Business

The Advisor

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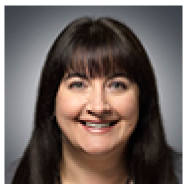
The Redwater Decision: The Alberta Energy Regulator - Trumped by Federal Bankruptcy Law



By Kathleen Shannon and Sean Wallace

Highlights

- Federal Bankruptcy laws prevail to the extent of a conflict with otherwise valid provincial law. Receivers may renounce uneconomic assets.
- The Alberta Energy Regulator (AER) does not have a super priority over secured creditors. Receivers are not bound by closure or abandonment orders in respect of renounced assets.
- The orphan well problem may get worse.
- There is a heightened risk of a declaration being made against officers and directors of bankrupt corporations – the effect of which is to preclude future employment as a director or officer of an Alberta oil and gas company.
- The AER announced it is appealing this decision as it is concerned that "The decision may encourage further receiverships and bankruptcies as a means of avoiding end of life obligations and poses a risk of a significant increase in the number of orphaned AER licensed assets."

Discussion

In *Redwater Energy Corporation (Re)*[1], the Alberta Court of Queen's Bench ruled against the AER, holding certain sections of the *Oil and Gas Conservation Act*[2] ("*OGCA*") and Pipeline Act[3] inoperative to the extent if applied their effect would frustrate a receiver or trustee's ability to renounce the uneconomic assets of a bankrupt energy company.

Redwater Energy Corporation ("Redwater") was a publicly listed junior oil and gas corporation. After a number of unsuccessful drilling initiatives and acquisitions depleted its cash resources in mid-2014, it defaulted on its loan facilities. Grant Thornton Limited ("Receiver") was initially court-appointed as the receiver and later the trustee in bankruptcy of Redwater's assets.

The Receiver assessed Redwater's 127 AER licensed assets – which included wells, facilities, and pipelines – and advised the AER that it would only be taking possession and control of the 20 most valuable assets (the "Retained Assets"). The Receiver opted to renounce the remaining assets as is permitted by the federal Bankruptcy and Insolvency Act[4] ("BIA").

The AER responded by issuing a series of closure and abandonment orders regarding the Renounced Assets pursuant to the *OGCA* and the *Pipeline Act* ("Abandonment Orders"). Notably, under this provincial legislation, all "licensees" – explicitly including receivers and trustees in bankruptcy – are required to comply with AER requirements, and there is no accommodation for renouncing licensed assets. The Receiver advised that it did not intend to comply with the Abandonment Orders in respect of the Renounced Assets.

The AER brought an application to compel the Receiver to comply with the Abandonment Orders and to fulfill all of the provincial statutory obligations of Redwater in relation to abandonment, remediation and reclamation of all licensed assets as directed. Further, it argued that since any funds required to comply with the Abandonment Orders would be drawn from the Redwater estate prior to the payment of fees or disbursements to any other creditors the Receiver would not be subject to personal financial risk. In the bankruptcy regime, the AER's position would effectively give it a super priority claim over all secured and unsecured creditors.

The Receiver brought a counter-application to not only dismiss the AER's application, but also to approve a sales process to market the Retained Assets whereby the AER could not condition its transfer approval on compliance with the Abandonment Orders. Normally, licence transfers must be approved by the AER to be effective. When a licence transfer application is submitted the Liability Management Rating ("LMR") of both the transferee and the transferor post-transfer is calculated. The LMR is the ratio of licensee's deemed assets in the Licensee Liability Rating Program, Large Facility Liability Management Program, and Oilfield Waste Liability Program to its deemed liabilities in these programs. If either the transferee's or the transferor's post-transfer LMR would be below a ratio of one, the AER will not approve the transfer unless a security deposit is provided to cover the difference between the deemed liabilities and deemed assets plus any existing liability management security deposits.

Chief Justice N. Wittman, in his written decision, held that requiring the Receiver to comply with the Abandonment Orders for the Renounced Assets would create an operational conflict between the *BIA* and the definition of licensee under the *OGCA* and *Pipeline Act*. He invoked the doctrine of federal paramountcy: when otherwise valid federal and provincial legislation are incompatible, the provincial law is rendered inoperative to the extent of the conflict or inconsistency. Accordingly, the Chief Justice held that the provincial law frustrated the federal bankruptcy regime and was therefore inoperative to the extent that it:

- Prevented the Receiver from renouncing licensed assets which provide no economic benefit to creditors and which could put a Receiver at personal financial risk;
- Required the Receiver to comply with the Abandonment Orders as a super-priority to any

other claims against Redwater, including secured and unsecured creditors; and
- Allowed the AER to frustrate transfer applications by requiring the Receiver to meet AER conditions regardless of the fact that the licensed assets had been renounced.

Accordingly, he dismissed the AER application and granted the Receiver's counter-application. The Abandonment Orders issued by the AER were rendered inoperative to the extent that they would require the Receiver to deal with the Renounced Assets.

This decision has significant implications for the Alberta oil and gas industry. As a result of the Court's decision, once a receiver or trustee renounces a licensed asset, it will not be bound by AER closure or abandonment orders issued to the receiver or trustee regarding the renounced asset, nor will it assume any liability for the renounced assets. Prior to this decision there was concern that receivers and trustees would refuse mandates in the oil and gas industry due to potential liabilities associated with low value assets. This decision confirms that receivers and trustees do not have to take on these risks.

As stated by Chief Justice Wittman, the potential financial and environmental repercussions are very real. While this decision provides comfort both to secured lenders and energy companies seeking credit facilities, any surge in renounced licensed assets could result in a corresponding increase in orphaned assets. This could in turn result in increased orphan well fund levies to the oil and gas industry. The AER has commenced an appeal of the Court of Queen's Bench Decision, taking the position that receivers and trustees should not be permitted to avoid end of life obligations and that the decision poses a significant risk of an increase in orphaned assets.

AER Bulletin 2016-10 heightens the concerns for industry as it states that directors and officers of insolvent energy companies remain responsible for ensuring compliance with all AER requirements, including the continued care and custody of all AER-licensed assets. The AER may continue to carry out its enforcement regime against the licensee and/or its directors and officers for any failure to comply with its requirements. For a director or officer, this may include being individually named in an order issued under section 106 of the *OGCA* or section 51 of the *Pipeline Act* – which will, while it remains in effect, effectively end an individual's ability to be employed as a director or officer of an oil and gas corporation operating in Alberta.

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[1] 2016 ABQB 278.

[2] RSA 2000, c O-6.

[3] RSA 2000, c P-15.

[4] RSC 1985, c B-3.

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