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Majority of the Court of Appeal Confirms Chief Justice Wittmann's *Redwater* Decision

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Case Commented On: *Orphan Well Association v Grant Thornton Limited*, 2017 ABCA 124 (CanLII)

The background to this case is discussed in my post on Chief Justice Wittmann's decision here. That post summarized that decision and its effect as follows:

> Chief Justice Neil Wittmann has concluded that there is an operational conflict between the abandonment and reclamation provisions of the province's *Oil and Gas Conservation Act*, RSA 2000, c O-6 (OGCA) and *Pipeline Act*, RSA 2000, c P-15 and the federal *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (BIA). Thus, a trustee in bankruptcy is free to pick and choose from amongst the assets in the estate of the bankrupt by disclaiming unproductive oil and gas assets even where (and especially so) those assets are subject to abandonment orders from Alberta's oil and gas energy regulator, the Alberta Energy Regulator (AER). As a result, the value of the bankrupt's *productive* assets is preserved for the benefit of secured creditors. AER abandonment orders do not bind a trustee with respect to the disclaimed properties and do not constitute costs of administration of the bankrupt's estate. Since the trustee has no responsibility for disclaimed assets, the trustee should be in a position to transfer non-disclaimed producing assets to a third party purchaser without objection from the AER on the basis of any deterioration in the liability rating associated with the unsold non-producing assets. If either the AER or the Orphan Well Association (OWA) carries out the abandonment of the disclaimed assets such costs may constitute a provable claim in bankruptcy but, as a general creditor, the AER/OWA would likely only recover cents on the dollar.
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> The practical effect of this decision is that the AER's authority to enforce abandonment orders at the cost of the licensee is unenforceable at precisely the time when the AER most needs to be able to exercise that power i.e. when the licensee is insolvent. Furthermore, one of the AER's principal mechanisms to ensure that a licensee has assets on hand to cover its liabilities (its authority to withhold consent to the transfer of assets which result in the deterioration of a licensee's ability to discharge its obligations) is no longer available. Thus, the entire provincial scheme for protecting Albertans from the abandonment costs in relation to non-productive wells is seriously compromised, and, as a result, in the case of a bankrupt licensee the costs of abandonment will necessarily be assumed by the Orphan Well Fund or the province. If the costs are assumed by the Fund

> this means that the industry as a whole bears the burden; if the costs are assumed by the province (perhaps by a cash infusion into the Fund) this means that all Alberta taxpayers bear the burden of discharging these abandonment and reclamation obligations. While this result flies in the face of any conception of the polluter pays principle it is, according to Chief Justice Wittmann, the necessary result of the interpretation of the relevant statutes and the application of the constitutional doctrine of paramountcy.

Two appeals were launched, one by the OWA and one by the AER. Four intervenors lined up in support of the appellants: Alberta, Saskatchewan, British Columbia, and the Canadian Association of Petroleum Producers (CAPP). Supporting the respondents was the Canadian Association of Insolvency and Restructuring Professionals. In reserved reasons the majority (per Justice Slatter with Justice Schutz concurring) dismissed the appeals. Justice Sheilah Martin dissented.

As noted in my earlier post, Chief Justice Wittmann canvassed three possible conflicts between the applicable federal and provincial legislation: (1) a possible conflict between the trustee's power to renounce and continuing liability under provincial legislation; (2) a possible conflict between the distributional scheme mandated by the *BIA* and the allocation of resources required by provincial legislation; and (3) a possible conflict between the scheme of the *BIA* and the AER's rules and practices with respect to the approval of licence transfers. Chief Justice Wittmann found there to be a conflict under each of these headings. Since the existence of a conflict under any one of these headings is sufficient to resolve the case in favour of the receiver/secured creditor interests it follows that appellants have to succeed on all grounds to have the provincial rules apply.

While the majority decision did not follow these headings it did confirm Chief Justice Wittmann's conclusions with respect to each of these issues; indeed, it perhaps went beyond him on a number of points.

The Power to Disclaim

The majority affirmed that the trustee has a broad power to disclaim assets. The power (at para 68) is not limited to circumstances where the trustee might be exposed to personal liability. This is confirmed by the fact that the *BIA* contemplates that the trustee might take into account "economic viability" when assessing the power to disclaim. Furthermore, in the view of the majority, section 14.06 does not create a right to *disclaim* assets but instead (at para 68) "assumes that the right exists." Finally, the trustee apparently need not rely on the power to disclaim since (at para 70) "the trustee can simply ignore valueless assets in the estate and turn them back to the bankrupt at the end of the insolvency process." This latter may be true but absent the statutory power to disclaim surely a receiver must comply with *applicable* provincial laws until the insolvency process comes to an end.

Implications of the AER's Rules for Distribution Under the *BIA*

The majority concluded, following and applying *Newfoundland and Labrador v AbitibiBowater Inc.*, 2012 SCC 67 (CanLII), [2012] 3 SCR 443 (*AbitibiBowater*), that the AER abandonment orders were claims provable in bankruptcy with no special claim to priority. In doing so the

majority applied the three-part test from *AbitibiBowater* for the assessment of whether or not an environmental order is a claim provable in bankruptcy. The three-part test is as follows (at para 26 of *AbitibiBowater* and quoted here at para 60):

> (a) There must be a debt, liability or obligation to a creditor. When a regulatory body exercises its enforcement powers against a debtor, it is a "creditor" in insolvency proceedings (at para. 27);
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> (b) The debt, liability or obligation must be incurred at the relevant time in relation to the insolvency. For environmental claims, this can be before or after the insolvency proceedings have commenced (*CCAA*, s. 11.8(9); *BIA*, s. 14.06(8)); and
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> (c) It must be possible to attach a monetary value to the debt, liability or obligation. The claim may be contingent, as long as it is not too remote or speculative to be included with the other claims. That depends on whether there is "sufficient certainty" that the regulatory body will ultimately perform remediation and crystallize the claim (at para. 36). In assessing the certainty of the claim, the court can examine the entire factual context, including whether the debtor is in control of the property, whether it has the means to comply with the order, whether there are other parties responsible for the remediation, as well as the effect that compliance with the order would have on the insolvency process.

According to the majority however (following Chief Justice Wittmann), the appellants conceded that the first two conditions were fulfilled and thus the majority focused their attention on the third condition. By contrast Justice Martin as we will see also examined whether the first of the two conditions was satisfied. As for the third condition the majority found that it was satisfied both in substance and at a technical level. At the substantive level, the obligation to remediate the wells fulfilled the condition regardless of whether (at para 77) "Redwater's obligation to remediate the wells arises directly from a cleanup order, or indirectly from a Directive which imposes financial consequences on the transfer of assets. The Regulator's policy on transfers essentially strips away from the bankrupt estate enough value to meet the outstanding environmental obligations." Neither did it matter whether the AER would carry out the remediation work itself or whether this would be done by a sub-delegate such as the OWA. In either case there would still be a creditor (which is actually an element of the first condition). Furthermore, while the concept of certainty may depend on the factual context it would, for example, certainly be met if the AER took security as a condition of approving a transfer. Such a condition also makes it clear that the *effect* of the AER policies on licence transfer is to transfer value from the estate to ensure the fulfilment of environmental obligations. The majority put it this way (at para 81):

> The regulatory technique of placing financial conditions on a transfer of the AER licences in order to shift value in the bankrupt estate to discharge the environmental obligations provides sufficient "certainty" to meet the *AbitibiBowater* test. It both fixes a monetary value on the obligations, and makes it certain that funds will be set aside to perform the remediation. …. The Regulator cannot, by purporting to deal with licensing requirements, effectively upset the priorities in the *BIA …"* (references omitted)

The *BIA* Scheme and the AER's Licence Transfer Scheme

The majority did not deal separately with this issue but instead largely discussed it as part of their overall assessment of the AER's rules. Thus, as noted above, the majority saw an inconsistency between the *BIA* and the AER's policy of demanding security payments inter alia where a transfer by a licensee (including a trustee) was proposing a transfer which would result in the transferor's Licensee Liability Rating (LLR) ratio falling below 1.0.

The Dissent

For Justice Martin the outcome of this case was to be determined in the crucible of co-operative federalism. There can be no doubt that the *BIA* and all of the provincial statutes at issue here are valid statutes:

> The question is whether both can co-exist. I have concluded that they can. … Governments at both levels share the environment and the imperative need to protect it for all Canadians today and in the future. The right to a natural environment free of pollution is a widely held value throughout Canada: see *Ontario v Canadian Pacific Ltd*, 1995 CanLII 112 (SCC), [1995] 2 SCR 1031, 24 OR (3d) 454 at para 55. Canadians and their elected representatives recognize that this right is to be enjoyed not only by those living today but by future generations also. That objective depends upon the vigilant enforcement of legislative safeguards. (at para 107)

In sum, Justice Martin was not prepared to support the broad interpretation of the powers of a trustee endorsed by the majority. Rather it was her view that such a broad interpretation, particularly of the power to disclaim, (at para 114)

> … contravenes principles of statutory interpretation, co-operative federalism and the rule of law. Specifically, I conclude that the Trustee cannot disclaim the end of life licence obligations on the basis they are not real property. Further, while trustees have certain powers under the BIA, these are designed to protect trustees from personal liability, not confer on them the authority to disregard binding provincial legislation. The estate of the bankrupt remains liable for these end of life environmental obligations and they cannot be renounced by the Trustee.

With this in mind Justice Martin fundamentally disagreed (at para 112) with the characterization of the issue adopted by Chief Justice Wittmann who had framed the issue as whether the Regulator can "effectively create a priority for abandonment and environmental liabilities in bankruptcy." For Justice Martin that begged the question since (at para 112) "It is premised on the assumptions that licence obligations are debts not public duties, and that there is a conflict between the legislative schemes."

Given her emphasis on the idea or ideal of co-operative federalism it was natural for Justice Martin to focus on the tests for conflict within the paramountcy doctrine, drawing attention to the ideas that "harmonious interpretations of federal and provincial legislation should be favoured over interpretations that result in incompatibility" (*Saskatchewan (Attorney General) v Lemare*

Lake Logging Ltd 2015 SCC 53 (CanLII), [2015] 3 SCR 419 at para 21) and that "Absent a genuine inconsistency, courts will favour an interpretation of the federal legislation that allows the concurrent operation of both laws. … *Conflict must be defined narrowly, so that each level of government may act as freely as possible within its respective sphere of authority*" (*Alberta (Attorney General) v Moloney*, 2015 SCC 51 (CanLII), [2015] 3 SCR 327 at para 27, emphasis added by Justice Martin). Of particular importance perhaps is this passage from *Husky Oil Operations Ltd v Minister of National Revenue*, 1995 CanLII 69 (SCC), [1995] 3 SCR 453 which Justice Martin quotes in the following context (at paras 155-156):

> [155] The Supreme Court has been equally clear that it is only a clear conflict, entailing a reordering of federal priorities that will result in a declaration that a provincial law is inapplicable in bankruptcy. This was made clear in *Husky Oil* at para 36.
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> > [36] I underline that the "effect" which Roman and Sweatman speak of is the effect on bankruptcy *priorities*…. Consequently, clear conflict, that is an inconsistent or mutually exclusive result, which in this case entails a *reordering* of federal *priorities*, is necessary to declare a provincial law to be inapplicable in bankruptcy. [emphasis in original]
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> [156] A mere effect on bankruptcy generally, such as an effect on the value of a bankrupt's estate or the amount that is available for distribution under the bankruptcy regime, does not frustrate the purpose of the *BIA*, and does not render a provincial law inapplicable in bankruptcy: see *Northern Badger* at para 63. This is made explicit by s 72(1) of the *BIA*, which ensures that provinces continue to have the ability to regulate property and civil rights during bankruptcy. The provincial law must have the much narrower effect of reordering bankruptcy priorities before it will be declared in conflict with the *BIA* and therefore inapplicable

Informed by this interpretive approach, Justice Martin suggests that there are two parts to her judgement (at para 160). In the first part she considers and rejects the argument that the AER's orders must be construed as a provable claim in bankruptcy. In the second part she examines and rejects the claim that Alberta's regulatory regime conflicts with the *BIA*. In fact, I think that the first part breaks down into two sections the first section dealing with the existence of a provable claim in bankruptcy using the three-part test from *AbitibiBowater* and the second section dealing with the power to disclaim. I will use those three headings here.

A Provable Claim in Bankruptcy?

Like the majority, Justice Martin applied the three-part test from *AbitibiBowater* but in this case Justice Martin focused on the first part of the test. In Justice Martin's view the AER was not a creditor of the insolvent debtor. The cost of abandonment and reclamation was a cost inherent in the properties themselves and the overall regulatory scheme, it was not a cost (at para 185) "owed to the Regulator, or to the province." She went on to comment (at para 187)

> The requirement that a licensee obtain AER approval for licence transfers is fundamentally different from the clean-up orders at issue in *Abitibi*. The province

> has to be able to maintain control over the transfer of well and pipeline licences during a bankruptcy and there is no reason why that regulatory requirement cannot co-exist with the distribution of a debtor's estate. The trustee must comply with the licensing requirements during the bankruptcy process. The trustee cannot, for example, transfer AER-issued well licences to an unqualified licensee; AER approval is required for any transfer. Similarly, the trustee must comply with the LLR program when seeking to transfer licences. The requirement to post security as part of the licence transfer is not, in my view, a "debt" owed to the AER or the province. It is part of the conditions attached to the licence. The AER does not become a creditor when it seeks to enforce the licence conditions, whether it does so by the issuance of abandonment orders or otherwise. The definition of "creditor" in *Abitibi* does not fit comfortably with the LLR program at issue here.

Could the Receiver Rely on the Power to Disclaim?

I think that we can all agree (at paras 189, 201) that the power to disclaim, the power to "pick and choose", is an extraordinary power and furthermore that section 14.06 of the *BIA* which expresses the power is hardly a model of clear legislative drafting. It is therefore a provision which requires careful interpretation. While Justice Martin begins (at para 192) with the usual starting point in *Re Rizzo & Rizzo Shoes Ltd (Re)*, 1998 CanLII 837 (SCC), [1998] 1 SCR 27, 154 DLR (4th) 193 at para 21 she soon moves to rely more heavily (at para 201) on "the principle of cooperative federalism, which requires courts to avoid placing too broad an interpretation on the federal legislation and to read the federal and provincial legislation harmoniously so as to avoid a conflict wherever possible."

Justice Martin's alternative interpretation of section 14.06 of the *BIA* was based upon her understanding of the amendments made to the *BIA* in 1992 and 1997. The purpose of those amendments in her view was to protect trustees from personal liability (absent gross negligence or wilful misconduct) and to provide a super-priority to a government engaging in environmental clean-up activities on the debtor's property—but only in relation to that particular property that is the subject of the clean-up and any contiguous real property of the debtor. That suggested two limits on the power to disclaim (at paras 201-214): (1) the power should only be available to protect the trustee's personal liability, and (2) the power should only be available where the super-priority provisions offered a realistic remedy to a government.

The second argument is perhaps the most far-reaching insofar as Justice Martin's point here is that the super-priority solution will never provide an effective remedy in the oil and gas sector (perhaps specifically the conventional oil and gas sector) since the only property that could be the subject of the secured super-priority claim is the debtor's incorporeal oil and gas interest in the form of a Crown licence or freehold lease which, by definition, no longer has any value. Justice Martin puts the point this way (at paras 218, 223 – and see also at para 220, emphasis is Justice Martin's):

> [218] Section 14.06(7) grants the Crown a super-priority in the debtor's real property so that the Crown may recoup some of the costs incurred to clean up the environmental damage on that same property. This provision, and the compromise inherent in it, is effective only where it is the debtor's real property that has

> suffered environmental damage. It has no application here. There is no "real property of the debtor" in which the Crown can take a super-priority. The well licence is not real property, and it is nonsensical to contemplate a super-priority attached to an abandoned well or to a mineral interest often already owned by the Crown and leased to the debtor. In enacting subsection 14.06(7), Parliament intended to provide a meaningful source of recompense if the public incurs remediation costs to clean up a debtor's property. In this situation, that intention is rendered meaningless.
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> [223] Sub-section 14.06(4) was not intended to operate in Alberta's regulatory environment. The balance struck by s 14.06 does not take into account the third party surface owner, who is a common player in the Alberta system. The diminution in value of that party's land will be the result of the debtor's failure to fulfill obligations that were statutorily imposed when the licence was issued, and the lender, who knew of the obligations when funds were advanced, will benefit. Sub-section 14.06(4), and its reference to a trustee renouncing interests in real property, simply does not apply to the end of life obligations attached to AER licences. Even assuming the assets can be renounced, the end of life obligations would continue to bind the remaining parts of the estate.

In sum, since the super-priority is meaningless in Alberta's oil and gas context there can be no power to disclaim.

Does Alberta's Scheme Conflict With the *BIA*?

As all members of the Court recognize there are two branches to the paramountcy test which Justice Martin framed this way at para 229: (1) is it operationally impossible to comply with both the federal and provincial law? and (2) does the provincial regime frustrate the purpose of the federal law? Justice Martin concluded that neither branch of the test was satisfied. The principal operational conflict arises because the provincial legislation deems the receiver to be the licensee even where the licensee has renounced. But, (at para 233) if there is no power to renounce (as Justice Martin had previously found) there can be no operational conflict. As for the alleged frustration of purpose of the *BIA*, Justice Martin had already signaled her response to this question in her discussion of co-operative federalism. In her view (at para 235) the objective of the *BIA* "is the equitable distribution of assets among creditors. It will be recalled that this purpose is achieved by requiring creditors wishing to enforce a claim provable in bankruptcy to participate in one collective proceeding: *Moloney* at para 34. There is frustration of purpose where the effect of a provincial law is to conflict with or alter the priorities established by the *BIA*; where the provincial law purports to give priority to one provable claim over others: *Husky Oil* at para 40." There was no frustration of that purpose here since (at para 239) "[t]he cost of abandoning licensed wells and reclaiming well sites is an ongoing regulatory obligation and an inherent part of the licensed asset, well known and understood by the debtor licensee and the licensee's lenders." Furthermore (at para 240),

> The continued application of the regulatory regime following bankruptcy does not determine or reorder priorities among creditors, but rather values accurately

> the assets available for distribution. The value of the debtor's estate must take into account the end of life obligations associated with the licences that form a part of that estate. If this means that, in the end, there is less value available for distribution to the creditors, that is part of the bankruptcy scheme and the risk that the creditor takes when lending on the basis of the debtor's assets, with their associated obligations.

Justice Martin supported this assessment by reference to the "fundamental principle of bankruptcy law that 'creditors should not gain on bankruptcy any greater access to their debtors' assets than they possessed prior to bankruptcy': *RBC v North American Life Assurance Co*, 1996 CanLII 219 (SCC), [1996] 1 SCR 325, [1996] 3 WWR 457 at para 18." In this case (at para 241) The regulatory regime, prior to bankruptcy, contemplates that the value of all a licensee's licensed assets will be available to satisfy all end of life obligations. This is the basis of the LLR program, and that regulatory approach is factored into decisions regarding, for example, the approval of licence transfers, a licensee's entitlement to additional licences, and the amount of security the licensee will be required to post upon licence transfer. The licensee's lenders are aware of the system. The occurrence of a bankruptcy should not enable lenders to avoid the system and access the value of specific licensed assets while ignoring the corresponding end of life obligations.

In sum (at para 243) Alberta's legislation does "not seek to reorder priorities on bankruptcy, nor ... is that its effect." And as a result there was no frustration of the federal purpose.

Brief Assessment and What's Next?

While the appellants may have lost, they now have in hand a well-reasoned dissenting opinion which has the added benefit of reframing the issues in terms of cooperative federalism and the parallel application of federal and provincial laws. The AER has already announced that it intends to seek leave to appeal to the Supreme Court of Canada.

If the Court grants leave I suspect that much of the focus will be on the scope of the power to disclaim. Justice Martin has made a brave effort to cabin that power in favour of an outcome that makes policy sense and preserves the idea that the polluter should pay. But in doing so she has created a sector specific exception from the power to disclaim. That may be reaching too far.

This post may be cited as: Nigel Bankes "Majority of the Court of Appeal Confirms Chief Justice Wittmann's *Redwater* Decision" (3 May, 2017), online: ABlawg, http://ablawg.ca/wp-content/uploads/2017/05/Blog_NB_RedwaterCA.pdf