Extending The Redwater Super-Priority Principle Beyond The Oil And Gas Industry

On May 30, 2024, the Supreme Court of Canada (SCC) denied leave to appeal in *Travelers Capital Corp. v. Mantle Materials Group, Ltd.* This case confirms that the regulatory super-priority established by *Orphan Well Association v. Grant Thornton Ltd.* (*Redwater*) extends beyond the oil and gas industry, while opting not to clarify the line between assets related and unrelated to an environmental condition.

In 2023, the Alberta Court of King's Bench (ABKB) issued the chambers decision *Re Mantle Materials Group, Ltd.* (*Mantle*). It held that Alberta Environment and Protected Areas (AEPA) had a super-priority over secured creditors for the reclamation obligations of a gravel extraction business.

Two separate appeals of *Mantle* to the Alberta Court of Appeal (ABCA) were dismissed.

Ultimately, the chambers judge had the final word on *Mantle* as the SCC denied the application for leave to appeal the ABCA decisions. As a result, the principles originally set out in the chambers decision remain good law and mark a continued evolution of the law on abandonment and reclamation obligations and creditors' priorities.

Priority of Environmental Obligations

In *Redwater,* the SCC granted the Alberta Orphan Well Association (a non-profit organization operating under the delegated authority of the Alberta Energy Regulator) a super-priority ranking for costs related to an oil and gas company's abandonment and reclamation obligations. *Redwater* effectively established that secured lenders to oil and gas producers rank behind the regulator regarding the regulator's enforcement of a company's reclamation and other environmental obligations. As previously discussed by Blakes, *Redwater* created uncertainty for secured lenders to companies in any industry with the potential for significant environmental liability.

Since *Redwater*, courts and legal practitioners have sought to clarify the application of the decision. The Alberta courts, specifically, continue to delineate the limits of the *Redwater* decision. Among other decisions, the Alberta courts have held that:

- abandonment and reclamation regulatory obligations are inherent, applying regardless of the existence and/or timing of any enforcement action by the regulator, and the assets of a bankrupt oil and gas company are to be treated as a single pool (see *Manitok Energy Inc. (Re)* (*Manitok*));
- real estate held by a bankrupt oil and gas company is subject to the *Redwater* super-priority, and abandonment and reclamation regulatory obligations take priority over claims for unpaid taxes from municipalities (see *Orphan Well Association v. Trident Exploration Corp.* (*Trident*)); and
- *Redwater* does not provide a basis for a private litigant's super-priority claim (as opposed to a regulator's claim) for environmental remediation costs (see *Qualex-Landmark Towers Inc. v. 12-10 Capital Corp.*).

The Latest Development: Mantle

Background

Mantle Materials Group, Ltd. (Mantle) operated gravel pits on public and private lands in Alberta. Mantle acquired the gravel pits through a reverse vesting order pursuant to the *Companies' Creditors Arrangement Act* proceedings of JMB Crushing Systems Inc. (JMB). Before Mantle acquired the gravel-producing properties, the AEPA issued Environmental Protection Orders (EPOs) to JMB for some of the gravel pits. The EPOs required end-of-life reclamation steps to be completed. Pursuant to the reverse vesting order, Mantle remained liable for JMB's abandonment and reclamation obligations set out in the EPOs.

Once Mantle acquired the gravel pits (i.e., after the EPOs had been issued), Travelers Capital Corp (Travelers) loaned Mantle C$1.7-million to acquire equipment for use in its operations (Equipment). Mantle granted Travelers a purchase-money security interest (PMSI), providing a first-priority security interest over the Equipment.

Mantle began to experience operational problems and issues with excessive debt and filed a notice of intention to make a proposal (NOI) under section 50.4 of the *Bankruptcy and Insolvency Act* (BIA). As part of its NOI proceedings, Mantle proposed to satisfy its outstanding EPO end-of-life obligations before any payments to its creditors by creating and ranking various restructuring charges (Restructuring Charges), which included a fund to finance the reclamation work. The Restructuring Charges were to receive priority over all other debts, including Travelers' PMSI.

Mantle, supported by the AEPA, submitted that the *Redwater*, *Manitok* and *Trident* decisions supported its approach. Specifically, Mantle and the AEPA submitted that all three decisionsdictate that end-of-life environmental

obligations must be satisfied before any other creditor may recover from the insolvent estate, and that the whole estate of an insolvent entity must first be used to satisfy end-of-life environmental obligations.

Travelers disagreed, submitting that *Redwater* established an exception to the super-priority for assets that are unrelated to a debtor's environmental obligations. According to Travelers, the Equipment was simply operating equipment unrelated to the environmental conditions and damage, and therefore the PMSI was not outranked by Mantle's environmental obligations. Travelers alsosubmitted that *Trident* should not be followed, as it is inconsistent with *Redwater* and *Manitok* and violates the doctrine of vertical *stare decisis,* which dictates which courts must follow which decisions.

Court of King's Bench Decision

In *Mantle*, the chambers judge approved Mantle's proposal, including the Restructuring Charges. In reaching his decision, the chambers judge first considered whether all of a debtor's assets are captured by the super-priority principle. He noted that, according to *Redwater* and *Manitok*, environmental obligations are an estate obligation that must be satisfied before any creditor claims are satisfied. He noted further that while *Redwater* and *Manitok* established that all oil and gas assets should be treated as if they were related to environmental obligations, *Trident* extended this principle to the other assets of an oil and gas business, even if they were not directly involved in oil and gas production. After considering horizontal and vertical *stare decisis*, the judge found no reason not to follow *Trident*.

Second, the chambers judge determined whether a distinction could be made between the equipment and real estate in *Trident* and the Equipment in the present case. The judge found that the Equipment, such as a conveyor, dump truck and

excavator, were part of Mantle's gravel production business. He stated, "The equipment over which Travelers has a security interest is as much a part of Mantle's gravel business as the equipment and real estate in *Trident* was a part of Trident's oil and gas business." As a result, the Equipment was not "unrelated" to Mantle's environmental obligations and was therefore captured by the *Redwater* super-priority. The court, however, declined to comment on how a "line should be drawn between related or unrelated assets," leaving that discussion for another day.

Lastly, the chambers judge noted that Travelers conducted due diligence before entering into the PMSI, which included reviewing documents that indicated the existence of Mantle's EPO obligations and the security that Mantle posted with AEPA. Before signing the PMSI, Travelers had an opportunity to assess the risk, make an informed decision and negotiate the cost of borrowing by Mantle.

Ultimately, the chambers judge determined that the PMSI must be subordinated to the Restructuring Charges because the Restructuring Charges were necessary for the completion of work to address the EPO obligations.

First Leave to Appeal

Travelers applied to the ABCA for a declaration that leave was not required to appeal the ABKB decision under section 193(c) of the BIA, or in the alternative, applied for permission to appeal. In *Mantle Materials Group, Ltd. v. Travelers Capital Corp.*, the court determined (a) whether Travelers had a right to appeal pursuant to section 193(c) of the BIA and (b) whether the leave to appeal should be granted.

The court first determined that Travelers was required to obtain leave. The court then applied the factors to be considered on an application for leave to appeal under section 193(e) of the BIA, noting that "the test essentially requires

that the proposed appeal must be on a point of significance for which there is at least an arguable case."

Travelers argued that, regardless of *Redwater* and *Manitok*, there was an unaddressed issue in its case because the Equipment was unrelated to an environmental condition or damage. Therefore, according to Travelers, it should be able to realize upon its security without waiting for Mantle to complete its environmental obligations.

The court, however, followed *Redwater* and *Manitok* in affirming the overarching principle that abandonment and reclamation obligations are binding on a bankrupt estate.

The court further emphasized that the obligations are not tied to the type of asset. It also, perhaps most significantly, stated that the fact that Mantle is not an oil and gas company does not change the application of the reasons in *Redwater* or *Manitok*.

The court also held, however, like the chambers judge in the first instance, that "the question of what are 'assets unrelated to the environmental condition or damage'" was not arguable on the facts and therefore not decided by the case.

Overall, the court dismissed the application for leave to appeal.

Second Leave to Appeal

In *Mantle Materials Group, Ltd. v. Travelers Capital Corp.*, the court denied Travelers permission to appeal the holding that Travelers did not have a right to appeal pursuant to section 193(c) of the BIA.

Final Leave to Appeal

Travelers then applied for leave to appeal both ABCA decisions to the SCC. The SCC dismissed the application for leave to appeal on May 30, 2024. No reasons for the dismissal were

provided, as is normal SCC practice.

Conclusion

The law continues to evolve as the courts grapple with how and when to apply the super-priority principle from *Redwater*. *Mantle* confirms the expansion of the *Redwater* super-priority principle beyond oil and gas and into other industries subject to regulatory oversight, such as the natural resource extraction industry. As provided in *Trident*, assets that are part of a debtor's extraction business are subject to a super-priority in favour of the abandonment and reclamation obligations arising from its extraction business. *Mantle* emphasizes that these obligations are not limited to a specific type of asset. However, the exact determination of what constitutes a related asset versus an unrelated asset in the context of environmental obligations remains uncertain. Clarification of that issue will have to await another case with different facts. In the meantime, we will continue to closely monitor developments in this area.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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