Intelligence MEMOS

From: Fenner Stewart

To: The Hon. Margaret McCuaig-Boyd, Alberta Minister of Energy

Date: March 28, 2019

Re: Supreme Court decision in Redwater was the right result but does not solve Alberta's orphan well problem

The *Orphan Well Association v. Grant Thornton* (so-called Redwater) case considered whether Alberta's mechanism for funding oil and gas well reclamation conflicted with the federal *Bankruptcy and Insolvency Act*. The Supreme Court of Canada held that the two did not conflict, so Alberta's funding mechanism survived.

The court`s decision was critical to ensuring that creditors could not skim "good" producing assets from a bankrupt oil and gas company, leaving the public holding the environmental liabilities for cleanup of orphan wells. As I wrote in an earlier Intelligence Memo, allowing bankrupt companies to avoid their environment obligations would have undermined a long-established covenant for Alberta's oil and gas sector. However, the result in *Redwater* does not remedy the substantial liability that Alberta faces for wells abandoned by defunct companies that lack offsetting assets and Alberta must revamp its financial assurance requirements for oil and gas operators.

When a drilling company goes bankrupt, the Alberta Energy Regulator does not allow the bankrupt company's trustee to sell its well assets without also doing one of the following:

(1) reclaiming the bankrupt's value-negative well assets;

(2) selling the value-negative assets with the valuable assets; or

(3) posting a security to cover the environmental liabilities.

In the *Redwater* case, the regulator refused to facilitate a sale unless the trustee met one of the three requirements, but the trustee (Grant Thornton) refused to accept its authority. At trial, Grant Thornton asserted that the regulator's demand ran afoul of the *BIA*. It argued that the regulator was trying to collect a debt as a creditor, and was attempting to use provincial law to jump the queue for creditors dictated by the *Bankruptcy and Insolvency Act*. In other words, the regulator was butting in line, undermining the *BIA*, which dictated that the regulator had a lower priority to the proceeds of the sale than it claimed.

Grant Thornton's arguments relied on *Newfoundland* v. *AbitibiBowater*, a 2012 case, in which, a Quebec-based company (Abitibi) announced that it was going into restructuring and permanently closing all operations in Newfoundland. The province reacted by seizing Abitibi's in-province assets. It then imposed environmental orders that the company could not meet, since it no longer had access to the seized land. When Abitibi failed to obey the orders, Newfoundland imposed fines for non-compliance. Newfoundland asserted that it had a right to collect its fines before any distribution to creditors. The SCC rejected this argument, deeming that Newfoundland was a creditor was attempting to frustrate the bankruptcy process and take proceeds from Abitibi that the BIA dictated belonged to other creditors.

In *Redwater*, the lower courts agreed that the regulator was acting as Newfoundland had: it was a creditor jumping the queue. However, the Supreme Court disagreed, holding that the regulator was not a creditor, but a disinterested regulator, that was merely ensuring the bankrupt party complied with its legal obligations. Put differently, the court rejected the holding of the lower courts that a provincial regulator could not enforce a law, if it diminished the value of a bankrupt party's estate.

Does the judgement fix the orphan well problem? No, the problem of oil and gas companies orphaning wells to the regulator will continue to resurface until the Alberta reforms its legislation for well reclamation. This conflict between the regulator and the insolvency community was merely a symptom of the problem, not the problem itself. As observed in another recent Intelligence Memo, Alberta must strengthen its contingency funds for reclamation by requiring operators to post adequate financial assurance for the potential cleanup liability.

Does the judgement undermine creditors? No, in terms of affecting financing, the court has merely affirmed the status quo: the law is the same as it has been since at least the early 1990s.

Does this mean that the case had no impact? Certainly not. One must understand that regulatory compliance always costs a business money. Without the court's judgement, any time a provincial regulator attempted to impose the law upon a firm that filed for bankruptcy, it would have diminished the value of the estate in question, and would have conflicted with the *BIA*. Effectively, without the court's judgement, the *BIA* would have created a broad immunity to provincial law for anyone who filed for bankruptcy – potentially creating perverse incentives, which could have had consequences stretching well beyond the scope of oil and gas activities.

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