses in responding to a spill, the ministry does not have to do so.

When faced with an environmental problem caused by an insolvent company, it is reasonable to expect provincial and federal environmental regulators to try to use their enforcement powers such that they fall under *Redwater* rather than *AbitibiBowater* by crafting their enforcement orders so as not to create a provable claim.

It is also reasonable to assume regulators concerned with issues besides environmental ones in the Alberta oil and gas industry are taking a close look at *Redwater*. Regulators of mining, forestry, transportation, agriculture, fishing and numerous other regulated industries and activities in Canada come to mind.

### Secured creditors across Canada should take note

Time will tell if *Redwater* will be applied more broadly than to environmental obligations of an insolvent oil company. We assume regulators will try to use *Redwater* when faced with an insolvent company with regulatory obligations.

Secured creditors in many other instances and industries in Canada should consider what the potential shift in traditional priorities to a bankrupt's estate might mean to repayment of their secured loans. Borrowers should consider the implications of lenders less willing to provide financing. It is also likely that lenders will want a comprehensive understanding of a borrower's regulatory obligations and will expand their lending due diligence to understand a borrower's assets retirement obligation and require stricter covenants in loan agreements.

The ultimate outcome of a borrower in a regulated industry becoming insolvent will be governed by the facts of each case and the particular enforcement strategies regulators use to prevent enforcement orders being provable claims and having their orders stayed upon an insolvency. It is clear, however, that *Redwater* will have future implications to lenders, other creditors and borrowers in many industries.

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