Restructuring and Insolvency Deals in the Oil Patch: Recent Trends and Developments

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Market forces, the pandemic, and regulatory changes in recent years have created both opportunities and challenges for the energy industry. Insolvencies are being used to shed liabilities, for strategic restructurings, and to minimize the environmental liabilities that would otherwise end up with industry-funded orphan programs. Recent jurisprudence continues to shift this landscape and has left insolvency, particularly in the oil patch, in a state of flux.

According to the Office of the Superintendent of Bankruptcy, insolvencies in the Canadian mining and oil and gas sectors peaked in 2016, with 83 insolvencies filed by corporations under the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act. This corresponded with oil prices hitting a thirteen-year low. By 2018, the number of energy company insolvencies was down to 27, as creditors, the energy industry and insolvency practitioners awaited the Supreme Court of Canada's decision in Orphan Well Association v Grant Thornton Ltd, 2019 SCC 5 [Redwater]. While filings rebounded slightly in 2019, 2020, and 2021, uncertainty following Redwater, the pandemic, and the rebound of oil prices as a result of the Russia/Ukraine war have continued to reduce the number of insolvencies from what had been anticipated.

As creditors and regulators continue to adapt to the Court's decision in Redwater, new tools and dynamics have emerged. Legislative changes have provided the Alberta Energy Regulator with more levers to influence insolvencies and sales thereunder. Reverse Vesting Orders [RVOs] provide the potential to bypass license transfer requirements, maintain tax attributes, and shed certain liabilities to increase the chance that struggling energy companies can exit insolvency proceedings as solvent entities. However, these areas are still in flux. Courts and commentators have recently opined on the possibility of limiting the future use of RVOs, and there is a growing tension between municipalities and regulators on the issue of taxes post-Redwater. As companies seek to purchase assets from struggling companies or address obligations during insolvency proceedings, deal structure has become more important than ever.

This paper will explore the basics of insolvency in the oil patch, recent developments in the sector, and things practitioners should know moving forward.

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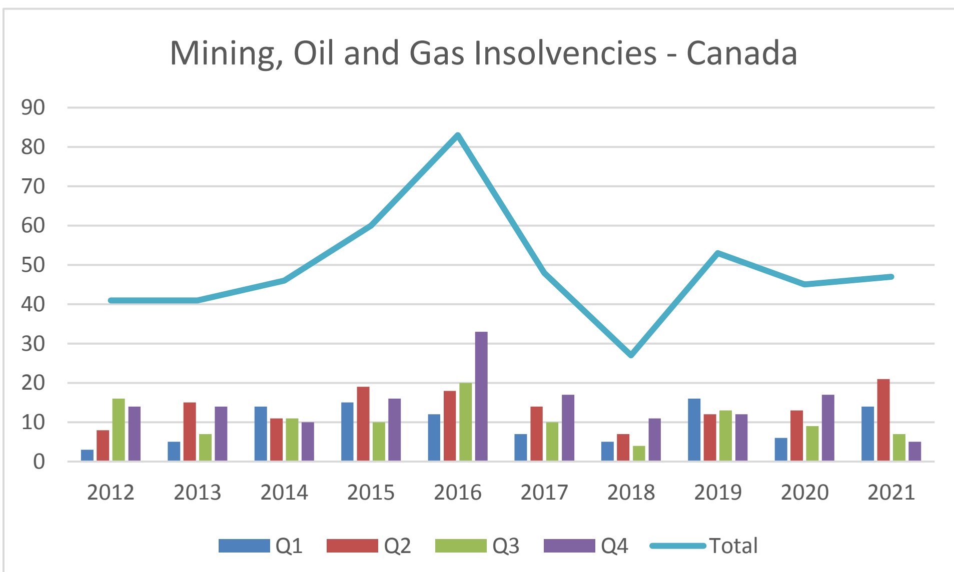
I. INTRODUCTION

In recent years, the energy industry has been hit with volatile pricing, an increased focus on reduced emissions, and reduced access to capital. A worldwide pandemic exerted pressures on both consumers and producers – pressures now being compounded by growing inflation across Canada – and altered workplaces and labour pools. Widely available governmental funding has allowed many companies and individuals to stay afloat to date, but such funding is poised to run out. The war in Ukraine has recently added more uncertainty for energy companies to navigate. All of this occurs against the backdrop of an oil and gas industry in a developed stage of its lifecycle, with a growing number of inactive and orphan wells.

Insolvency and restructuring professionals have had to pivot to address these growing challenges. One of the greatest challenges has come via the Supreme Court of Canada's decision in *Orphan*

Well Association v Grant Thornton Ltd,[1] which has altered the focus of oil and gas insolvencies from maximizing return for creditors to minimizing the liability to be addressed by provincial orphan well programs.

Insolvencies in the Canadian mining and oil and gas sectors peaked in 2016. This coincided with both the Alberta Court of Queen's Bench's decision in *Redwater* and oil prices hitting a 13-year low. By 2018 however, the number of energy company insolvencies had dropped to 27 (from 86 in 2016), as creditors, the energy industry and insolvency practitioners awaited the Supreme Court of Canada's final ruling. Post-*Redwater*, insolvency filings have rebounded slightly (53, 45, and 47 filings in the energy sector in 2019, 2020, and 2021, respectively).[2] In the first quarter of 2022, the sector saw an additional nine insolvencies nationwide.



According to the Alberta Energy Regulator (the "**AER**"), between the May 2016 *Redwater* Court of Queen's Bench decision and January 30, 2019, Receivers and Trustees involved in 28

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[1] 2019 SCC 5, [2019] 1 SCR 150 [*Redwater*].
[2] Office of the Superintendent of Bankruptcy Canada, "Insolvency Statistics" (last modified 10 May 2022), online: *Government of Canada* <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/h_br01011.html>.

insolvencies renounced their interest in more than 10,000 AER-licensed wells, facilities, and pipelines; the deemed liabilities of these sites totalled almost $335 million. In that same period, the Orphan Well Association's ("**OWA**") inventory of wells increased more than 300%, from 768 wells to 3,100.[3] By April 1, 2022, 2,456 orphan sites had been flagged for decommissioning (including 1,700 wellbores and 278 facilities), as had 2,513 pipelines.[4]

Impacts are additionally being felt by municipal governments and landowners. In 2021, approximately 69 rural municipalities reported a total of $245 million in property tax arrears associated with oil and gas operations.[5] In an effort to address this issue, on December 8, 2021, Alberta proclaimed into force Bill 77, the *Municipal Government (Restoring Tax Accountability) Amendment Act, 2021* ("**Bill 77**"), giving municipalities a super-priority over a broader range of property by virtue of the special lien provisions contained in section 348 of the *Municipal Government Act*.[6] Still, municipal governments continue to struggle to recover owed taxes. Similarly, between 2014 and 2018, withdrawals from general government revenue to pay landowners who did not receive payment under their surface lease agreements were reported to have ballooned 1,081%, from $540,000 to $6.4 million. In 2020, the number of applications to the Land and Property Rights Tribunal, seeking payment for mineral rights, rose 19% to 4,361 applications, a 125% increase from 2017.[7] One media outlet reported that its Freedom of Information and Protection of Privacy requests to the Land and Property Rights Tribunal and

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3 "Redwater Decision", online: *Alberta Energy Regulator* <https://www.aer.ca/protecting-what-matters/holding-industry-accountable/redwater>.
4 "Orphan Inventory" (last modified 1 May 2022), online: *Orphan Well Association* <https://www.orphanwell.ca/about/orphan-inventory/>.
5 Kelsey J. Meyer & Keely Cameron, "Alberta Proclaims New Legislation to Address Municipal Tax Arrears" (19 January 2022), online (blog): *Bennett Jones* <https://www.bennettjones.com/Blogs-Section/Alberta-Proclaims-New-Legislation-to-Address-Municipal-Tax-Arrears>; "Restoring tax accountability", online: *Government of Alberta* <https://www.alberta.ca/restoring-tax-accountability.aspx>; "Restoring Tax Accountability Fact Sheet" online (pdf): *Government of Alberta* <https://www.alberta.ca/assets/documents/ma-restoring-tax-accountability-fact-sheet.pdf> [*Tax Accountability Facts*].
6 SA 2021, c 22.
7 Geoffrey Morgan, "Oil is at $70 – pay your bills: Farmers fume as frustration mounts over oil companies' unpaid leases and rural taxes" (15 June 2021), online: *Financial Post* <https://financialpost.com/commodities/energy/oil-gas/alberta-farmers-fume-unpaid-oil-company-leases-rural-taxes>.

Alberta Environment and Parks revealed that the government had been left on the hook for $20,378,834 in unpaid land rents in 2020 alone.[8]

In the face of these challenges, creative approaches have been adopted to address evolving circumstances and continued uncertainty. This paper looks at the opportunities and challenges for restructuring and insolvencies in the oil patch.

II. INSOLVENCY BASICS

A. Types of Formal Insolvency Proceedings in Canada

1. Overview

Canadian bankruptcy and insolvency proceedings are governed by two federal statutes: the *Bankruptcy and Insolvency Act*[9] and the *Companies' Creditors Arrangement Act*.[10]

The four most common types of bankruptcy and insolvency proceedings in Canada are:

1. Restructuring proceedings under the CCAA ("**CCAA proceedings**");
2. Court-ordered receivership under the BIA and/or provincial statutes[11] ("**receiverships**");
3. Proposals to creditors under the BIA ("**BIA proposals**"); and
4. Assignments in bankruptcy under the BIA ("**bankruptcies**").

CCAA proceedings and BIA proposals may be referred to as "debtor-in-possession" proceedings, because the debtor company remains in possession and control of its property and assets, and retains the power to operate its business. The debtor company's directors and officers will continue to execute their normal duties in these proceedings.

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[8] Sharon J. Riley, "Alberta covered $20 million in unpaid land rent for oil and gas operators in 2020" (9 March 2021), online: *The Narwhal* <https://thenarwhal.ca/alberta-oil-gas-land-rent-2020/>.

[9] RSC 1985, c B-3, as amended [BIA].

[10] RSC 1985, c C-36, as amended [CCAA].

[11] In Alberta, s. 13(2) of the *Judicature Act*, RSA 2000, c. J-2, as amended, authorizes the Court of Queen's Bench to grant an order appointing a Receiver in all cases "in which it appears to the Court to be just or convenient" and "on any terms the Court thinks just".

Bankruptcies and receiverships are very different in nature, because a Trustee in bankruptcy or a Receiver takes possession and control of the debtor's property and may operate the debtor's business, for the limited purpose of liquidating the debtor's assets. There is no continuing role for directors and officers of the debtor company.

Operating upstream oil and gas companies, which are the focus of this paper, are incredibly complex and technically challenging businesses, and are subject to a great deal of regulatory oversight. Typically, they are also businesses of such a nature that continuing to operate them during an insolvency proceeding is the best way to maximize their value. CCAA proceedings and BIA proposals provide much more flexibility than bankruptcy to allow for the continued operation of a business during its insolvency. For these reasons, the most common insolvency proceedings used to deal with upstream companies' insolvencies are receiverships and CCAA proceedings, which will be the primary focus of this paper.[12]

2. CCAA Proceedings

The general purpose of CCAA proceedings is to enable an insolvent company to create a Plan of Compromise and Arrangement (a "**Plan**"), on which the company's creditors vote. The ultimate goal is the continuation of the debtor company's business for the benefit of all of its stakeholders. A debtor company may also use the CCAA to effect a sale of its business, which is a permissible use of the statute in certain circumstances.

[12] BIA proposals share many common features with CCAA proceedings, and for this reason will not be discussed separately for the remainder of this paper.

The CCAA applies only to insolvent corporations against whom there are claims over $5 million. CCAA proceedings are almost exclusively commenced voluntarily by the debtor company. The essential characteristics of CCAA proceedings are:

1. an Initial Order granted by the court imposing a very broad stay of proceedings that prevents creditors from commencing or continuing claims against the debtor for an initial period of 30 days, subject to extension by further court order;
2. the continued operation and possession of the debtor company of its business and assets; and
3. the appointment of an insolvency professional (a licensed insolvency trustee) known as the Monitor, who is charged with the responsibility of monitoring and assessing the debtor's business and financial affairs and reporting to the court.

Once the debtor obtains the initial stay of proceedings, it seeks to formulate a Plan that must be presented to and accepted by its creditors and approved by the court. Alternatively, it can also seek to have the court approve a sale of its assets. An asset sale, unlike a Plan, does not require creditor approval, and need only be approved by the court.

Counterparties and prospective asset purchasers in CCAA proceedings will typically find themselves dealing with the debtor company, with some participation and oversight from the court-appointed Monitor.

As the debtor is still in possession of its assets, regulators tend to take a more stringent approach to compliance than they do in receiverships, where operations fall under the Receiver.

3. Receiverships

Receivers can be appointed privately by a secured creditor or appointed under a court order. The choice is typically based on the complexity of the business and the overall value of the debtor's assets. Given the complexity of upstream oil and gas businesses, Receivers in the industry are almost always court-appointed.

In a court-ordered receivership, the Receiver takes legal custody and possession of all assets and the debtor's right to deal with its assets immediately ceases. The Receiver's mandate is to realize on all assets for the benefit of its creditors and the Receiver has increased powers to operate the business as part of the realization.

A receivership typically concludes upon the sale of or alternate realization of all of the debtor’s assets. If the secured creditors have not been paid in full, the matter goes no further. If there is a surplus once a Receiver has realized on the assets and fully paid out the secured creditors, the Receiver may bankrupt the debtor to facilitate the payment of dividends to unsecured creditors, or commence a proof of claim process itself.

Counterparties and prospective asset purchasers in receiverships will most commonly deal primarily with the Receiver. While it is common for Receivers to retain at least key members of the debtor company's staff after the receivership commences, the Receiver becomes the decision maker.

4. Sales Processes

Once insolvency proceedings have been commenced, the debtor and its creditors will begin seeking alternatives for maximizing value to the creditors. This usually takes the form of a sale and investment solicitation process ("**SISP**"). The SISP will be officially commenced upon issuance of an order of the court authorizing the debtor, subject to the oversight by the Monitor or the Receiver, to seek value-maximizing proposals which may involve one or more of the following:

1. sale of all of the debtor's assets to a single purchaser;
2. sale of multiple asset packages to multiple purchasers; or

3. debt or equity investment in the debtor to allow the debtor to emerge from its insolvency proceedings as a going concern.

The court order approving the SISP will establish a structured process for commencing and completing a value maximizing transaction which will generally include the following steps:

1. authorize the Receiver or Monitor to commence marketing the debtor's assets, establish a virtual data room and prepare necessary marketing materials such as a teaser and confidential information memorandum;

2. require all potential bidders to enter into a confidentiality or non-disclosure agreement as a condition to accessing the debtor's due diligence information;

3. establish a process for receiving proposals from buyers or investors. Typically the process will be undertaken in two stages, whereby the bidders will be requested to submit a first-round letter of intent or expression of interest, which will include indicative pricing or consideration that the investor or purchaser is prepared to pay under the SISP, and then a second stage where a short-listed subset of purchasers will submit binding offers to purchase;

4. establish detailed rules and parameters for determining whether a bid will be qualified for consideration by the Monitor or Receiver. Bids that do not meet the strict rules are at risk of being rejected for not complying with the bid rules approved by the court; and

5. establish a timeframe for completing all of the above steps and return to court for a Sale Approval and Vesting Order and fix a closing date for the transaction.

While a SISP process will appear to be more structured than a typical M&A process, many of the same elements are present. In addition, while Monitors and Receivers are charged with overseeing the sale process, it is often the case that specialty investment banks will be retained to conduct the sale process, as a means of ultimately maximizing overall value to the creditors.

As an alternative to a broadly-marketed SISP, it is often the case that there is a natural buyer or investor in a debtor's assets. In the oil and gas context, this is often an entity that operates assets in close proximity to the debtor, or is already a partner in certain projects. In these circumstances, in order to save the time and cost of running a full SISP, a Monitor or Receiver will often engage in discussions with this third party to determine whether it is willing to submit a "stalking horse bid" for the assets. If the entity is prepared to make a stalking horse bid, a binding purchase and sale agreement will be entered into with the stalking horse bidder, and that agreement will then be approved by the court. The asset is then subjected to a focused marketing process to determine whether any other investors are prepared to exceed the offer made in the stalking horse bid. If a superior offer is received as a result of the marketing process, then the stalking horse offer will terminate and the stalking horse bidder will be paid a break fee to reimburse it for the costs of making the bid. In these scenarios, the break fee is subject to approval of the court and typically ranges between 2-3% of the purchase price set out in the stalking horse bid. In addition, if the stalking horse bidder and one or more other potential purchasers indicate their willingness to increase their offer, then an auction will be arranged by the Receiver or the Monitor in order to maximize the value payable to the debtor. In the event that the asset is sold by way of an auction process, if the stalking horse bidder is not ultimately the successful purchaser, it will still be paid the break fee set out in the stalking horse bid.

In either a SISP or a stalking horse process, once the marketing process has been completed and a purchaser or investor has been identified which is acceptable to the creditors, the transaction will be approved by the court by a sale approval and vesting order. In a typical sale situation, this order approves the transfer of the assets to the purchaser "free and clear of all claims and encumbrances", such that the purchaser will receive clean title to the assets moving forward.

Finally, it should also be noted that when determining the successful purchaser of an asset, or package of assets, the Receiver or Monitor and the court may also take into account the interests of stakeholders other than creditors, such as the AER or OWA, to ensure that the transaction that is approved does not cause additional, or unnecessary, burdens on such other stakeholders.

5. Vesting Orders

As noted above, one of the primary benefits to a purchaser who buys oil and gas assets in a CCAA proceeding or a receivership is the near-absolute quieting of title, via "vesting order". The Ontario Court of Appeal recently conducted a comprehensive discussion of the purpose and history of vesting orders, in *Third Eye Capital Corporation v Dianor Resources Inc*.[13] The Court described the essential nature of vesting orders, and their importance in Canadian insolvency proceedings, as follows:[14]

> To appreciate the significance of vesting orders, it is useful to describe their effect. A vesting order "effects the transfer of purchased assets to a purchaser on a free and clear basis, while preserving the relative priority of competing claims against the debtor vendor with respect to the proceeds generated by the sale transaction"
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> …
>
> [the vesting order] is the cornerstone of the modern "restructuring" age of corporate asset sales and secured creditor realizations ... The vesting order is the holy grail sought by every purchaser; it is the carrot dangled by debtors, court officers, and secured creditors alike in pursuing and negotiating sale transactions. If Canadian courts elected to stop granting vesting orders, the effect on the insolvency practice would be immediate and extraordinary. Simply put, the system could not function in its present state without vesting orders.

Thus, the essential "bargain" represented by a vesting order, in its simplest form, is:

1. approving the transaction in which the purchaser pays the purchase price to the debtor company or the presiding court officer;

2. "vesting" title to the debtor's assets in the purchaser "free and clear" of all the claims of the debtor's creditors; and

3. deeming the purchase proceeds to stand in the "place and stead" of the debtor's assets, so that the pre-existing creditors' claims as against those assets become claims, to the same extent and with the same priority, against the purchase proceeds.

[13] 2019 ONCA 508 [*Dianor*].
[14] *Ibid* at paras. 25 and 27, citing David Bish & Lee Cassey, “Vesting Orders Part 1: The Origins and Development” (2015), 32:4 Nat’l. Insolv. Rev. 41.

The powerful effect of vesting orders, and their necessity, is obvious. The value of an insolvent company's assets is, by definition, less than the total liabilities owed by the company.[15] In that circumstance, without court supervision and the "cleansing" effect of a vesting order, it is virtually impossible for a company to sell its assets to a purchaser and convey title, free and clear of all creditor claims. Without vesting orders, insolvent companies' assets would be frozen and it would be virtually impossible to monetize such assets to allow payment of creditors.

In Alberta, the insolvency bar and the Court of Queen's Bench have established the Alberta Template Orders Committee, which has published, and periodically updates, template court documents that are commonly used in insolvency proceedings, including CCAA proceedings and receiverships.[16] Among the documents it has produced is a Template Approval and Vesting Order (the "**Template AVO**").[17]

Given the importance of the upstream oil and gas industry in Alberta, the Template AVO contains many provisions that are ready-made to address issues that arise with respect to the transfer of upstream oil and gas assets.[18] The key provisions of the Template AVO, including the upstream oil and gas elements, are as follows:

1. deeming service of the application for the order to be good and sufficient;[19]
2. approving the purchase and sale transaction;

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[15] Setting aside those (relatively rare) cases in which the insolvency is liquidity-based, and in which the sale of the company's assets in insolvency proceedings results in full payment to all creditors.

[16] The Committee also publishes and updates documents that are commonly used in other areas of commercial law, such as: *Mareva* injunctions, *Anton Piller* Orders, and interim and final orders for corporate arrangements under the *Business Corporations Act*, RSA 2000, c. B-9.

[17] The Committee's Template Approval and Vesting Order is drafted to be used in receivership proceedings, but parties commonly adapt it for use in CCAA proceedings, bankruptcies and BIA proposal proceedings as well.

[18] The Template AVO is a "living document" and insolvency practitioners regularly add to and refine its provisions, to take into account developing law and developing realities in the industry. Typically, in an application for the approval of a vesting order, counsel will provide the Court with a blackline, showing any deviations from the Template AVO. The Court retains full discretion to grant any order that is appropriate in the circumstances, and commonly approves orders that deviate from the Template AVO, if the deviations are justified on the facts of the case.

[19] Best practice is to ensure that all of the debtor company's creditors are served with notice of the application, along with any affected municipalities, the AER (and the energy regulators of other Provinces, if the debtor has assets in those jurisdictions), Alberta Energy and Canada Revenue Agency.

3. subject to approval of the AER, vesting title to all the debtor's assets in the purchaser, free and clear of all creditor claims (with the option of also specifically listing some or all of the claims to be vested out);

4. expressly directing the relevant government authorities (including the Registrar of Land Titles, Alberta Energy and the Personal Property Registrar) to discharge creditor registrations against the transferred assets and to register the transfer to the purchaser;

5. confirming that the pre-existing creditor claims against the debtor's assets can no longer be asserted against those assets (and are formally barred), but instead become claims against the purchase proceeds; and

6. confirming that the purchaser shall enjoy quiet possession to the purchased assets, free from any interference by the debtor or its creditors.

The jurisdiction of the courts to grant a vesting order has been strongly affirmed by the Ontario Court of Appeal and the Alberta Court of Appeal in recent court cases.[20]

6. Executory Contract Disclaimers

Another potentially beneficial aspect of insolvency processes, both for debtor companies seeking to restructure and asset or share purchasers, is the fairly broad right of insolvent debtor companies, or their court officers, to unilaterally terminate (or "disclaim") executory contracts. Both the CCAA[21] and the BIA[22] provisions governing proposals expressly provide for the ability to disclaim executory contracts. The process required under those Acts is:

1. if the Monitor (in CCAA proceedings) or the Proposal Trustee (in BIA proposal proceedings) approves of the disclaimer, the debtor company can simply give notice of the intended disclaimer to the counterparty;

2. if the counterparty does not object to the disclaimer, it becomes effective 30 days after the date of the notice; and

3. if the counterparty objects to the disclaimer, or if the court officer does not approve it, the contract can only be disclaimed by court order.

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[20] *Dianor*, *supra* note 13; *DGDP-BC Holdings Ltd v Third Eye Capital Corporation*, 2021 ABCA 226.
[21] CCAA, *supra* note 10, s 32.
[22] BIA, *supra* note 9, s 65.11.

Virtually any type of agreement can be disclaimed, with very limited exceptions.[23] While contract disclaimers by Receivers are not expressly authorized by legislation, Canadian insolvency courts have long recognized their authority to do so.

The goal of disclaimers is to allow a restructured debtor company to enhance the prospects of a successful restructuring, by shedding uneconomic obligations. In cases where the outcome is a sale of the debtor company's shares or assets, the ability to disclaim uneconomic contracts enhances the value of the assets or shares being sold, for the benefit of the larger body of creditors. A disclaimer can be challenged by a counterparty where it is likely to cause significant financial hardship to a party to an agreement or can otherwise be demonstrated to be unfair, inappropriate, unreasonable and made in the absence of good faith negotiations.[24]

If a disclaimer becomes effective, either because the notice is not objected to, or by way of court order, then the counterparty has a provable claim against the debtor company for its losses resulting from the termination of the contract. Notwithstanding the 30-day notice period, a recent decision, *Bellatrix Exploration Ltd*,[25] has been interpreted by some as providing authority that where the notice period is breached, the breach only results in a pre-filing unsecured claim. This recently arose in the CCAA proceedings of Coalspur Mines (Operations) Ltd., whereby in the face of an exclusive obligation to ship to the Ridley Terminal, Coalspur shipped to another terminal on the morning prior to disclaiming its agreement with Ridley Terminals Inc. As the parties ultimately settled the matter, there is no further clarity as to the disclaiming parties' obligations during the notice period.

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[23] The only categories of contracts that a debtor company cannot disclaim are "eligible financial contracts", collective agreements, a financing agreement under which the debtor company is the borrower and a lease of real property under which the debtor company is the lessor.
[24] *Re Allarco Entertainment Inc.*, 2009 ABQB 504 at para. 59.
[25] 2020 ABQB 809.

B. Deal Points and Transaction Issues

As noted above, insolvency transactions have many elements in common with routine M&A transactions. However, there are a number of points at which insolvency M&A diverges from the norm. One primary difference is that assets purchased, or investments made, through an insolvency process will be completed on a strictly "as-is/where-is" basis, with no recourse to the debtor following closing. In addition, purchasers will only receive a bare minimum of representations and warranties under the final form of purchase agreement, and all representations and warranties will expire on closing. As such, a purchaser's due diligence takes on a heightened level of importance beyond what is typical of an ordinary M&A process. Purchasers must be comfortable with all aspects of their due diligence, including financial, legal and regulatory matters, before submitting their proposed offer. At the same time, because of the additional risk that purchasers are assuming, it is often the case that the purchase price for distressed assets is significantly lower than what these assets might be sold for by a solvent company.

Another unique aspect of a distressed M&A transaction relates to the assignment of contracts. As noted above, executory contracts may be disclaimed. However, if contracts exist which are critical to the operation of the business, then provided that the purchaser brings such contracts current, by paying what are known as "cure costs", then the assignment of these critical contracts will be effected on closing pursuant to the vesting order. This is an important element to keep in mind, as one of the key transaction risks, third-party contractual consents, can be managed through this process.

When submitting an offer for distressed assets, the SISP or stalking horse process will require proposed purchasers to submit a deposit as part of its bid. The amount of the deposit will typically be 10% of the purchase price stated in the purchaser's offer. This deposit will be held by the

Monitor or Receiver until the end of the sale process and may be forfeited by the purchaser in certain circumstances, the most common being where the purchaser's offer has been accepted and the purchaser fails to close the transaction for reasons which are within its control. In these circumstances, the purchaser with the next highest offer will be contacted and be given the opportunity to consummate a transaction for the subject assets.

It is noted that while many of the corporate aspects of a distressed M&A transactions are truncated and otherwise modified due to the overarching court process, certain others must still be adhered to. A few examples being:

1. purchasers of oil and gas assets must still meet all necessary eligibility requirements of the AER;
2. the proposed transactions will need to be assessed to determine whether any filings or approvals are required under federal statutes, such as the *Competition Act*[26] or the *Investment Canada Act*.[27] To the extent that these statutes apply, all necessary regulatory filings must be made, and all approvals must obtained, prior to closing the transaction; and
3. when transferring oil and gas assets, applicable rights of first refusal ("**ROFRs**") remain effective as against the assets being transferred, and all necessary ROFRs will need to be complied with or cleared in advance of closing.

III. DEVELOPMENTS IN OIL AND GAS INSOLVENCIES AND RESTRUCTURINGS

A. Continued and Evolving Impacts of *Redwater*

Despite the Supreme Court of Canada's decision in *Redwater* having been released in February 2019, its impacts are still being felt as courts, creditors and regulators continue to grapple with its application.

[26] *Competition Act*, RSC 1985, c C-34.
[27] *Investment Canada Act*, RSC 1985, c 28 (1st Supp).

1. Background to the Redwater Decision

In 2015, Redwater Energy Corp. was placed into receivership by its secured creditor. In response to a disclaimer by the court-appointed Receiver of a portion of assets that the Receiver had determined to be unsaleable as a result of significant environmental liabilities, the AER issued an abandonment order with respect to the disclaimed assets and brought an application compelling the Receiver to fulfill the statutory obligations as licensee in relation to the disclaimed assets. The Alberta Court of Queen's Bench decision in *Redwater Energy Corporation (Re)*,[28] issued on May 17, 2016, found that Trustees and Receivers of insolvent companies could disclaim uneconomic oil and gas assets and, following the disclaimer, were not responsible for complying with the abandonment order or posting security in respect of the disclaimed assets. Following this decision, there was a marked increase in insolvencies and the number of wells in Alberta's orphan well program[29] (increasing from 705 as of March 31, 2015 to 3,128 at the end of 2018[30]).

The decision was appealed through to the Supreme Court of Canada and, in February 2019, the Court issued its *Redwater* decision. The majority allowed the appeal, finding that the AER was not acting as a creditor seeking to enforce its abandonment and security requirements, and that these obligations could coexist and operate alongside the BIA. In finding that the AER was not acting as a creditor on the facts before them, the majority relied upon a clarified application of the test for determining whether a regulatory obligation amounts to a provable claim in bankruptcy, set

[28] 2016 ABQB 278 [*Redwater QB*].

[29] The Alberta Orphan Well program is a predominantly industry-funded program, whereby the Alberta Energy Regulator issues an annual levy to industry members based on their deemed liabilities (as defined in the program) and the funds are used by the Orphan Well Association to carry out abandonment and reclamation activities with respect to sites that have been deemed as an orphan by the Alberta Energy Regulator in accordance with the *Oil and Gas Conservation Act*, RSA 2000, c. 0-6.

[30] "2015/16 Annual Report" (June 2016) at 11, online (pdf): *Orphan Well Association* <https://www.orphanwell.ca/wp-content/uploads/2018/01/OWA-2015-16-Ann-Rpt-Final.pdf>.; "Annual Report 2018" at 8, online (pdf): *Orphan Well Association* <https://www.orphanwell.ca/wp-content/uploads/2019/07/OWA-2018-19-Ann-Rpt-Final.pdf>.

out in *Newfoundland and Labrador v AbitibiBowater Inc*.[31] The three-part *Abitibi* test requires the following three conditions be satisfied for a regulatory obligation to constitute a provable claim:

1. there must be a debt, liability or obligation to a creditor;
2. the debt must be incurred before the debtor becomes bankrupt; and
3. it must be possible to attach a monetary value to the debt, liability or obligation.

The dissent cautioned that *Redwater* could result in more orphaned properties by discouraging insolvencies as enforcement of the AER's orders would leave creditors without any recovery. The dissent advised that the AER was not without options to protect the public from unaddressed liabilities, as it could adjust its liability management requirements, require the posting of security up front, increase funding for the OWA and seek judicial intervention where it suspects a company of strategically using insolvency to avoid its regulatory requirements.[32]

2. Post-Redwater

Redwater has been considered in approximately 55 cases, only a portion of which have looked at its application in the context of oil and gas insolvencies.

a) Manitok Energy

In *Manitok Energy Inc (Re)*,[33] the chambers judge held that builders' lien holdbacks held in trust for lien claimants were not property of Manitok's estate and could not be used to satisfy unrelated environmental liabilities. *Redwater* was held to be inapplicable. The Receiver sought leave to appeal on four grounds, all of which were founded on the Receiver's assertion that the chambers judge misinterpreted *Redwater* by:

[31] 2012 SCC 67 [*Abitibi*].
[32] *Redwater*, *supra* note 1, at para. 289-290.
[33] 2021 ABQB 227.

1. failing to consider the Receiver's duty to satisfy regulatory obligations;
2. focusing on the portions of *Redwater* that discussed paramountcy;
3. departing from previous decisions that gave priority to regulatory obligations; and
4. erroneously considering the timing of the AER's abandonment orders.

Leave was granted over the entire decision with no specific reasons provided.[34] A number of municipalities were granted intervener status, as they had interests based on their statutory lien for unpaid municipal taxes.

On appeal, the Court of Appeal found all assets of an oil and gas company were to be treated as a single pool to be used to address regulatory obligations, including the sale proceeds of the valuable assets.[35] The Court of Appeal did however leave it open as to whether assets completely unrelated to the oil and gas company would be captured by the priority afforded regulatory orders. To date, the cases that have considered *Redwater* have dealt with the sale of oil and gas related assets. It is noted that the AER's liability management regime and legislation has historically focused on the use of a licensees production and oil and gas assets for addressing its liability.[36] However, the AER has recently started to take a broader look at the overall finances and assets of a licensee in granting eligibility, which may signal an intention to cast a wider net over the assets it will look to for the purpose of addressing a company's obligations.

b) Yukon Zinc

In *Yukon (Government of) v Yukon Zinc Corporation*,[37] the Court of Appeal applied *Redwater* to determine whether the Government of the Yukon had a provable claim in bankruptcy as a result of the failure of the debtor to provide reclamation security and the extent of the priority afforded

[34] *Manitok Energy Inc (Re)*, 2021 ABCA 323.
[35] *Manitok Energy Inc (Re)*, 2022 ABCA 117 at paras. 28-41.
[36] See for example section 32 of the *Oil and Gas Conservation Act*, RSA 2000, c 0-6.
[37] 2021 YKCA 2.

under section 14.06(7) of the BIA. Unlike in *Redwater*, the Yukon Government was seeking a provable claim.

The Court found that Yukon's security requirements did not constitute a debt as the Government had no authority to collect security through an action under its legislation. The Court also clarified section 14.06(7) of the BIA, which provides for a super-priority security interest over "real property or an immovable" of the debtor affected by the environmental condition and any contiguous real property or immovable where the government incurs costs in carrying out environmental work. The Court found that "real property" does not include a partial interest in land such as a mineral interest.

c) Perpetual Energy

In *PricewaterhouseCoopers Inc v Perpetual Energy Inc*,[38] the Court of Appeal confirmed that, in accordance with *Redwater*, end-of-life obligations should be considered when looking at whether a company is insolvent, as they form an inherent part of asset value. In *Perpetual*, the appellant Trustee in bankruptcy had alleged that a transaction was void under section 96 of the BIA for being a transfer at undervalue.

Perpetual had transferred for nominal consideration a number of licensed petroleum assets, mainly shallow gas wells, almost two-thirds of which were shut in or abandoned such that the associated end-of-life obligations were significant (the "**Transfer**"). Perpetual continued operating for 17 months under a new name (Sequoia Resources Corp.) before assigning itself into bankruptcy in

[38] 2022 ABCA 111.

March 2018. The Trustee challenged the Transfer, asserting it was at undervalue by more than $217 million.

Perpetual was heard twice in chambers and twice in the Court of Appeal. The Court of Appeal overturned the chambers judge on both appeals and considered *Redwater*. The Court held that the chambers judge had framed too narrow a question in asking whether end-of-life obligations were "obligations, due or accruing due" pursuant to section 96 of the BIA. Contrary to *Redwater*, the chambers judge had not considered whether the entirety of the end-of-life obligations could or should be incorporated elsewhere into the balance sheet solvency test. This tainted the entire insolvency analysis.[39] End-of-life obligations are an inherent part of asset value and when they do not constitute a conventional debt payable to an identifiable creditor, they may still depress asset value.[40] Time and context will determine whether it is appropriate to account for end-of-life obligations under the heading of assets (by depressing asset value), liabilities (by incorporating a positive liability obligation), or both, in the balance sheet solvency test, but they must be accounted for somewhere.[41] This finding may have significant impacts on the timing at which a company could be considered insolvent and whether transactions that it undertakes will withstand scrutiny.

d) Bow River

In March 2022, in the Saskatchewan receivership proceedings of Bow River Energy Ltd. ("***Bow River***"), the supervising justice considered whether *Redwater* applies in Saskatchewan. Certain municipalities argued that it did not apply as the legislation in the provinces differs and the Ministry of Energy and Resources had acted in bad faith and had failed to issue an abandonment

[39] *Ibid* at para 31.
[40] *Ibid* at para 39.
[41] *Ibid* at para 45.

order until too late in the process (after the Receiver had received court approval of the sale of select assets of Bow River).

In both *Manitok* and *Bow River* the timing of the regulatory orders was considered. This is interesting as in *Redwater* the orders were only issued after the Receiver had determined what wells it was selling and disclaimed the remainder. In *Redwater*, the Receiver was bound to use funds from the sold assets to address the abandonment order with respect to the disclaimed assets. Similarly, the majority in *Redwater* found that the security deposit requirements that are associated with the transfer of licences were not an obligation owed to a creditor. The posting of security as part of the approval of a transfer request necessarily occurs post sale and suggests that a regulator may not need to take a regulatory step early in an insolvency proceeding. The Court of Appeal in *Manitok* has reaffirmed that the timing of the abandonment order is not determinative.

While the foregoing suggests some attempts to rein in the applicability of *Redwater*, it continues to hold strong, subject to regulatory amendments and policies, which may impact future applications of the *Abitibi* test. The Saskatchewan Court of Queen's Bench has yet to issue its final decision in *Bow River*.

e) Giant Grosmont

On May 5, 2022, BDO Canada Limited, in its capacity as Trustee of Giant Grosmont Petroleums Ltd., sought advice and direction from the Alberta Court of Queen's Bench as to whether it could proceed to pay final dividends in the usual course. At issue was whether the Trustee should use the funds in the bankrupt's estate to reimburse claims approved via a proof of claims process – which primarily related to costs incurred prior to bankruptcy in relation to abandonment and reclamation work – or whether the funds had to be held to address future claims related to environmental work which had yet to occur. Giant Grosmont held nominal non-operated interests as a working interest participant ("**WIP**") in a number of oil and gas wells regulated by the AER. Giant Grosmont was not, however, the licensee of the wells and had never held AER licenses, approvals, authorizations, or permits.

In correspondence with the Trustee prior to the application, the AER appeared to take the position that the funds had to be held to address environmental work which had yet to occur. Citing section 30 of the *Oil and Gas Conservation Act*,[42] which states that a WIP is responsible for their proportionate share of the suspension, abandonment, remediation, and reclamation costs of wells or facilities in which they hold working interests, the AER seemingly indicated that Giant Grosmont had regulatory obligations as a WIP. In its brief before the Court, the Trustee argued that the regulatory obligations were instead obligations owed by the *licensees*, and that any proportionate amounts owed by WIPs were *debts* owed by the WIP to the licensee, not the AER.

Ultimately, the AER did not object to the Trustee's application and the Court ordered that the Trustee pay the claimants, notwithstanding Giant Grosmont's outstanding non-operated oil and gas interests and associated future obligations. At the hearing, the AER advised that it was not objecting to the payment of the funds to creditors since the claims primarily related to abandonment and reclamation work that had been completed or were to be completed in the future. Interestingly, the AER's ultimate position in Giant Grosmont's proceedings was opposite its position in *Manitok Energy*. There, the AER had disputed payment to service providers that had carried out reclamation work, saying the funds instead needed to be used for unaddressed work.

[42] RSA 2000, c O-6.

In a second application with similar issues, the liquidation and dissolution of Richdale Resources Ltd., the AER consented, on a without prejudice basis, to the payment of funds to creditors, with the residual funds in the estate being paid to the AER in trust. As such, there is still no clarity as to whether *Redwater* imposes regulatory obligations on non-operated WIPs and, to the extent that it does, how that might impact the obligations imposed on licensees.

B. Regulator-Initiated Insolvencies

In 2017, the AER, for the first and only time, brought an application to have a Receiver appointed over the assets of Lexin Resources Ltd. The Receiver did not take possession of the assets but rather the assets were placed in the care and custody of the OWA.[43] This step was taken, in part, as a result of concerns regarding the ability of the company to safely operate its assets, including high-risk assets, like sour gas wells in proximity to the City of Calgary.

It was anticipated that the AER would initiate further insolvencies following *Redwater*, as reluctance by creditors has grown given the uncertainty of recovery. In fact, in 2020, the AER amended the *Oil and Gas Conservation Act*[44] to explicitly enable it to apply to the Court of Queen's Bench for the appointment of a Receiver, Receiver-Manager, Trustee or a Liquidator of the property of a licensee. This power, however, is subject to regulations which have not been enacted. Accordingly, while the legislative amendment seemed to indicate an intention of the AER to be more active in commencing insolvencies, the amendment has had the opposite effect, seemingly removing the ability of the AER to commence such proceedings. In this legislative vacuum, it has been the OWA, as a delegate of the AER that has stepped in to appoint Receivers to ensure that abandoned assets are managed and maintained for the benefit of the public and, where possible,

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[43] "Court approves receiver for Lexin assets" (21 March 2017), online: *Alberta Energy Regulator* <https://www.aer.ca/providing-information/news-and-resources/news-and-announcements/announcements/announcement-march-21-2017>.
[44] *Supra* note 42.

assets are placed into the hands of responsible operators.[45] These proceedings have been primarily commenced pursuant to section 13(2) of the *Judicature Act*, since the OWA is often not a creditor entitled to seek relief under the BIA.

One of the first OWA-initiated insolvencies involved Trident Exploration Limited, which ceased operations and advised in an April 30, 2019 press release:

> Although we have substantially settled the terms on a financing solution with our primary creditors for an orderly restructuring and sales process, we were unable to secure AER support for a restructuring in a timely fashion. Ultimately, the recent *Redwater* decision, regulatory uncertainty and a lack of egress has created a treacherous environment for energy investors that dare to risk their capital in Canada.[46]

Since then, a number of other OWA-initiated receiverships have occurred where AER licensees have ceased operations. Unlike traditional energy insolvencies, the primary focus of these insolvencies is on maximizing the number of liabilities that are assumed through the sales process, with offers being assessed based on the amount of deemed liabilities addressed, through considering both the assumption of liabilities and portion of the purchase price that will be available to address the environmental liabilities associated with the unsold assets. To date, these processes have often involved multiple purchasers purchasing portions of the assets and, in some cases, have required the insolvent estate to assume cure costs.

It has been in this context that disputes with municipalities have arisen as municipal taxes have been routinely vested off as there are no funds available for any creditors, with any funds resulting

[45] "Annual Report 2020/21" at 33, online (pdf): *Orphan Well Association* <https://www.orphanwell.ca/wp-content/uploads/2021/07/OWA-Annual_2020_web3.pdf>.

[46] *Orphan Well Association v Trident Exploration Corp, et al* (May 2, 2019), Calgary Action No. 1901-06244, Affidavit of Lars De Pauw sworn on May 2, 2019, Retrieved on March 27, 2022 <https://www.pwc.com/ca/en/car/trident/assets/trident-003_050319.pdf>.

from a sales process being used to either offset the OWA's costs in funding the process or to address environmental liabilities.

As municipalities have steadily increased their standing in receivership proceedings, purchasers have been willing to take on responsibility for paying outstanding municipal taxes. However, in a number of circumstances purchasers have negotiated into their purchase agreements the requirement that the Receiver must first attempt to have municipal taxes vested off and only if such application is not successful will the purchaser be responsible for paying any such surviving amounts in connection with closing.

C. Municipality Priority Disputes

While the enforcement of regulatory end-of-life obligations has the benefit of enabling sites to be repurposed for other uses, it does not assist municipalities in their immediate need to address municipal tax arrears, which affect the performance of their mandates. It has been estimated that the oil and gas industry accounts for 60-90% of the tax base in some municipalities and, in 2021, municipal tax arrears in Alberta totalled approximately $253 million.[47] Some municipalities place the blame on energy regulators for granting licenses to companies, or allowing companies to continue to hold licenses, while they are not paying their taxes. These tensions have been heightened in certain recent insolvencies commenced by the OWA and Ministry of Energy and Resources, where tax arrears have ultimately been vested off.

In addition to Bill 77, discussed further below, the Alberta Government has attempted to offset municipal losses with provincial programs. The government extended the Provincial Education Requisition Credit ("**PERC**") for an additional two years from its initially scheduled conclusion

[47] Janet French, "Oil and gas companies now owe Alberta rural communities $253M in unpaid taxes" (8 March 2022), online: *CBC News* <www.cbc.ca/news/canada/edmonton/oil-and-gas-companies-now-owe-alberta-rural-communities-253m-in-unpaid-taxes-1.6377641>.

after the 2021 intake, in order to assist with tax recovery challenges. PERC provides municipalities with an education property tax credit equal to the uncollectable education property taxes on delinquent oil and gas properties. In addition to extending the program, the government increased the program's annual credits to $30 million for the 2021-2022 tax year intake, and $15 million for the two years of the extension.[48]

Additionally, the Canada Community-Building Fund, formerly the Gas Tax Fund, continues to assist more than 3,600 communities across the country to the tune of more than $2 billion. While not directly aimed at assisting losses as a result of municipal tax arrears of oil and gas companies, the Fund assists municipalities in establishing local infrastructure priorities and was accelerated in 2020 to help communities better recover from the COVID-19 Pandemic.[49]

Still, as outlined below, many municipal priority disputes are proceeding to litigation.

1. Virginia Hills

In *Northern Sunrise County v Virginia Hills Oil Corp*,[50] the substantive issue before the Court was whether taxation provisions in the *Municipal Government Act*[51] granted priority in bankruptcy proceedings to municipalities for tax arrears related to linear property such as telecommunications systems and pipelines. The appellant municipalities sought to collect tax arrears on the linear property of two insolvent energy companies, including a pipeline and related equipment.

The Court considered section 348 of the MGA, which grants municipalities the statutory authority to recover municipal taxes. Section 348(d)(i) creates a special lien on land and any improvements

[48] "Provincial Education Requisition Credit", online: *Government of Alberta* <https://www.alberta.ca/provincial-education-requisition-credit.aspx
[49] "The Canada Community-Building Fund" (last modified 14 January 2022), online: *Government of Canada* <https://www.infrastructure.gc.ca/plan/gtf-fte-eng.html>.
[50] 2019 ABCA 61.
[51] RSA 2000, c M-26 [MGA].

to the land if the tax to be recovered is a "property tax". The Court noted that the remedies in the MGA that apply to the taxation of linear property were not categorized as related to land, suggesting that the special lien on land and improvements to the land created by section 348(d)(i) did not apply to linear property taxes.[52] When read in its grammatical and ordinary sense, and in harmony with the scheme of the MGA, the reference in section 348(d)(i) to "property tax" did not include linear property tax arrears and, therefore, no special lien was created in respect of those arrears.[53]

Additionally, linear property taxes were to be imposed on an *operator*, not on the *owner* of linear property or the land on which the property was situated. The owner and operator are often not the same person in oil and gas relationships. Read in the scheme of the MGA, it would be unjust to attach a special lien to the linear property if the owner of the linear property was not also the operator, from whom the arrears were due and owing.[54] The MGA therefore did not grant the appellant municipalities priority in bankruptcy proceedings for tax arrears related to linear property.

2. Reid-Built Homes

In *Edmonton (City) v Alvarez & Marsal Canada Inc*,[55] the Alberta Court of Appeal again considered unpaid municipal property taxes under section 348 of the MGA. At base, the question on appeal was whether the chambers judge had properly exercised his discretion under section 243(6) of the BIA when he refused to prioritize a Receiver's charge for fees and disbursements

[52] *Supra* note 50 at para 45.
[53] *Ibid* at para 46.
[54] *Ibid* at para 48.
[55] 2019 ABCA 109 [*Reid-Built Homes*].

over a municipality's claim for unpaid property taxes. The receivership order gave priority to the Receiver's charges over other claims.

The Court of Appeal ultimately allowed the Receiver's appeal. The municipality again argued the applicability of section 348, and its special lien over land and any improvements, to property tax amounts owing. It argued that its claim for unpaid property taxes should rank ahead of the Receiver's charge.

The Court noted the necessity of the super-priority given to Receiver's charges, without which parties would be reluctant to take on receiverships.[56] It also highlighted that the creditor who brings the application for the receivership should not be left to bear the entire financial burden of the proceedings – those costs are to be shared amongst all the creditors, as collective action is preferable to unilateral action.[57] The Court held that there was no principled reason for drawing a distinction between the municipal tax claims advanced by the City of Edmonton, and the positions advanced by other mortgagees and lienholders which had been unsuccessful.[58] There was nothing on the record that suggested Edmonton would receive no benefit from the process undertaken by the Receiver[59] and, in fact, Edmonton's taxes were ultimately to be paid out of the properties sold in the receivership.

The Court of Appeal therefore held that the discretion under section 243(6) had not been exercised on a principled basis by the chambers judge. The Receiver's super-priority for its fees and disbursements was restored in accordance with the original receivership order.[60]

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[56] *Ibid* at para 17.
[57] *Ibid* at para 18, 23.
[58] *Ibid* at para 21.
[59] *Ibid* at para 25.
[60] *Ibid* at para 26.

3. Legislative Amendments

In the wake of *Virginia Hills* and *Reid-Built Homes*, the Alberta Government introduced Bill 77 seemingly in an attempt to strengthen municipal budgets by giving municipalities a super-priority over a broader range of property.[61]

Effective December 8, 2021, the amendments clarified that linear tax arrears were to be included under the special lien in section 348 of the MGA, and now constitute secured claims over all of the debtor's assessable property located within the municipality; these claims have priority over all but Crown claims and environmental regulatory obligations.[62] The amendments also addressed the concerns that the Court of Appeal had expressed with regard to differences in ownership of linear property by providing for joint and several liability for municipal tax arrears, as between the taxed individual and the owner.

In addition to the legislative amendments to the MGA, recent amendments to certain AER Directives incorporate the consideration of municipal tax arrears, however do not provide the AER with the specific authority to require licensees to pay arrears owing. Specifically, *Directive 067: Eligibility Requirements for Acquiring and Holding Energy Licences and Approvals* now permits the consideration of municipal tax arrears when assessing if a licensee poses unreasonable risk. *Directive 088: Licensee Life-Cycle Management*, which became effective December 1, 2021, also considers municipal tax arrears when assessing transfers involving public land dispositions. *Directive 088* provides that transfer applications involving public land dispositions will be rejected where either the transferor or transferee owes taxes to a municipality.

[61] Meyer & Cameron, *supra* note 5.
[62] *Tax Accountability Facts*, *supra* note 5.

While these amendments may provide an increased incentive for licensees to address municipal tax arrears, it is unclear whether they will result in decreased tax arrears or create further challenges for the survival of companies already burdened with significant arrears or facing declining production. In such circumstances, the ability to vest off arrears through insolvency proceedings may be the only option available to keep assets from ending up with provincial orphan programs. In a recent Ontario decision involving the insolvency of an oil and gas company in Southwestern Ontario, Clearbeach Resources Inc., the Court granted the sale of the company by way of a reverse vesting order. The RVO provided for the vesting off of municipal tax arrears. In granting the RVO, the Court noted that the municipalities would be worse off in the event of a bankruptcy, which would result in no funds being available for past or future municipal taxes.[63]

Notwithstanding these amendments and the Court of Appeal's decision in *Manitok*, it is anticipated that tensions between municipalities and the regulators will continue.

D. Re-emergence of Lender- or Debtor-Initiated Insolvencies

Prior to *Redwater*, it was not unusual for Receivers or creditors to reach out to the AER to seek to negotiate an outcome that would enable some assets to be sold and some recovery for creditors. Since *Redwater*, the AER has taken the position that there should be no recovery by creditors until all the environmental obligations of the debtor company have been addressed. As predicted by the dissent in the *Redwater*, this has resulted in some reluctance by creditors to commence insolvency proceedings.

[63] *CCAA Plan of Arrangement – Clearbeach and Forbes*, 2021 ONSC 5564 (Endorsement), online (pdf): *MNP Debt* <https://mnpdebt.ca/-/media/files/mnpdebt/corporate/corporate-engagements/ccaafiling/clearbeach-resources-inc/court-endorsement-dated-august-16-2021.pdf>.

Similarly, while in the OWA-initiated insolvencies the AER will permit assets to be sold piecemeal, this has not been permitted in proceedings commenced by creditors or debtors. For example, in the CCAA proceedings of Bow River, Bow River found purchasers for more than 90% of its operating assets, however a large number of inactive liabilities would have been left behind. In response, the AER objected to Bow River proceeding with the sales and the directors and officers of Bow River ultimately resigned. The OWA initiated insolvency proceedings with respect to the Alberta assets, and the Saskatchewan Ministry of Energy and Resources initiated proceedings for the first time with respect to the Saskatchewan assets.

To increase the likelihood of obtaining regulatory approval of sales in lender- or debtor-initiated insolvencies, it is important to ensure liabilities will be addressed. However, as discussed below, even where a purchaser will assume all of the environmental liabilities, there is no guarantee that the regulator will approve the transaction. The AER will consider each purchaser under its new licensee capability assessment. Where all liabilities will be assumed by the purchaser, the economics of the transaction can be impacted and require other trade-offs to enable the transaction to proceed.

Such trade offs are demonstrated by the insolvencies of ACCEL Canada Holdings Limited and ACCEL Energy Canada Limited (the "**ACCEL Entities**"). The ACCEL Entities were Alberta-based oil and gas companies, which commenced proposal proceedings on October 21, 2019 under Part III of the BIA. In November 2019, proceedings followed under the CCAA and the Court granted an order authorizing an interim financing loan, secured by an interim lenders' charge that had been granted priority over all the ACCEL Entities' other creditors.

After a sales process, the Court selected the credit bid of Third Eye Capital Corporation ("**Third Eye**"), which included all of the assets of the ACCEL Entities and incorporated significant environmental liabilities. Third Eye was the secured creditor of ACCEL Canada Holdings Limited and also the agent pursuant to the interim financing loan, the majority of which was funded by funds arranged by Third Eye. The sale was initially intended to proceed as a single transaction but, for various reasons, it proceeded in two steps: first, the sale of ACCEL Holdings' assets, with the interim lenders paid in cash at the closing of that transaction, and second, the ACCEL Energy transaction following.

Prior to the closing of either sale, the Court granted Third Eye's receivership application and PricewaterhouseCoopers was appointed as Receiver. The receivership order gave the Receiver the power to borrow, and provided that the Receiver’s borrowings charge would take priority over all other charges, including the interim lenders' charge granted in the CCAA proceedings. This recognized the changing risk profile for a lender looking to fund proceedings following unsuccessful CCAA proceedings.

DGDP, a minority lender in the interim lender group, objected to the approval of the ACCEL Energy sale (later unsuccessfully appealing it), and argued that the transaction should not have been approved unless the interim lenders’ charge was being repaid in full (even though ACCEL Energy had only borrowed part of the interim loan and was repaying that part in cash at closing).

Subsequently, in connection with the approval of the sale of ACCEL Holding's assets, the Receiver brought an application seeking, among other things, the Court's advice and direction as to whether the Receiver could accept Third Eye's offer to pay out the remaining interim loan (including DGDP's share thereof) by way of a gross overriding royalty ("**GORR**") instead of cash, as the cash component of the offer had been exhausted by other necessary obligations. In response, DGDP brought its own competing application for repayment of the interim loan by a GORR on terms that differed slightly from what Third Eye was proposing. The Court approved the sale and directed repayment of the interim loan by way of Third Eye's proposed GORR, but with some additional terms that had been requested by DGDP in its competing application.

When considering whether to approve of the sale, the case management judge noted the broad and liberal scope of section 243(1) of the BIA, which governed her power to direct the Receiver to enter into the agreement. Further, she also recognized that while debtor-in-possession financing is very important to insolvency proceedings, interim lenders' preferences do not trump the court's powers to restructure the affairs of the insolvent parties and do what is equitable in the circumstances.

DGDP appealed. The Court of Appeal in *DGDP-BC Holdings Ltd v Third Eye Capital Corporation*[64] rejected DGDP's argument that the GORR was not a form of repayment and was essentially no more than a promissory note, leaving DGDP in a worse position. The Court found that there was no question that the GORR constituted a form of repayment as it provided for a stream of cash paid over time, with a put option that forced the purchaser to repay the outstanding balance when certain conditions were met. Further, DGDP obtained an advantage through the GORR, as its debt ranked on equal footing with the Receiver's borrowing charge and the GORR attached to ACCEL Energy’s lands as well as ACCEL Holdings' lands.

[64] 2021 ABCA 284.

E. Emergence of RVOs

Reverse vesting orders are a relatively new trend in Canadian insolvency law. To understand the potential impact and power of RVOs in the context of upstream oil and gas transactions, it is necessary to revisit the nature of approval and vesting orders ("**AVOs**"), which were described above.

Recall that the general proposition of an AVO is that a purchaser pays the purchase price to the debtor company or the court officer, in consideration for receiving the debtor company's assets "free and clear" of creditor claims. Thus, the AVO allows for the removal of the *assets* from the debtor's insolvent estate. After the transaction closes, the insolvent debtor is in exactly the same position as before, except that the assets it previously owned have been exchanged for the (presumably fair market) cash value of those assets. Thereafter, the debtor company or court officer will distribute that cash, in accordance with the pre-existing rights and priorities of the creditors. In almost every case, the debtor company cannot repay all its creditors in full and, after all the cash has been distributed, the company continues to exist, with no further assets but with remaining liabilities that it cannot satisfy. Usually, the company is struck from the corporate registry once it is no longer actively administered and ceases filing annual reports.

While very powerful at achieving the goal of allowing insolvent companies to effectively transact their *assets*, AVOs have limitations. They do not allow for the purchase and sale of attributes of the debtor company that are *not* assets. Examples include tax attributes (i.e. loss pools) and certain regulatory attributes (licenses and regulatory approvals that cannot be transferred between corporations, but rather are inherent attributes of a company).

Traditionally, in Canadian insolvency proceedings, such non-asset attributes have only been transacted to third parties via Plans. Plans are specifically authorized under the CCAA and in BIA proposal proceedings.[65] There is no ability to make plans to creditors in receiverships or bankruptcies. The process required to make and obtain approval for Plans is generally the same under the CCAA and in BIA proposal proceedings:

1. the debtor company may make a proposal for the compromise of its creditors' claims, on a class-by-class basis;[66]
2. the court retains the discretion to determine the proper classification of creditors;
3. creditors are entitled to file proofs of claim against the debtor company;
4. the proofs of claim are vetted in a summary process, to determine their validity, quantum and proper classification;[67]
5. each class of creditors whose rights are to be affected in the Plan are entitled to vote on the Plan;
6. prior to the vote or votes being held, the Plan must be sent to every affected creditor;[68]
7. each affected class of creditors must approve the Plan, on the basis of a statutorily-mandated "double majority";[69]
8. if the creditors vote in favor, the debtor company then applies to the court to have the Plan "sanctioned";
9. at the sanction hearing, the court determines whether the Plan is fair and reasonable; and
10. if approved by the court:
    i. the creditors' pre-existing claims against the debtor company are irrevocably released and discharged; and
    ii. the only obligations owed by the debtor company to its creditors are the obligations contained in the Plan.

[65] See e.g. CCAA s. 4, BIA s. 50.
[66] For example, "unsecured creditors" and "secured creditors" are two customary and distinct classes of creditors.
[67] Subject to appeals to the court.
[68] Under the CCAA, the debtor company must receive court authorization to send the Plan to creditors and call meetings. In BIA Proposals, this preliminary court application is not required.
[69] Of those creditors who vote on the Plan, 66% in value and 50% in number must vote in favor.

From the perspective of a "purchaser" who is transacting with the debtor company in connection with a Plan, the key benefit is the court-sanctioned compromise of creditor claims: a sanctioned Plan effectively releases and discharges all of the debtor company's pre-existing obligations to its creditors, even though the debtor company did not repay all those creditors in full. In conjunction with this compromise of claims, a Plan can also provide for the cancellation of the debtor company's shares, and the issuance of new shares to a third-party "purchaser". Thus, a court-approved Plan can, in essence, deliver to a third-party the ownership of a debtor company that has been "cleansed" of all creditor claims but that still retains all its assets, along with all inherent corporate attributes that are not assets (such as tax attributes and regulatory licenses).

It is apparent, therefore, that Plans offer far greater flexibility to restructure a corporation than a simple asset sale that is approved by an AVO. However, as is also apparent from the description above, Plans entail far more legal "process" than simple asset transactions. Whereas an asset purchase and sale could be approved by a court in a single court application for an AVO, Plans require far more steps, and present far more potential complications. A Plan must be carefully drafted and negotiated with creditor classes. Sufficient notice of the Plan must be given to creditors. There is a risk that one or more classes of creditors may vote against the Plan. Disputes about the claims of large or significant creditors can delay sanction and implementation of the Plan, as they may need to be resolved before the result of the votes can be determined. To obtain positive votes of certain classes of creditors, consideration may have to be offered to classes of creditors who would otherwise be considered to be "out of the money".

RVOs potentially offer the benefits of both AVOs and Plans: they allow a purchaser to acquire the shares of a debtor company "cleansed" of all its creditors' claims, but without the need for any Plan, or meetings of creditors. The way RVOs do this is to "reverse vest" undesired assets, and all or substantially all creditor claims, *out* of the debtor corporation into either an affiliated corporation, or a creditor trust. Then, in the same order, the court approves the transfer of the debtor company's shares, or the issuance of new shares, to the purchaser. From a procedural perspective, the RVO would be approved in a single court application.

The use of RVOs is on the rise. The structure has been popularized in the restructurings of cannabis producers over the last two years.[70] One of the unique aspects of those companies is that they require a Health Canada license to produce cannabis products, and the process for obtaining a replacement license for a new operator is intensive and time-consuming. Thus, purchasing the shares of a licensed producer is much more efficient than purchasing its assets and applying for a new license. Courts have also approved RVOs in the context of mining companies,[71] and in other sectors.

The utilization of RVOs in upstream oil and gas transactions has the potential to deliver valuable debtor company attributes to purchasers in an efficient manner. An obvious benefit is that well, pipeline and facility licenses would not need to be transferred.[72] Tax loss pools inherent in upstream oil and gas companies can be significant, given the enormous capital required for development in the industry, and the challenging economic environment of the last seven or more years. The assignment and novation of the multitude of third-party agreements that are typically held by any sizable active upstream oil and gas company would also be unnecessary. As well, many ROFR processes can be avoided because assets are not being sold.

[70] See e.g. *Re Green Relief Inc,* 2020 ONSC 6837; *Wayland Group Corp, 2751609 Ontario Inc and Nanoleaf Technologies Inc* (April 21, 2020), Toronto CV-19-00632079-00CL (Ont SCJ); *Beleave Inc* (September 18, 2020), Toronto CV-20-00642097-00CL (Ont SCJ); *FIGR Brands, Inc, Canada's Island Garden Inc, and FIGR Norfolk Inc* (June 10, 2021), Toronto CV-21-00655373-00CL (Ont SCJ).

[71] *Re Stornoway Diamond Corporation* (October 7, 2019), Montreal 500-11-057094-191 (Que SC); *Re Dominion Diamond Mines ULC et al* (November 16, 2021), Calgary Action No. 2001-05630.

[72] As explained below, this does not mean that such transactions would not be subject to AER scrutiny and approval.

The use of RVOs has not yet become commonplace in upstream oil and gas company restructurings, but is beginning. The Alberta Court has granted RVOs in the CCAA proceedings of Salt Bush Energy Ltd.[73] and Bellatrix Exploration Ltd.,[74] and in the receivership of Elcano Exploration Inc.[75] The Ontario Superior Court has granted one RVO in respect of an upstream oil and gas company.[76]

Most RVOs recently granted by Canadian insolvency courts share the following essential components:[77]

1. deeming service of the application for the order to be good and sufficient;[78]
2. approving the transaction;
3. transferring title to those assets of the debtor that the purchaser does not wish to retain ("**Transferred Assets**") in either an affiliate of the debtor ("**Residualco**") or in a trust established for the benefit of the debtor's creditors ("**Creditor Trust**");
4. transferring all the liabilities of the debtor ("**Transferred Liabilities**") in either Residualco or in the Creditor Trust;
5. declaring that the Transferred Assets and Transferred Liabilities are absolutely and irrevocably transferred to Residualco or the Creditor Trust, without any recourse to the debtor company;
6. approving the transfer of, or issuance of, a controlling shareholding interest in the debtor company, to the purchaser;
7. expressly directing the relevant government authorities (including the Registrar of Land Titles, Alberta Energy and the Personal Property Registrar) to discharge creditor registrations against the debtor company; and

[73] *Re Salt Bush Energy Ltd and 2345141 Alberta Ltd* (May 19, 2021), Calgary Action No. 2101-06512 (Alta QB).
[74] *Re Bellatrix Exploration Ltd* (June 22, 2021), Calgary Action No. 1901-13767 (Alta QB).
[75] *Tallinn Capital Energy et al v Elcano Exploration Inc et al* (March 11, 2022), Calgary Action No. 2101 – 08818 (Alta QB).
[76] *CCAA Plan of Arrangement – Clearbeach and Forbes*, 2021 ONSC 5564.
[77] Unlike AVOs, there are not yet any "template" RVOs, and the form of RVOs have been developed and evolved by insolvency practitioners on a case-by-case basis.
[78] As with applications for AVOs, best practice for RVO applications is to ensure that all of the debtor company's creditors are served with notice of the application, along with any affected municipalities, the AER (and the energy regulators of other Provinces, if the debtor has assets in those jurisdictions), Alberta Energy and Canada Revenue Agency.

8. confirming that the pre-existing creditor claims against the debtor's assets can no longer be asserted against the debtor company (and are formally barred), but instead become claims against Residualco or the Creditor Trust.

Because the desired assets will still be owned by the same entity (the debtor company) both before and after the transaction, there is no need to provide for their transfer, nor to direct any authorities to register the purchaser as the new owner of those assets.

While the use of RVOs in upstream oil and gas restructurings holds promise, it should be noted that some courts have begun to question whether RVOs are appropriate in all situations in which insolvency practitioners have attempted to use them. In *Re Harte Gold Corp*,[79] Penny J of the Ontario Superior Court made the following cautionary comments about the use of RVOs:[80]

> … I think it would be wrong to regard employment of the RVO structure in an insolvency situation as the "norm" or something that is routine or ordinary course. Neither the BIA nor the CCAA deal specifically with the use or application of an RVO structure. The judicial authorities approving this approach, while there are now quite a few, do not generally provide much guidance on the positive and negative implications of this restructuring technique or what to look out for. Broader-based commentary and discussion is only now just now starting to emerge. This suggests to me that the RVO should continue to be regarded as an unusual or extraordinary measure; not an approach appropriate in any case merely because it may be more convenient or beneficial for the purchaser. Approval of the use of an RVO structure should, therefore, involve close scrutiny. The Monitor and the court must be diligent in ensuring that the restructuring is fair and reasonable to all parties having regard to the objectives and statutory constraints of the CCAA. This is particularly the case where there is no party with a significant stake in the outcome opposing the use of an RVO structure.

Penny J proposed the following framework of inquiry to be applied when courts consider whether to approve RVOs:

1. why is the RVO necessary in this case?;

[79] 2022 ONSC 653.
[80] *Ibid* at para. 38.

2. does the RVO structure produce an economic result at least as favourable as any other viable alternative?;

3. is any stakeholder worse off under the RVO structure than they would have been under any other viable alternative?; and

4. does the consideration being paid for the debtor's business reflect the importance and value of the licences and permits (or other intangible assets) being preserved under the RVO structure?

At least one academic commentator has sounded a similar note of caution.[81] While the future of RVOs in Canadian restructuring law is not certain, it appears likely that RVOs will continue to be an available tool in appropriate cases and can provide significant benefits and efficiencies in oil and gas restructurings.

F. Changing Regulatory Regime

Following the initial ruling in *Redwater*, the Government of Alberta commenced a liability management review and the AER announced measures which included:

1. Bulletin 2016: Obligations of Licensees When in Insolvency or When Otherwise Ceasing Operations. This provided a reminder that licensees cannot walk away from their obligations;

2. Bulletin 2016-16: Alberta Energy Regulator Measures to Limit Environmental Impacts Pending regulatory Changes to Address the *Redwater* Decision, which was subsequently revised by Bulletin 2016-21. The Bulletins require companies with a liability management rating below 2.0 that are seeking to have assets transferred to them to demonstrate to the AER that they will be able to address the liabilities with a rating less than 2.0. This process provided the AER the discretion to collect information it had not previously reviewed related to the company's finances, business plans and reserves;

3. Bulletin 2017-13: Changes to process for Transfer Application Decisions. This introduced a 30-day notice period for the transfer of a license, making it easier for parties to file statements of concern;

4. 2017 Debtor Registry. In response to concerns with the AER enforcing its statutory lien pursuant to section 103 of the *Oil and Gas Conservation Act* which is not required by statute to be registered, the AER started to post the name and amount of debts owed to

[81] Janis P Sarra, "Reverse Vesting Orders – Developing Principles and Guardrails to Inform Judicial Decisions", 2022 CanLIIDocs 431.

it. This registry was subsequently adopted by the Alberta Securities Commission. In August 2019, the AER ceased updating the registry and then subsequently removed it;

5. New 2017 Edition of *Directive 067: Eligibility Requirements for Acquiring and Holding Energy Licences and Approvals*. The Directive enabled the AER to collect additional information regarding a licensee and provided ongoing reporting requirements for a licensee to advise as to material changes that might result in the AER finding that the licensee poses an unreasonable risk; and

6. Creation of the voluntary Area Based Closure ("**ABC**") Program which encourages licensees to work together to abandon, remediate and reclaim sites to achieve economies of scales.

It was not until July 2020, more than a year after *Redwater*, that more fulsome amendments were introduced, many of which did not come into effect until December 2021. The first of these changes was the introduction of legislative amendments to *Oil and Gas Conservation Act* and *Pipeline Act*.[82] Notably, the changes do not impact coal or oil sands projects despite neither being immune to insolvencies.

The amendments include:

1. the introduction of a formal requirement for licensees and, when directed, working interest participants, to provide reasonable care and take measures to prevent impairment or damage that results in or could reasonably be expected to result in harm to the integrity of a well, facility, pipeline, the environment, human health, safety or property;

2. the ability of the AER or OWA to continue operations where they take over the management and control of a well or facility, however production is not permitted unless consent is provided by the owner and lessee of the mineral rights;

3. surprisingly, despite *Redwater* holding that the AER's enforcement of security requirements is not a "debt", the AER proceeded to amend its legislation to specify that outstanding security deposits are a debt subject to the AER's statutory lien; and

4. as previously noted, legislation was amended to authorize the AER to appoint a Receiver, however subject to regulations that have not been developed.

[82] RSA 2000, c P-15.

In December 2021, the AER released *Directive 088: Licensee Life-Cycle Management* and *Manual* 023*: Licensee Life Cycle Management*. In addition to expanding upon the criteria used to assess the risk posed by a licensee, beyond the liability management rating, *Directive 088* imposes minimum obligations for all licensees with inactive inventories to spend annually on abandonment, remediation and reclamation activities. These changes pose additional challenges for seeking to transfer assets as it is no longer enough to consider the impacts of the transaction on the purchaser's liability management rating. Now parties also need to consider a number of other factors which are not publically available:

1. financial health;
2. estimated total magnitude of liability (active and inactive), including abandonment, remediation and reclamation;
3. remaining lifespan of mineral resources and infrastructure and the extent to which existing operations fund current and future liabilities;
4. management and maintenance of regulated infrastructure and sites, including compliance with operational requirements;
5. rate of closure activities and spending and pace of inactive liability growth; and
6. compliance with administrative regulatory requirements, including the management of debts, fees and levies.

Despite the adoption of these new measures, the AER still has not rescinded Bulletin 2016-21, which was established as an interim measure, while the AER works with "industry, other stakeholders, and the Government of Alberta to develop broader and more permanent regulatory measures in accordance with government policy in response to the *Redwater* Decision."[83]

[83] Hélène de Beer, "Revision and Clarification on Alberta Energy Regulator's Measures to Limit Environmental Impacts Pending Regulatory Changes to Address the Redwater Decision" (8 July 2016), online: *Alberta Energy Regulator* <https://www.aer.ca/regulating-development/rules-and-directives/bulletins/bulletin-2016-21>.

Most recent developments in the AER's processes have included the removal of general eligibility when a licensee enters into insolvency proceedings and issuance of an abandonment order and seeking to apply *Redwater* in scenarios not involving licensees. While the AER's *Directive 067* does note that the commencement of insolvency proceedings may amount to a material change resulting in an unreasonable risk, in some cases formal insolvency proceedings may provide a stabilizing factor enabling a company to exit such proceedings debt free and in a better position than many of its competitors. With respect to the issuance of abandonment orders, this appears to have been in response to the lower court's decision in *Manitok* which had, in part, found that *Redwater* did not apply because of the timing of the issuance of the abandonment order.

The AER has also started seeking to enforce environmental obligations against working interest participants other than the licensee as demonstrated in the bankruptcy of Giant Grosmont and the liquidation of Richdale discussed above. This poses a number of challenges as the AER does not maintain current records of working interest participants and only recently made it possible for licensees to update working interests in One Stop. Because of this development, it is recommended that parties to a transaction ensure that steps are taken to have the licensee update the working interests with the AER as part of the post-closing steps.

IV. LOOKING FORWARD

As discussed throughout this paper, the remedies and processes available in formal insolvency proceedings may present valuable opportunities for energy companies, particularly in the context of current market prices and the Alberta oil and gas industry's current position in its life-cycle. Companies may use restructuring proceedings to shed liabilities and emerge stronger and more competitive; distressed assets and companies may be acquired for a fraction of the normal start-up costs and utilized under a different business model or with an eye to repurposing existing infrastructure for utilization in energy transition.

Still, the oil and gas sector is faced with significant uncertainty and while utilizing insolvency proceedings may have benefits, the outcomes are far from certain. The post-*Redwater* landscape is still being explored by insolvency practitioners and companies alike, and matters are further complicated by evolving legislation and policies, new court decisions, and increasing costs of doing business.

The authors anticipate that municipalities will continue to seek new mechanisms to enforce municipal tax obligations, including challenging priorities and regulatory obligations asserted by regulators. It is also possible that, in the context of this evolving regulatory landscape, courts may determine that environmental abandonment and reclamation obligations have become sufficiently certain to crystallize into a creditor claim in insolvency proceedings. This is especially the case as policies are adopted and funding is provided to address environmental obligations,[84] diminishing orphan well backlogs.

Insolvency and restructuring law in the patch has undergone seismic shifts in the last decade, making what is already a specialized area all the more complicated. Continued uncertainty, could enable dynamic and creative companies to position themselves to reap the benefits through strategic purchases or restructurings.

[84] In 2020, the Federal government announced $1.72 billion in funding to be provided to support Alberta, Saskatchewan and British Columbia in cleaning up orphaned and inactive oil and gas wells, pipelines and facilities.