
Insolvency, *Redwater* and AER LMR 2.0

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TODAYS TOPIC

Paul Negenman and Sarah Nelligan of Lawson Lundell LLP will provide a brief summary of:

- 1. Bankruptcy and insolvency law in Canada;**
- 2. Overview of the AER Directive 006 and the Redwater decision; and**
- 3. An Overview of AER Bulletin 2016-16 , entitled:**
“Licensee Eligibility – Alberta Energy Regulator Measures to Limit Environmental Impacts Pending Regulatory Changes to Address the Redwater Decision”

PART 1: BANKRUPTCY AND INSOLVENCY

- I. Introduction
- II. Debtor in Possession Regimes
 - A. *Companies' Creditors Arrangement Act*
 - B. Proposals under Division I of Part III of the *Bankruptcy and Insolvency Act*
 - C. Division II of Part III of the *BIA* – Consumer Proposals
- III. Receiverships
 - A. Privately-Appointed Receiverships
 - B. Court-Appointed Receiverships
- IV. Bankruptcy
- V. Director & Officer considerations

INTRODUCTION

Framework for Canadian insolvency law:

- *Companies' Creditors Arrangement Act* (“CCAA”)
- *Bankruptcy and Insolvency Act* (“BIA”):
 - ▶ Division I Proposal – Corporations and Natural Persons;
 - ▶ Consumer Proposals – Natural Persons, debt limit;
 - ▶ Bankruptcy.
- Receivership:
 - ▶ Instrument Appointed;
 - ▶ Court Appointed.
- Regimes with Specific Application:
 - ▶ *Farm Debt Mediation Act, Winding-Up and Restructuring Act, Securities Act, Financial Institutions Act, etc.*

INTRODUCTION

Terminology:

1. “Insolvent”
 - ▶ Equity insolvency – cash flow, unable to meet obligations as they fall due or not paying obligations as they fall due
 - ▶ Balance sheet insolvency – net worth, value of assets, if disposed of at fairly conducted sale under legal process, would not pay all obligations
2. “Bankrupt”
 - ▶ Formal legal state pursuant to *Bankruptcy and Insolvency Act*
3. “Trustee”
4. “Proposal Trustee”
5. “Monitor”
 - ▶ Pursuant to a forbearance vs. pursuant to Court Order under the CCAA

DEBTOR IN POSSESSION (“DIP”) REGIMES

- Reorganizations under the CCAA.
- Restructuring under Division I of Part III of the *BIA*.
- Consumer Proposals under Division II of Part III of the *BIA*.

DIP REGIMES - CCAA

Purpose:

- Gives an insolvent company the opportunity to find a way out of financial difficulties by reaching compromises or arrangements with its creditors, while maintaining the status quo through retained control and stay of proceedings.

To qualify the company must:

- be a Canadian incorporated company or foreign incorporated company having assets or doing business in Canada or conducting business in Canada.
- be insolvent.
- have debt in excess of \$5,000,000.

CCAA PROCEEDINGS

- Initial Application & Initial Order - Initiated by debtor.
- Model CCAA Order - usually provides for:
 - ▶ Stay of proceedings, appointment of Monitor, authority to repudiate various agreements, authorization of DIP financing, authorization of certain priority charges to secure payment for administration costs, monitor & counsel's fees & directors' charge (statutory or other obligations that arise post-filing).
- Stay prevents one from attempting to accelerate, suspend, discontinue, repudiate, terminate or etc. any contract, agreement, license or permit in favour of or held by the debtor company (unless consented to by debtor and monitor or with leave of the Court).
- Payment of rent and C.O.D. for goods on a go forward basis is not typically stayed.

DIP REGIMES - CCAA

- Plan of Arrangement:
 - ▶ Prepared by debtor with assistance of Monitor;
 - ▶ Proposal to debtor's creditors designed to allow it to carry on in business or liquidate assets;
 - ▶ Creditors divided into "classes";
 - ▶ Claims process.
- Presentation to creditors for approval:
 - ▶ "Double majority vote" – must be accepted by all classes of creditors, in each case by a majority in number of the creditors, representing at least 2/3rds of the total dollar value of the debts.

DIP REGIMES - CCAA

- Submitted for court approval:
 - ▶ Have the statutory requirements been met?
 - ▶ Has anything not authorized by the CCAA been done?
 - ▶ Is the CCAA Plan fair and reasonable?
- If Plan is not approved – try again though likely applications to lift stay and debtor company put into receivership or bankruptcy.

DIP REGIMES – BIA DIV. I PROPOSALS

Division I of Part III of the *BIA*

- Purpose is similar to that of the CCAA process.
- Contract between a debtor and its creditors.
- “Initiated by filing a Notice of Intention to file a Proposal (“NOI”) or a Proposal:
 - ▶ Stay of proceedings for pre-filing debts (unless s. 244 notice period expired).
 - ▶ Strict timelines set out in the *BIA*:
 - Proposal Trustee’s filings;
 - Proposal to be filed 30 days after NOI unless extensions granted by the court (45 days at a time, no longer than 5 months);
 - Failure to meet timelines = deemed bankrupt.

DIP REGIMES – BIA DIV. I PROPOSALS

- Proposal presented to creditors:
 - ▶ Unsecured creditors vs. secured creditors;
 - ▶ Creditors divided into classes.
- Proposal must be approved by each class of unsecured creditor:
 - ▶ Double majority vote;
 - ▶ If not approved – insolvent person deemed bankrupt.
- Court Approval:
 - ▶ If approved – binding on all parties.
- Failure to fulfill terms of Proposal:
 - ▶ Trustee/creditor may apply to court for order that it be annulled. If granted, deemed bankrupt.

DIP REGIMES – CCAA VS. BIA PROPOSALS

- Flexibility:
 - ▶ CCAA – flexible;
 - ▶ *BIA* – highly structured, strict time limits.
- Consequences of Plan / Proposal rejection:
 - ▶ Ability to submit another plan versus automatic assignment into bankruptcy.
- Degree of control by debtor.

RECEIVERSHIPS

- Privately-Appointed Receivership:
 - ▶ As per security agreement;
 - ▶ Alberta *Personal Property Security Act*, s. 65;
 - ▶ Notice required:
 - 10 days (*BIA*, s. 244(1)).
 - ▶ Requires cooperation of the debtor;
 - ▶ Receiver's Duties:
 - Primarily to secured creditor but must operate in a commercially reasonable manner.

RECEIVERSHIPS – COURT-APPOINTED

- *Judicature Act*, s. 13(2) , PPSA, s. 65(7), BIA, s. 243(1), *Business Corporations Act*, s. 99(a).
- “Just and Convenient”.
- Generally a receiver will be appointed:
 - ▶ Debtor refuses to cooperate;
 - ▶ To preserve the property pending realization when ordinary legal remedies are ineffective in enabling a person who possesses rights over the property to obtain the benefit of those rights;
 - ▶ To safeguard and preserve the property from some danger which threatens it .

RECEIVERSHIPS – COURT-APPOINTED

- Model Receivership Order
 - ▶ “Receiver is empowered and authorized, but not obligated to...”;
 - ▶ Power to disclaim contracts.
- Stay of proceedings
- Court-Appointed Receiver
 - ▶ Officer of the court;
 - ▶ Duties.
- Realization on assets of debtor
 - ▶ Model order – Approval and Vesting;
 - ▶ Sales subject to approval of the transfer of applicable licenses, permits and approvals by the Alberta Energy Regulator pursuant to section 24 of the *Oil and Gas Conservation Act*.
- Distribution of Proceeds
- Model Order – Discharge of Receiver

BANKRUPTCY

- The liquidation of the estate of a bankrupt via a detailed process which includes priority rules:
 - ▶ “Fair and orderly”
- Voluntary or Involuntary.
- Involuntary process:
 - ▶ Alleged unsecured debt of at least \$1000.00 and an “act of bankruptcy”
 - ▶ Acts of bankruptcy include:
 - Fraudulent conveyance of property;
 - The debtor submits a statement to creditors showing it is insolvent;
 - The debtor has ceased to meet liabilities generally as they become due.

BANKRUPTCY

General Process:

- Stay of proceedings.
- Appointment of Trustee in Bankruptcy
 - ▶ Duties of Trustee
- Debtor's property vests in Trustee
 - ▶ Exceptions
- Trustee's ability to disclaim contracts.
- Assets incapable of realization.
- Employees deemed to be terminated.
- Creditors file Proof of Claim - "Provable claim".

BANKRUPTCY

- Claims – Priority Rules
 - ▶ Preferred Claims:
 - Each must be paid fully before the claimants in the next class are entitled to receive anything;
 - Includes funeral expenses, costs of administration of bankrupt estate, maintenance & support payments, municipal taxes, claim of landlords under a lease for up to 3 months of rent arrears & up to 3 months of accelerated rent following bankruptcy.
 - ▶ Ordinary Claims:
 - Unsecured, non-preferred claims;
 - Pro rata distribution.
 - ▶ Postponed Claims:
 - Ex) non-arms' length transactions and claims of profit sharing lenders.

BANKRUPTCY

- Discharge
 - ▶ Automatic or by court order;
 - ▶ Individual Bankrupt:
 - Personal tax debtors.
 - ▶ Corporate Bankrupt:
 - May only seek discharge if debts are paid in full.
- Claims that survive bankruptcy
 - ▶ Fraud, misrepresentation, student loans (7 year rule), spousal support, alimony, etc.

DIRECTOR & OFFICER'S LIABILITY

- Liabilities imposed on directors in the case of an insolvent corporation include:
 - ▶ Failure to deduct, withhold, remit, or pay certain income tax amounts;
 - ▶ Failure to deduct, withhold, remit, or pay certain amounts for pension or other benefits;
 - ▶ Failure to remit GST and/or PST;
 - ▶ WEPPA;
 - ▶ Abandonment and reclamation deposits under *Oil and Gas Conservation Act*, s. 106 or liability under an Environmental Protection Order.

PART 2: REDWATER

AER Directive 006 and the OGCA

The purpose of the *AER Directive 006 Licensee Liability Rating Program* (LLR) is to minimize the risk to:

- the Orphan Fund;
- the general public (through government),

posed by unfunded well, facility, and pipeline abandonment and reclamation liability.

DIRECTIVE 006

Directive 006 is the AER regulatory framework that governs the ability of licensed operators (Business Associate Code holders) to operate wells, facilities and pipelines in Alberta.

The “Licensee Liability Rating Program”.

DIRECTIVE 006 – Licensed Operator

It is crucial to remember that the LLR applies to the AER licensed operator of the well, facility or pipeline.

The AER does not care about your underlying working interest in the well.

The licensee takes 100% of the LLR hit.

DIRECTIVE 006 – LLR

Every licenced well, facility and pipeline is included in the AER administered LLR online database.

Each well and facility has a dollar specific:

- Deemed asset value (the numerator);
- Deemed liability value (the denominator).

Pipelines do not generally have assigned values.

DIRECTIVE 006 – LMR

Individual well and facility LLR values are aggregated by “eligible producer licensee” and the total deemed assets over deemed liabilities is your corporate LMR (Liability Management Ratio).

Your corporate LMR is calculated monthly and the resultant ratio (not the dollar amounts) is posted on the AER website under “Liability and Management Programs”.

DIRECTIVE 006 – The 1.0 Rule

If your monthly calculated LMR falls below a ratio of 1.0, you are required to post a Security Deposit with AER, in a form acceptable under *Directive 068 – ERCB (AER) Security Deposits*.

DIRECTIVE 006 – The 1.0 Rule

Failure to post a Security Deposit, or otherwise maintain a LMR above 1.0 is a non-compliance event under the brand new *Manual 013 Compliance and Enforcement Program* (formerly, *Directive 019: AER Compliance Assurance*).

A noncompliance triage assessment would be conducted by the AER, which process can result in a global refer status and **ultimately abandonments and closure orders.**

ALL OF THIS IS NOW SUBJECT TO THE 2.0 RULE PER BULLETIN 2016-16 DISCUSSED IN PART 3 BELOW.

Provincial Law

- Directive 006 is a regulation enacted pursuant to the *Oil and Gas Conservation Act* (OGCA).
- The AER is a delegated board created by the Provincial Government, again under the OGCA.
- All of this occurs under the under “property and civil rights” provisions of section 92 of the *Constitution Act 1867*.

Federal Law

- The BIA discussed by Sarah earlier, is a federal power head of power under subsection 91.21 of the Constitution Act 1867.
- *Redwater* deals with the constitution interplay between the Provincial law under Directive 006 and Federal law under the BIA.
- So really, *Redwater* is about stuff you should have learned in grade 12 social studies class.

REDWATER - Issue

- Bankruptcy and Insolvency is a federal power under the Constitution Act. Ergo, federal bankruptcy law has **paramountcy** over Provincial laws.
- Under POGG Federal laws have paramountcy.
- However, Provincial laws are allowed **concurrent jurisdiction** if there is no direct conflict.

REDWATER - Issue

- Is the AER under Directive 006 “merely” a creditor of Redwater, such that the Court could compel this partial sale of the good stuff under the BIA?
- Or can the AER, under Directive 006, coexist with the BIA and be allowed to take first in the bankruptcy proceeding.

REDWATER - Facts

Receivership of Redwater Energy Corp.:

- Grant Thornton is Receiver and Trustee in Bankruptcy;
- ATB is the primary secured creditor.

Queen's Bench decision - *Redwater Energy Corporation (Re)*,
[2016 ABQB 278](#).

Already appealed to the Alberta Court of Appeal. September(ish) hearing date is the buzz right now.

REDWATER - Facts

- Redwater LMR below 1.0, ergo Security Deposit required.
- **“Non-Producing” licensed assets – 72 licensed wells and facilities.**
- “Producing” licensed asset – 19 wells and facilities.

REDWATER - Facts

Receiver determines that:

- It is “inconceivable that anyone would purchase them [non-producing licensed assets] under current market conditions”.
- If the [Redwater] estate were obligated to incur all abandonment and reclamation costs, the costs would exceed the value of the estate and result in no recovery for creditors, including ATB.

REDWATER - Facts

- Receiver chooses to “**renounce**” the non-producing AER licenses.
- Has the ability to do so under section 14.06 of the BIA.
- *Total Aside* – Renounce is a funny word. I think I had to *renounce* a bunch of things during Confirmation (at Church) when I was a kid.

REDWATER - Facts

- AER is not amused.
- Issues **closure and abandonment orders** for all Redwater licenses on the basis that no one is in care and custody of the wells and facilities.
- Also puts Redwater on Global Refer status.
- *“The orphan fund is designed to deal with orphans, not children that the parent wishes to disown.” (paragraph 5 of CAPP Affidavit).*

REDWATER – Arguments - AER

Under an old 1991 ABCA case called *Badger Oil*, we see the AER position.

ERCB order to abandon and suspend wells in the interest of public safety. Was the receiver bound to act or is the Board a mere creditor.

Note – this is before Directive 006.

REDWATER – Arguments - AER

[63] In my view, there is **no such direct conflict** in this case. The Alberta legislation regulating oil and gas wells in this province is a statute of general application within a valid provincial power. It is general law regulating the operation of oil and gas wells, and safe practices relating to them, for the protection of the public. **It is not aimed at subversion of the scheme of distribution under the *Bankruptcy Act* though it may incidentally affect that distribution in some cases.** It does so, not by a direct conflict in operation, but because compliance by the Receiver with the general law means that less money will be available for distribution.

[64] ...the Receiver, the manager of the wells with operating control of them, was bound to obey the provincial law which governed them [emphasis mine]

The AER is emphasising the **polluter pays** public policy principle.

REDWATER – Arguments - Trustee

- However, the 2012 Supreme Court of Canada decision in *AbitibiBowater Inc.* confused matters.
- Province of NFLD issues an environmental protection order compelling Abitibi to file remediation action plans for industrial sites.

REDWATER - Arguments - Trustee

The Court found that:

“Not all orders issued by regulatory bodies are monetary in nature and thus provable claims in an insolvency proceeding, **but some may be**”

REDWATER – Arguments - Trustee

“Subjecting such orders to the claims process does not extinguish the debtor’s environmental obligations any more than subjecting any creditor’s claim to that process extinguishes the debtor’s obligation to pay a debt. It merely ensures that the Province’s claim will be paid in accordance with insolvency legislation. **Full compliance with orders that are found to be monetary in nature would shift the costs of remediation to third party creditors and replace the polluter-pay principle with a “third-party-pay” principle**”

REDWATER - Decision

Everything really turns on the application of 14.06 of the BIA, which states, in part:

Costs for remedying not costs of administration

*14.06 (6) If the trustee has abandoned or **renounced any interest in any real property, or any right in any immovable, affected by the environmental condition or environmental damage, claims for costs of remedying the condition or damage shall not rank as costs of administration***

REDWATER - Decision

Chief Justice Neil Wittmann decides that Directive 006 conflicts with the BIA, such that the Directive cannot have effect on the renounced assets:

*[156] In the result, the **Trustee is not a licensee of the renounced assets**, ought not to be required to assume any liabilities, and is not bound by the Abandonment Orders relating to the renounced assets in seeking approval of the sales process to market and sell the assets remaining under its possession and control of. In other words, so long as the Trustee renounces the affected property in accordance with section 14.06(4), **the AER cannot attempt to impose on the Trustee the obligation to remediate the renounced property by performance or posting security***

REDWATER - Decision

He is also clear that AER abandonment and reclamation costs should not be granted a polluter pays public policy priority:

REDWATER - Decision

[173] ... the situation does meet, in my opinion, what was intended by the majority of the Court in AbitibiBowater. Compliance with the orders would require the Trustee and Receiver to expend funds by way of security that would be used to perform the abandonment work. **The effect is that if the obligations to remediate property are fully complied with by the Trustee within this bankruptcy context, the claim of the Province for remediation costs will be given a super priority not provided for under section 14.06.** The creditors deprived of the usual order of priority in bankruptcy will be subject to a “third-party-pay” principle in place of the “polluter-pay” principle. The history of amendments to the BIA in this case shows that Parliament intended that the priority of creditors as provided under section 14.06, and thus the distribution of funds, ought not to be disturbed by provincial legislation. In the result, I find that although not expressed in monetary terms, the AER orders are in this case intrinsically financial.

REDWATER - Decision

Like I said, just like grade 12 social studies class:

*[174] In this case, the obligation to comply with the orders directly affects Redwater's estate. Indeed, the obligation to comply with the orders requires payment of or the posting of security for, the abandonment costs to the AER in priority to all other creditors. **Those actions frustrate the primary purposes of the BIA.** These costs are not a sanction of regulatory nature, but would have a direct effect on the scheme of distribution provided under the BIA.*

REDWATER – My Thoughts

Possible immediate consequences:

- Bad assets can be left behind on a receivership or bankruptcy sale (“**Renounced**”).
- *Query* - Do you get to renounce just the well license or have you also renounced the:
 - ▶ Mineral rights?
 - ▶ Surface Lease?

REDWATER – My Thoughts

- Bank gets more money on bankruptcy.
- Will they push troubled companies through this process?
- WIPs or OWF get more bad wells.
- Might help with financings and bank debt.

REDWATER – My Thoughts

This is the beginning of the beginning:

- Appeal already filed and the parties are arguing about an automatic right of appeal (AER) vs. leave to appeal (trustee). Or something like that.
- Appeal could be heard as early as September. Again, or something like that.

REDWATER – My Thoughts

- It appears that any “stay” would apply only to the Redwater assets.
- In other deals, the law as it currently stands would apply.

PART 3: AER BULLETIN 2016-16

- Well, it did not take long for the AER to respond to Redwater with Bulletin 2016-16.
- Opens with an excellent summary of Redwater and then quotes the actual Court decision:

“In this case, public interest is at stake if the licensee, who is also part of the public, does not fulfil its environmental duties. The potential financial and environmental repercussions are very real.”

PART 3: AER BULLETIN 2016-16

- The AER then puts all of us on notice that changes are coming:

*“The AER and OWA have appealed the decision. The AER is also working on **appropriate regulatory measures** to address the decision’s impacts and ensure that statutory environmental liabilities associated with energy development in Alberta are adequately and appropriately addressed.”*

PART 3: AER BULLETIN 2016-16

- So, new measures from the AER should be expected.
- I expect they will not attempt to challenge the BIA directly, but will indirectly attempt to plug any abandonment, reclamation or environmental liability risk to the public (and perhaps OWL).
- Sure smells like a bond on well licensing is coming. Or maybe a great big OWF levy increase? Who knows.

PART 3: AER BULLETIN 2016-16

- The **immediate** changes in the Bulletin are bad enough:
 - ▶ More scrutiny on BA Code applications and first deals into a new operator (Directive 067); and
 - ▶ “As a condition of transferring existing AER licenses, approvals, and permits, ***the AER will require all transferees to demonstrate that they have a liability management ratio (LMR) of 2.0 or higher immediately following the transfer.***”

PART 3: AER BULLETIN 2016-16

- So, now we have an immediate **2.0 transferee LMR rule**.
 - ▶ No grandfathering or implementation delay for pending deals.
 - ▶ **Honest to God, would a 90 day implementation period have killed them.** This is causing havoc in deals that are in process or very recently closed (with pending LTAs).

PART 3: AER BULLETIN 2016-16

- The AER “script” says transferees will not be permitted to apply for Security Deposit refunds after the transfer, i.e. to get back to the 1.0 rule.
- Ergo, it is unclear at this time if we now have a two tiers of AER licensees:
 - ▶ 1.0 if you are not a transferee post Bulletin date; and
 - ▶ 2.0 if you are.
- Or maybe a switch to 2.0 for everyone is coming...

PART 3: AER BULLETIN 2016-16

- In my humble view, this is the wrong response to a real issue.
 - ▶ Freezes many new companies out of A&D, right when deals are starting to happen.
 - ▶ Slows the traditional roll-over of assets to Newco's with good ideas, lower costs and new money.
 - ▶ Makes AB even less competitive.
- **I hear house prices in Saskatoon are really reasonable. Go Riders?**

THANKS FOR LISTENING

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