

Like Oil and Water: Courts Struggle to Mix Bankruptcy and Environmental Law – SCC to Hear Redwater Appeal

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The Supreme Court of Canada (SCC) granted leave to hear the appeal of *Orphan Well Association v Grant Thornton Limited*.¹ The SCC will reconsider whether trustees and receivers in bankruptcy must remediate wells in priority to the claims of secured creditors.

In April 2017, the Alberta Court of Appeal released its decision in *Redwater*.² The Court found that the Government of Alberta's environmental orders for oil well remediation did not have priority over secured creditors in bankruptcy proceedings.

In upholding the lower court's decision, set out in our [previous update](#), the Court of Appeal added to the "untidy intersection" between bankruptcy proceedings and provincial environmental law. Both Courts concluded that receivers and trustees were permitted to renounce an insolvent debtor's interest in its licensed assets while selling valuable licensed assets to maximize recovery for secured creditors.

The decision, as it stands, allows receivers and trustees in bankruptcy to disclaim unprofitable assets and not be required to fulfill certain environmental obligations associated with those disclaimed assets.

Recap

The case revolves around the assets of a junior, insolvent oil and gas producer, Redwater Energy Corporation (Redwater).

When Redwater's primary secured creditor began enforcement proceedings under the *Bankruptcy and Insolvency Act* (BIA), Grant Thornton Limited (GTL) was appointed as receiver and trustee.³ Several of Redwater's oil wells had costs of remediation exceeding the value of the wells. GTL took control of only 20 of 127 Redwater's assets and disclaimed the oil wells that had onerous environmental abandonment costs.

Alberta oil and gas legislation requires licensees, including trustees, to comply with "end-of-life" rules for oil wells. Where no one is financially capable of remediating and abandoning a well, the well is designated an "orphan well" under Alberta's *Oil and Gas Conservation Act* (OGCA).⁴

¹ 2017 ABCA 124 [*Redwater*].

² *Ibid.*

³ RSC 1985, c B-3 [BIA].

⁴ *Redwater* at para 21; *Oil and Gas Conservation Act* RSA 2000, c O-6, s 70 [OGCA].

The Alberta Energy Regulator (AER) ordered GTL to remediate the disclaimed oil wells before distributing funds to creditors. When GTL indicated that it did not intend to remediate the wells, AER and the Orphan Well Association (OWA) brought applications asking the court to void GTL's disclaimer of the non-producing wells and order GTL to comply with AER's orders. AER argued that Redwater's insolvency and bankruptcy did not affect Redwater's environmental obligations and that GTL was legally required to discharge those obligations before paying Redwater's creditors.

GTL brought a cross-application challenging the constitutionality of AER's stance on GTL's environmental obligations and seeking approval of the sale of Redwater's valuable wells.

At issue was whether AER's orders were provable claims in bankruptcy and therefore subject to bankruptcy proceedings. If AER's orders were subject to bankruptcy proceedings, other creditor's claims would take priority. The practical outcome being that the corporation would likely have no means of satisfying its environmental obligations after settling its obligations to other creditors. The cost of remediating the orphan wells would then fall on the Government of Alberta.

As we [previously reported](#), Alberta Court of Queen's Bench concluded that the applicable sections of the OGCA and *Pipeline Act* (PA) frustrate the federal purpose of the BIA of managing the winding up of insolvent corporations and settling the priority of claims against them. Based on the doctrine of paramountcy, the OGCA and PA were inoperable to the extent that they conflicted with section 14.06 of the BIA. This section of the BIA exempts a receiver or trustee from personal liability, allowing a trustee and receiver to disclaim assets, and prescribes the priority of environmental remediation costs.

OWRA and AER appealed the decision.

Court of Appeal Decision

The Court of Appeal upheld the lower court decision. The key issue on appeal was the priority and treatment of environmental claims in bankruptcy, and whether environmental claims were provable claims under section 14.06 of the BIA.

Priority and Treatment of Environmental Claims in Bankruptcy

The Court found that the BIA was amended in 1997 to specifically address environmental claims. The BIA now incorporates environmental claims into the general bankruptcy process, rather than exempting them. Following the test set out in *Newfoundland and Labrador v AbitibiBowater Inc.*, the Alberta Court of Appeal found that AER's orders were subject to bankruptcy proceedings.⁵ By refusing to permit the transfer of Redwater's valuable assets unless funds were set aside for remediation, AER reduced the environmental obligations to "sufficiently certain" monetary claims. Accordingly, AER cannot indirectly interfere with the value of assets in a bankruptcy by placing financial preconditions on the transfer of AER licences.

⁵ 2012 SCC 67.

Constitutional Law Issue

The Court of Appeal held that there was an operational conflict between federal and provincial regimes. The Court found that the provincial regulatory scheme frustrated the purposes of the BIA, which include determining the priority of claims against insolvent corporations. The practical outcome being that GTL did not have to comply with AER's remediation obligations prior to settling claims of secured creditors.

Nortel and Northstar

The dissenting opinion briefly considered the two leading cases in Ontario on environmental claims in bankruptcy and insolvency: *Nortel Networks Corporation (Re)* and *Northstar Aerospace Inc. (Re)*.⁶ In *Nortel*, the Court found that some of the Ministry of the Environment's (MOE, as it then was) orders had priority over creditor claims, but in *Northstar*, the Court found that the MOE's orders did not have priority.

Implications

The practical implications of *Redwater* may be far reaching not only for the worlds of bankruptcy & insolvency and oil & gas, but also for the world of director and officer liability.

Will we see more Alberta provincial environmental orders aimed at former directors and officers? In *Northstar*, after the Court found the MOE's orders did not have super priority in insolvency proceedings, the MOE issued a remediation order personally against the former directors and officers.⁷

We will look to the SCC to provide clarity on this important, albeit untidy, area of law.

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⁶ *Nortel Networks Corporation (Re)*, 2013 ONCA 599 [*Nortel*]; *Northstar Aerospace Inc. (Re)*, 2013 ONCA 600 [*Northstar*].

⁷ *Northstar Aerospace, Inc. (Re)*, 2012 ONSC 4423. Subsequently, on November 14, 2012, the MOE issued a Director's Order against the former directors and officers personally.