Enforcing Regulatory Powers in an Insolvency

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The Constitution in the Insolvency Tool Box

Prepared by:

Terry Czechowskyj &

Daniel K. Jukes

Miles Davison LLP

Calgary, Alberta

Presented by:

Terry Czechowskyj

Miles Davison LLP

Calgary, Alberta

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ENFORCING REGULATORY POWERS IN AN INSOLVENCY

INTRODUCTION

Oil and gas operators are currently witnessing the increasing involvement of Regulatory bodies in the sales process and liquidation of an insolvent corporation's assets. The days are gone when Receivers could look to realize on the assets of an insolvent oil and gas corporation without Regulatory bodies weighing in on how and when a sales process would be approved.

The legal landscape has changed significantly since 1991 when the Alberta Court of Appeal laid down the law as to how Receivers and Trustees could market the assets of insolvent oil and gas corporations.

As case law affecting Regulators evolved, the door was opened to allow Receivers and Trustees to push back on the involvement by Regulators in the administration of the estate of insolvent oil and gas corporations.

Within the last year, Receivers and Trustees have undertaken a constitutional challenge with respect to the Regulators' authority to control the sales process in receivership and bankruptcy estates and the obligations of Receivers and Trustees to comply with what are characterized as "monetary regulatory orders".

In addition to an in depth discussion of the arguments at play in the *Redwater* case and AER's position on them, the paper will also comment briefly on some recent decisions from Alberta's Surface Rights Board which demonstrate the difficulty regulators are having when faced with constitutional questions stemming from an insolvency.

HISTORICAL BACKGROUND

By 1990, the oil and gas industry in Alberta had matured to the extent that an average of 10-15 thousand wells were being drilled and produced each year. The number of wells that were being properly abandoned ranged at about 4000 per year. The result was the oil and gas industry was heading for a crisis in terms of the abandonment of well sites in a proper and orderly manner.

Notwithstanding that adequate legislation was in place to correct this discrepancy, industry itself did not deal with the obligation to abandon in a timely manner. The legislation was not enforced in a manner that required a minimum number of wells to be abandoned each year.

The result was that by 2013 about 450,000 wells had been drilled in Alberta and about 150,000 had been deemed to be abandoned. The potential exposure for abandonment costs exceeds $25 billion with costs estimated at $1.5 billion to clean up the current listing of the 150,000 abandoned well sites. To put that in perspective the current budget is $30 million for the Orphan Well Association who is mandated to clean up the sites when operators become insolvent. The average cost to properly abandon a well site is estimated to be $100,000.

To face this reality of an increasing number of well sites to be abandoned, in 2013 the Alberta Energy Regulator ("AER") amended the Licence Liability Rating program ("LLR") to ensure that the Orphan Well Association was properly funded to carry out its mandate.

The impact of the revised LLR program on the insolvency of an oil and gas corporation is that a large portion if not all of the generated sale proceeds from the assets must be dedicated to abandon the well sites that are no longer economic and have no residual value to the estate. As the price of oil and gas dropped from 2014 the result was that secured lenders were realizing less and less on their recoveries from the receiverships and bankruptcies of their oil and gas borrowers.

By 2015 with oil below $50/barrel it was apparent that lenders had to seriously consider even appointing a receiver as there was little benefit to be achieved for the lender when the abandonment liability was accounted for. To respond to this issue Receivers and Trustees began considering disclaiming the abandoned well sites pursuant to the provisions of the *Bankruptcy and Insolvency Act* ("BIA") and the provisions of the template receivership order.

The issue then arose as to the validity and constitutionality of the AER abandonment orders and LLR program in general. There was a new test that now had to be considered as to when a Regulator's orders can affect the priority of creditors in an insolvency.

The AER did not agree with the Receiver in the Redwater Energy Corp. ("Redwater") receivership in trying to disclaim assets which led to a test case being heard in December of 2015.

In Redwater the matter before the court was an Application by the AER for the following Declarations and Orders:

(a) That the disclaimer by the "Receiver" of a portion of the licensed assets of Redwater Energy Corp. ("Redwater") is void and unenforceable and contrary to section 2 of the initial order appointing the Receiver.