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Abandonment and Reclamation Obligations, Builders Liens, and Municipal Taxes in Oil and Gas Bankruptcy Proceedings

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Cases Commented On: *Manitok Energy Inc (Re)*, 2022 ABCA 117 (CanLII)

Re Manitok Energy Inc, 2022 ABCA 117 (CanLII) (*Manitok)* was released March 30, 2022. It relates to the bankruptcy of an Alberta oil and gas corporation and interprets the Supreme Court of Canada's decision in *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 (CanLII) (often referred to as *Redwater*, after the bankrupt company involved). The specific question before the Court of Appeal in *Manitok* was:

> Whether end of life obligations associated with the abandonment and reclamation of unsold oil and gas properties must be satisfied by the Receiver from Manitok's estate in preference to satisfying what may otherwise be first-ranking builders' lien claims based on services provided by the lien claimants before the receivership date. (*Manitok* at para 1)

The Court of Appeal concluded that abandonment and reclamation obligations of oil and gas assets take priority over builder's liens. *Manitok* also likely resolves the question of whether the abandonment and reclamation obligations (ARO) of oil and gas assets take priority over unpaid property taxes owed to rural municipalities: ARO will almost certainly take priority over unpaid property taxes. Several rural municipalities recognized this connection to their interests and obtained leave to intervene in *Manitok* back in September 2021 (see *Manitok Energy Inc (Re)*, 2021 ABCA 323 (CanLII)). It is possible that issue will still be litigated directly in relation to the bankruptcy of Trident Exploration Corp.

I also take this opportunity to provide some reflections on *Redwater*, which is now more than three years old.

The Background

Manitok is one of Alberta's bizarre stories of oil and gas bankruptcies. Manitok entered bankruptcy in February 2018. The Receiver managing the bankruptcy sold oil and gas assets from the bankrupt estate to several other oil companies before selling some wells to Persist Oil and Gas. Persist Oil and Gas was incorporated just after Manitok's bankruptcy and has the same President that Manitok did. Manitok's former management and investors had their bankruptcy lawyers create Persist Oil and Gas to reacquire Manitok's assets. This was not done secretively and seems to have been expressly permitted by the Alberta Energy Regulator (AER). The AER's reasoning for allowing this sort of transfer is not obvious, and the AER does not make any records relating to asset

transfers public, other than their responses to statements of concern like this one, where the AER dismissed the statement of concern of the Municipal District of Taber.

Manitok's bankruptcy process is particularly difficult to follow because some of the information was sealed, and some of the transactions were partially approved or completed before being restructured in response to Supreme Court's *Redwater* decision on January 31, 2019.

The Court of Appeal Decision

Re Manitok Energy Inc, 2022 ABCA 117 is the appeal of the Court of Queen's Bench decision in *Manitok Energy Inc (Re)*, 2021 ABQB 227 (CanLII). The Court of Appeal started by reviewing the history of Manitok and noting that the sale of Manitok assets to Persist Oil and Gas stipulated holdbacks to "cover the amounts of the two builders' liens and certain unpaid property taxes" (at para 6) and that the ARO still in the estate is around $44.5 million, significantly exceeding the value of the assets in the estate (at para 7).

The question of how to interpret *Redwater* focused on paragraph 159 of *Redwater*, which discusses the majority's understanding of section 14.06(7) of the federal *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (*BIA*). Paragraph 159 of *Redwater* reads:

> Accordingly, 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. In crafting the priority scheme set out in the BIA, Parliament intended to permit regulators to place a first charge on real property of a bankrupt affected by an environmental condition or damage in order to fund remediation (see s. 14.06(7)). 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. Although the nature of property ownership in the Alberta oil and gas industry meant that s. 14.06(7) was unavailable to the Regulator, the Abandonment Orders and the LMR replicate s. 14.06(7)'s effect in this case. Furthermore, it is important to note that Redwater's only substantial assets were affected by an environmental condition or damage. Accordingly, the Abandonment Orders and LMR requirements did not seek to force Redwater to fulfill end-of-life obligations with assets unrelated to the environmental condition or damage. In other words, recognizing that the Abandonment Orders and LMR requirements are not provable claims in this case does not interfere with the aims of the BIA — rather, it facilitates them.

Focusing on paragraph 159, the Justice at the Court of Queen's Bench found that Manitok's situation should be distinguished from *Redwater* because:

(a) Parliament intended to permit regulators to place a charge on property if it was affected by an environmental condition;
(b) The activities of the Alberta Energy Regulator in Redwater "replicated" the effect of s. 14.06(7) of the Bankruptcy and Insolvency Act;

(c) Redwater's only "substantial assets" were affected by an environmental condition, so the Alberta Energy Regulator orders did not extend to "assets unrelated to the environmental conditions."
(at para 23)

The Queen's Bench decision would have separated the bankrupt estate's assets into assets related to the environmental conditions over which the ARO would be a super-priority claim and assets unrelated to the environmental conditions on which the ARO would not have any special priority. The Court of Appeal rejected this approach, finding "[t]his interpretation would render *Redwater* meaningless" (at para 29), allow bankrupt companies to easily escape their ARO, and that "[t]he whole point of *Redwater*, however, is that the proceeds of the sale of the valuable assets must be applied towards reclamation of the worthless orphaned assets" (at para 30).

The Court of Appeal also rejected two other arguments. First, that the presence, absence, or timing of abandonment orders by the AER made a difference, saying "neither the existence of enforcement orders nor the sequence in which enforcement action is taken is relevant to the Receiver's duty to discharge public environmental obligations" (at para 41). Second, that *Redwater* changed the legal situation in the middle of the Manitok bankruptcy in a way that impacted the situation: "The *Redwater* decision did not change the law. It merely stated what the law had always been, despite the opinions of some in the industry to the contrary. The law was always as stated in the *Bankruptcy and Insolvency Act*, *Northern Badger*, *Abitibi*, and as confirmed in *Redwater*" (at para 43).

Commentary

Manitok and the cases relating to *Sequoia* (here and here) indicate the Court of Appeal's approach to interpreting *Redwater* is to protect the basic principle of *Redwater* (neatly summarized as "the proceeds of the sale of the valuable assets must be applied towards reclamation of the worthless orphaned assets" (at para 30)) from attempts to find interpretive approaches that would detract from that principle by focusing on precise details.

The policy implications of *Manitok* are more complex than the policy implications of *Redwater*. *Redwater* was effectively a dispute about the priority of claims between the AER enforcing ARO and banks. In *Manitok*, the Court of Appeal's approach helps pay for oil and gas remediation by keeping Manitok's assets available for the AER and the Orphan Well Association. However, this advantage likely comes at the expense of rural municipalities' ability to collect taxes from these bankrupt companies, which is also clearly in the public interest and is a major policy problem in Alberta. Another complicating detail is that one of the lien-holders involved held that lien for work "related to the reclamation and clean-up of specific oil and gas sites" (*Manitok Energy Inc (Re)*, 2021 ABQB 227 at para 18) so that the Court of Appeal's decision may make it riskier for oil and gas contractors to agree to clean-up sites belonging to corporations in financial trouble. This sort of tricky situation is common in bankruptcy cases where there is not enough money to go around and worthy creditors must lose out. The facts of *Manitok* are also complicated because Manitok's owners and investors are nearby, having become the owners and investors of Persist Oil and Gas which, as noted above, is now operating many of Manitok's former assets.

Redwater attracted public attention to the problems with the AER's system of ensuring clean-up of oil and gas assets (I have written on that problem often since *Redwater*, for instance, here and here). But a major issue raised in *Redwater* that has received less public attention is the federal government's errors in drafting section 14.06 of the federal *Bankruptcy and Insolvency Act*.

Section 14.06 of the *BIA* is a nightmare to interpret due to poor drafting. Justice Sheilah Martin, then on the Alberta Court of Appeal, but since elevated to the Supreme Court, wrote in her dissent: "[t]he only matter on which all parties before the Court agreed was that the language of s 14.06(4) is not a model of clarity" (*Orphan Well Association v Grant Thornton Limited*, 2017 ABCA 124 (CanLII) at para 201). That is a very judicious phrasing. The disastrously poor drafting of section 14.06 of the *BIA* is largely why the *Redwater* case went all the way to the Supreme Court, and is responsible for the legal dispute at the heart of *Manitok* (see *Manitok* at paras 20-27).

Principles of statutory interpretation keep judges from explicitly concluding the legislature is incompetent or drafted legislation in a way that makes no sense (see for instance, *Redwater* at paras 191 and 214). That has an important purpose in protecting the division of powers between the legislative and judicial branches. But I am not a judge. Section 14.06 of the *BIA* is a weird blend of policy misunderstandings and bad drafting. The federal government should have removed or reworked section 14.06 of the *BIA* immediately after *Redwater*. Although the *BIA* has been amended since *Redwater* was decided, section 14.06 has been left untouched.

As a final note, *Redwater* is a good case study in the limited power of litigation and courts (even the Supreme Court) to fix large policy problems. Legislative and regulatory action from both the federal and provincial governments is necessary to fix Alberta's orphan and inactive well problem and Canada's problems with handling environmental liabilities during bankruptcy.

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