Supreme Court Says: Polluters Must Pay

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The Supreme Court of Canada ("SCC") has overturned two lower court decisions in the famous "*Redwater* case" *(Orphan Well Association v Grant Thornton Ltd.* [1]). In a decision that will heavily impact the oil and gas industry, the SCC ruled oil and gas companies cannot walk away from environmental liabilities, even in the face of bankruptcy or insolvency:

> Bankruptcy is not a licence to ignore rules, and insolvency professionals are bound by and must comply with valid provincial laws during bankruptcy. [2]

The *Redwater* case concerns a constitutional law conflict between provincial oil & gas and environmental regulations and the federal bankruptcy & insolvency regime. The relevant provincial statutes are the *Environmental Protection and Enhancement Act* ("*EPEA*"), the *Oil and Gas Conservation Act* ("*OGCA*") and the *Pipeline Act*. The federal bankruptcy and insolvency regime is governed by the *Bankruptcy and Insolvency Act* ("*BIA*").

In 2015, Grant Thornton Limited ("GTL") was appointed as a Receiver of Redwater Energy under the *BIA*. During the proceedings, GTL advised the Alberta Energy Regulator ("AER") that it would only take possession of the most productive Redwater assets and would renounce the remaining assets which included wells, facilities and pipelines. In response, the AER issued abandonment orders under the *OGCA* and *Pipeline Act* regarding the renounced assets, and later brought an application for an order to comply. GTL brought a cross-application for the court to approve their sales process to exclude the renounced assets.

The Court of Queen's Bench ("QB") held the federal *BIA* prevailed over the provincial statues, the *OGCA* and *PA*. The Court found that the purpose of the *BIA* is to: (i) limit the liability of insolvency professionals so they would accept mandates, (ii) allow trustees to make rational economic assessments of the costs of environmental issues, and (iii) equitably distribute the debtor's assets. The provisions of the *OGCA* and *PA* have the potential to conflict with the purpose of the *BIA*.

In April 2017, the Court of Appeal upheld the ABQB decision. A majority of the Court focused on a significant risk: If environmental claims were given priority over secured creditors, then lenders would be less willing to finance the oil and gas industry.

Today, the SCC ruled the AER's use of provincial statutory powers does *not* conflict with the *BIA*. Instead, the provincial environmental obligations remain binding on the bankruptcy estate (assuming they cannot be reduced to provable claims):

> …the end-of-life obligations binding on GTL are not claims provable in the Redwater bankruptcy, so they do not conflict with the general priority scheme in the *BIA*. This is not a mere matter of form, but of substance. Requiring Redwater to pay for abandonment before distributing value to creditors does not disrupt the priority scheme of the *BIA*… Thus, the *BIA* explicitly contemplates that environmental regulators will extract value from the bankrupt's real property if that property is affected by an environmental condition or damage. [3]

As a result, this means provincial environmental obligations take priority over payments to creditors — most notably, lenders. A likely outcome is that financial institutions will include abandonment and reclamation obligations in their risk calculations when considering loan applications. It appears the lending risks can no longer be reallocated from banks to industry actors, such as the AER. Effectively, if an oil and gas company goes bankrupt, the lender no longer has priority over the AER, and the costs of abandonment and reclamation must be considered before the lending institution can be repaid.

Some may interpret this SCC ruling as positive news for the environment, landowners and taxpayers. However, the full impact of this decision remains to be seen. This decision will undoubtedly make it more difficult for creditors to collect amounts owed to them by defunct energy companies. As a result, lenders may be increasingly reluctant to lend to energy companies.

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[1] Orphan Well Association v Grant Thornton Ltd., 2019 SCC 5.

[2] Ibid at paragraph 160.

[3] Ibid at paragraph 159.