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What Are "Unrelated Assets" When It Comes to Environmental Reclamation Obligations? The Lending Industry Needs to Know

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Case Commented On: *Mantle Materials Group, Ltd v Travelers Capital Corp*, 2023 ABCA 302 (CanLII)

In recent years, the courts have seen many cases dealing with unfunded environmental reclamation obligations. Although these obligations have long raised issues, the Supreme Court of Canada's decision in *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 (CanLII) ("*Redwater*") commenced a new era for determining the priority for environmental end-of-life obligations in Canadian insolvencies (see my earlier post on *Redwater*, Lessons from *Redwater*: Disregard the *AbitibiBowater* Test and Legislate Super Priority for the Regulator).

Redwater dealt with environmental reclamation obligations at the intersection of insolvency law and environmental law. It determined that the Alberta Energy Regulator (the "AER") was not holding a provable claim in bankruptcy and could therefore assert its claim outside of the bankruptcy scheme. The result of this decision was that the AER obtained a common law super priority over the other creditors, effectively undermining the legislated priority of distribution scheme in the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 ("*BIA*").

Cases since *Redwater* have been testing its reach outside of the oil and gas sector, and in one case, outside the insolvency scheme altogether. *Redwater* dealt with an oil and gas insolvency. *Qualex-Landmark Towers Inc v 12-10 Capital Corp*, 2023 ABKB 109 (CanLII) ("*Qualex*") applied the *Redwater* principles, but it did so to a private real estate dispute outside insolvency proceedings. (See my post about *Qualex*, Environmental Obligations Enforced Between Private Parties: The Extension of *Redwater*. For an analysis of this evolution and how *Qualex* expands the application of *Redwater*, see Jassmine Girgis and Robyn Gurofsky, "Pushing the Boundaries of *Redwater*: How *Qualex* Expands the 'Protective Umbrella' for Environmental Reclamation Obligations", Annual Review of Insolvency Law, 2023, forthcoming, copy on file with the authors.) *Mantle Materials Group, Ltd v Travelers Capital Corp*, 2023 ABCA 302 (CanLII) ("*Mantle*") is the latest in a line of cases to apply *Redwater*, and the court found that environmental obligations take priority over secured creditors outside of an oil and gas context.

Cases have also been clarifying the principles raised in *Redwater*. One of the questions that *Redwater*, and the cases after it, left open is whether assets unrelated to the environmental obligations should be used to satisfy environmental contamination. This question also arose in *Mantle*, though the court again determined that it need not be answered on the facts of the case, as the assets were related assets.

The question of whether assets are related or unrelated is a pressing one, as lenders make their risk assessments based on whether particular assets are likely to become encumbered by environmental reclamation obligations. And until this question is resolved, the *Mantle* decision might serve as a warning to lenders to assume all assets are related until the courts articulate where the line should be drawn.

Facts

The respondent, Mantle Materials Group, Ltd ("Mantle"), operates gravel pits pursuant to licenses issued by Alberta Environment and Protected Areas ("AEPA") (formerly Alberta Environment and Parks). In 2021, Mantle acquired its gravel-producing assets through a reverse vesting order ("RVO") in JBM Crushing Systems Inc's ("JMB") *Companies Creditors Arrangement Act*, RSC 1985, c C-36 ("*CCAA*") proceedings. Once the *CCAA* proceedings had commenced, the AEPA issued Environmental Protection Orders ("EPOs") to JMB in respect of some of its gravel-producing properties.

EPOs are issued pursuant to the AEPA's authority under the *Environmental Protection and Enhancement Act*, RSA 2000, c E-12 at s 140. When the AEPA issues an EPO with respect of end-of-life reclamation, it is similar to an Abandonment and Reclamation Order ("ARO") issued by the AER. In other words, an EPO imposes environmental remediation obligations. Under the RVO, Mantle remained liable for the EPOs that had been issued on the properties it acquired from JMB.

After the JBM *CCAA* proceedings, Mantle entered into a loan transaction with Travelers Capital Corp ("Travelers"). Travelers loaned Mantle $1,700,000 for the acquisition of equipment for use in its operations and Mantle granted Travelers a purchase money security interest ("PMSI") over the equipment. Travelers registered its PMSI, which was designated to have first priority in the equipment, in the Alberta Personal Property Registry.

Mantle subsequently experienced operational problems. That, combined with the excessive debt it inherited from the JMB *CCAA* proceedings and the substantial reclamation obligations it was required to satisfy under the EPOs, led Mantle to become insolvent. In July 2023, Mantle filed a notice of intention ("NOI") to make a proposal under s 50.4 of the *BIA*.

Under the NOI, Mantle proposed to prioritize various charges (the "Restructuring Charges"), which were necessary to put the proposal into effect. The main part of the proposal was to carry out the end-of-life obligations under the EPOs. Mantle, arguing that *Redwater* mandated that these obligations be prioritized over any realizations by secured creditors, maintained that Traveler should not be permitted to realize on its security prior to Mantle completing the reclamation work, as doing so would jeopardize Mantle's ability to complete that work. AEPA supported this position. Travelers objected, arguing that the assets subject to its security were "assets unrelated" to the environmental obligations, and not caught by *Redwater's* super priority.

Decisions

In chambers, Justice Colin Feasby considered *Redwater*, *Manitok Energy Inc (Re)*, 2022 ABCA 117 (CanLII) ("*Manitok*"), and *Orphan Well Association v Trident Exploration Corp*, 2022 ABKB

839 (CanLII) ("*Trident*"). He concluded that the equipment subject to Travelers' security interest was part of Mantle's gravel business, as in, the assets to which Mantle's environmental obligations pertain, and was caught by the *Redwater* super priority.

The Alberta Court of Appeal dismissed Travelers' appeal, maintaining that the equipment in which Travelers had a security interest is part of Mantle's gravel production business, and it is equipment being used in the reclamation efforts (at para 21). It found that Mantle's only business is gravel production, and that it has no assets unrelated to these operations. It concluded by noting that the question of how to deal with assets unrelated to the environmental damage is important, but that it is not arguable on the facts of this case (at para 21).

My Comments

In *Redwater*, Chief Justice Richard Wagner, writing for the majority, held that unrelated assets were not required to satisfy Redwater's environmental liabilities. Specifically, he said,

> [O]nly Redwater's substantial assets were unaffected 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 (*Redwater* at para 159).

However, Wagner CJC did not comment on how to determine which assets are "unrelated" and how to make the distinction. Since *Redwater*, two cases have raised the issue of which assets can be used to satisfy environmental reclamation obligations.

The first case after *Redwater* to raise this issue was *Manitok*. Manitok Energy Inc and certain affiliates ("Manitok") was a public company engaged in oil and gas exploration. Manitok filed a NOI to make a proposal under the *BIA*, subsequent to which it went into receivership. The receiver sold its assets, and the proceeds of those sales remained in Manitok's estate. One of the two issues the court dealt with was whether "assets unrelated to the environmental condition or damage" were available to satisfy the abandonment and reclamation obligations (*Manitok* at para 33). On this issue, the court noted that *Redwater* did not draw a distinction between types of assets when it repeatedly referred to the "assets of the estate" (*Manitok* at para 35). It also noted that "there is no clear boundary between licensed assets and other assets" such as oil and gas rights, royalty rights, intellectual property, seismic data, and vehicles (*Manitok* at para 35). However, the Court refrained from making a decision on whether "assets completely unrelated to the oil and gas business" could be used to satisfy the reclamation obligations, finding it could be "left for another day" (*Manitok* at para 36).

In *Trident*, the Alberta Court of King's Bench was again faced with the issue of drawing a distinction between assets. Trident Exploration Inc and its affiliates ("Trident") were a group of privately-owned oil and gas exploration and production companies. Trident ceased operating, leading the Orphan Well Association to obtain a receivership order. After the receiver sold Trident's assets, including non-licensed assets such as real estate and machinery, the court had to decide whether the AER was entitled to the proceeds of sale and whether it would take priority over municipal tax obligations. The court decided the AER was entitled to the funds, including

those derived from the sale of Trident's real estate assets that were used for office or equipment storage. It said, "Trident had only one business: exploration and production of oil and gas. It makes no sense to differentiate real estate assets from other assets used in that business" (*Trident* at para 67). Similar to *Manitok*, by noting that Trident had only one business, the court also refrained from making a decision on whether assets completely unrelated to the oil and gas business could be used to satisfy environmental reclamation obligations (*Trident* at para 67).

The Alberta Court of Appeal took a similar stance in *Mantle*. Travelers argued that the equipment over which it had a security interest was not affected by an environmental condition or damage, and that it should therefore be able to realize on its security before Mantle fulfilled its environmental obligations (*Mantle* at para 18). The Court disagreed, maintaining that the abandonment and reclamation obligations were binding "on the bankrupt estate" (*Mantle* at para 19, quoting *Redwater* at paras 93 and 98 and *Manitok* at para 17), and that the "obligation was not tied to the type of asset" (*Mantle* at para 19).

The Court likened the proposed appeal to *Manitok*, where the court declined to draw a distinction between oil and gas assets and non-oil and gas assets, finding them all to be "assets of the estate" (*Manitok* at para 35). The Court in *Mantle* upheld the chambers judge's finding that Travelers' security interest is in the equipment which is part of Mantle's gravel production business, equipment which is being used in the reclamation efforts. It noted that Mantle's only business is gravel production and that it has no assets unrelated to these operations (*Mantle* at para 21).

Like in *Manitok* and *Trident*, the Alberta Court of Appeal in *Mantle* concluded that the question of assets unrelated to the environmental damage, and the policy concerns that stem from the question about financing businesses that have environmental obligations, are significant, but that on the facts of the case, these issues were not arguable (*Mantle* at para 21).

This is a pressing issue, as it further impacts lending when environmental reclamation obligations could arise. *Redwater* has already significantly impacted oil and gas industry lenders. The super priority imposed by the Supreme Court in *Redwater* overrode the priorities for which lenders had bargained when they entered into their lending agreements. By overriding lenders' legislated priority, *Redwater* reduced the certainty and predictability that every market economy seeks to preserve. After *Redwater*, there were significant concerns about reduced loan availability as lenders scrambled to understand how the decision would impact current and future loans and security interests.

This issue is again raised when it comes to the question of which assets are unrelated. In the chambers judge's reasons, he noted that Travelers had conducted due diligence prior to entering into the financial arrangement with Mantle, and that it had available documents showing Mantle's environmental obligations and the security it had posted with the AEPA. Feasby J noted this to show that Travelers had the opportunity to assess its risk prior to extending financing to Mantle. But the fact that Travelers proceeded to enter into this transaction after its due diligence likely indicates that its due diligence needed to be more extensive, or that it did consider Mantle's environmental obligations but then proceeded to make an erroneous assessment about these assets being related or about its PMSI taking priority. This too has the potential to severely chill the lending industry, as until lenders know where the line is between related and unrelated assets, they

will likely, particularly after *Mantle*, err on the side of assuming that all assets are related and make their lending decisions accordingly.

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