Cassels

Supreme Court of Canada Releases Decision in Redwater

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On January 31, 2019, the Supreme Court of Canada released its decision in *Orphan Well Association, Alberta Energy Regulator v. Grant Thornton Limited and ATB Financial.*[1] This important decision may have profound implications, potentially limiting the ability of oil and gas producers to secure credit and impairing the effectiveness of the insolvency system where debtors have significant regulatory obligations. Regulators may now argue that regulatory obligations have been vaulted to a super-priority status. Where those obligations exceed the value of the estate, and the transfer of assets is subject to regulatory control, it is unclear whether those assets could be sold in an insolvency process. Indeed, it is uncertain whether there would be a point to an insolvency process in those circumstances. This impact may well extend beyond the oil and gas industry to other regulated industries.

The case examined the intersection between insolvency law and provincial regulatory laws for the oil and natural gas industry. At issue were two points: (1) whether certain aspects of Alberta's oil and gas regulatory regime conflict with section 14.06 of the *Bankruptcy and Insolvency Act* (the BIA) and are therefore inoperative under the constitutional doctrine of federal paramountcy; and (2) whether environmental remediation obligations under the Alberta regulatory regime constitute monetary obligations subject to the BIA and its priority rules. Specifically, the Court examined whether a receiver can disclaim the debtor's interest in unsellable real property affected by environmental liabilities, sell the remaining assets, and distribute the net proceeds in accordance with the priorities set out in the BIA.

In a 5-to-2 decision, the majority of the Court determined that:

- Section 14.06 only permits disclaimer where the trustee or receiver is protecting itself from personal liability;
- A disclaimer under section 14.06(4) does not affect the liability of the estate to carry out abandonment and reclamation obligations, and notwithstanding the disclaimer, a trustee and receiver remains obliged to perform abandonment and reclamation obligations up to the amount of the assets in the estate;
- The limited charge in favour of the Crown created by section 14.06(7) evidences the intention of Parliament to permit priorities for abandonment and reclamation obligations;
- The first prong of the test in *AbitibiBowater*[2] decision was reformulated, such that a regulator is a creditor where it stands to benefit financially from an enforcement action and is not acting in the public interest;
- The sufficient certainty test in the third prong of *AbitibiBowater* was not satisfied; and
- The Alberta Energy Regulator can make transfers of licenses subject to the performance of all

abandonment and reclamation obligations of a debtor, without disrupting the priority provisions of the BIA.

The decision of the majority represents a policy shift in favour of environmental obligations and underscores the importance of regulators as interested stakeholders in the insolvency process.

Overall, the majority limited the interpretation of section 14.06 to protecting trustees and receivers from personal liability. As such, it determined that there was no conflict between the provincial legislation and section 14.06 and therefore the doctrine of paramountcy did not apply. The majority also reformulated and substantially narrowed the test for whether a regulatory obligation was a provable claim and therefore subject to the priority rules in the BIA.

Justice Côté wrote a strong dissent, noting that the majority effectively overturned the decision of the Court in *AbitibiBowater* and limited the effect of section 14.06 to protecting receivers and trustees from personal liability. At paragraph 221 of her reasons, she articulated the potential practical problems flowing from the reasons of the majority. Where the environmental liabilities exceed the realizable value of the assets, all of that value will be funnelled to meeting those liabilities, insolvency professionals will likely be reluctant to accept mandates, and debtors and creditors may have little reason to commence insolvency processes. Justice Côté expressed the view that the number of orphaned properties is likely to significantly increase as a result.

Over the coming months, the financial services industry, insolvency professionals, governments, regulators and courts no doubt will be digesting this decision and determining how they will respond to insolvencies in regulated industries going forward. It remains to be seen whether this will increase the headwinds already challenging the oil and gas industry. We will provide more in depth analysis in the days to come.

For more information on the potential impact of this decision, please contact the authors of this article or any member of our Restructuring & Insolvency Group.

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[1] *Orphan Well Association v. Grant Thornton Ltd.*, 2019 SCC 5.
[2] *Newfoundland and Labrador v. AbitibiBowater Inc.*, 2012 SCC 67, [2012] 3 SCR 443.
