Super-Priority for Environmental Obligations in Insolvency Law

May 21, 2020

In the recent decision of *British Columbia Attorney General v Quinsam Coal Corporation*, 2020 BCSC 640 (*Quinsam*), the British Columbia Supreme Court (the Court) considered the priority between a debtor's environmental liabilities and a secured creditor. In its analysis, the Court extensively discussed the Supreme Court of Canada's decision in *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 (*Redwater*). In reference to *Redwater*, the Court posed the following question:

> Did the Supreme Court of Canada intend to extend the "polluter pays" principles to *effectively create a super priority for the costs and environmental liabilities associated with the closure or abandonment of oil wells, mines and other resource extraction projects?*

Unfortunately, since the assets in dispute did not actually constitute the debtor's property, it wasn't necessary for the Court to answer that specific question. However, the fact such a question was posed serves as a reminder that *Redwater* may have done just that.

What you need to know

- The treatment of environmental obligations in insolvency proceedings remains a live issue.
- Although the secured creditor prevailed in this case, the findings and comments of the Court in Quinsam appear to confirm that the *Redwater* decision gave a super-priority to environmental obligations.
- The specific facts of each case will be key to determining whether, and the extent to which, environmental obligations have priority over secured creditors.
- Those lending to industries with significant environmental liabilities will need to be proactive in developing their security package and monitoring performance to manage risk.

The Quinsam decision - facts

The debtor, Quinsam, owned and operated the Quinsam Coal Mine (the Mine) and was the lessee of Middle Point Barge Terminal (Middle Point), where mined coal was stored and from where it was shipped. The Mine ceased operations on June 12, 2019. Quinsam made an assignment into bankruptcy pursuant to the *Bankruptcy and Insolvency Act*, RSC 1985 c B-3 (the BIA) on July 3, 2019. The trustee in bankruptcy of Quinsam (the Trustee) abandoned the Mine without fulfilling the closure, reclamation and remediation obligations imposed under the *Mines Act*, RSBC 1996, c 293 (the Mines Act). The trustee later abandoned Middle Point as well. As a result of the Trustee's abandonment of the Mine and Middle Point, the Province of British Columbia (the Province) successfully sought the appointment of its own receiver over Quinsam on September 20, 2019.

In response, the Province began to undertake the necessary work related to Quinsam's environmental obligations. The measures to properly reclaim the Mine are expected to cost several millions of dollars more than the security held by the Province.

Several months before its assignment, *Quinsam* executed a promissory note in favour of ENCECo Inc. (ENCECo) and granted ENCECo a security interest in its coal inventories and the proceeds of sale from such inventories. Those coal inventories were later sold on June 28, 2019 for approximately USD$1 million. The sale agreement provided that title to the purchased coal transferred on the date of the sale, however, the actual delivery of the coal and payment was to occur at a later date. The sale agreement was accompanied by an irrevocable direction to pay, directing the purchaser to pay a portion of the proceeds to ENCECo. In exchange for the direction to pay, ENCECo released its security interest in the purchased coal, but not in the proceeds.

The Parties' arguments

At issue in *Quinsam* was the entitlement to the proceeds from the sale of the coal inventory. The Province argued that the proceeds must be used to fund the unfulfilled environmental obligations imposed on Quinsam under the Mines Act. ENCECo argued that it was entitled to the proceeds as a secured creditor of Quinsam.

In support of its argument, the Province relied exclusively on the *Redwater* decision. The Province argued that *Redwater* stands for the proposition that unless the regulatory obligations at issue are claims under the BIA, the limited resources of a bankrupt company should be used to fulfill the company's environmental obligations before payment is made to secured creditors. ENCECo in response argued that *Redwater* must not be interpreted in such an overreaching manner, and in any event, was distinguishable due to the different legislative regimes in question.

The Court's decision

After an extensive consideration of *Redwater*, the Court agreed with ENCECo that the applicable legislation was distinguishable. Most notably, the Court concluded that unlike the legislation under consideration in *Redwater*, the Mines Act does not expressly make the bankrupt estate or trustee liable for end-of-life environmental obligations. However, the Court also noted that "there are aspects of *Redwater* that cannot be ignored".

Specifically, the Court relied upon *Redwater* in concluding that the Trustee's abandonment of the Mine was effective to limit only its own personal liability for the environmental orders issued by the Province, but the abandonment did not affect the ongoing liability and obligations imposed on Quinsam in relation to the closure, reclamation and remediation of the Mine. Further, "the abandonment did not permit [the Trustee] to simply walk away from the Mine."[1]

The Court also found that, as in *Redwater*, the Province was acting in the public interest and for the public good in issuing the orders respecting Quinsam's environmental obligations. The Province therefore did not meet the first part of the *Abitibi* test (being that there must be a debt, liability or obligation owing to a creditor) to have a claim provable in Quinsam's bankruptcy.

This conclusion was reached despite the Province holding a $7.3 million security deposit in relation to Quinsam's environmental obligations, and the trustee estimating the cost of the environmental liabilities at $11.9 million, which would make the Province's claim at least arguably quantifiable as a liability owing.

The Court finished its analysis of *Redwater* by asking whether "the Supreme Court of Canada intend[ed] to extend the "polluter pays" principles to effectively create a super priority for the costs and environmental liabilities associated with the closure or abandonment of oil wells, mines and other resource extraction projects?" While the Court declined to answer this question directly, it did state that "[t]aken at its highest, *Redwater* requires a trustee in bankruptcy or other insolvency professional to use the assets of the estate to satisfy the regulatory obligations imposed on the bankrupt."[2]

As a result of the sale agreement for the coal inventories and direction to pay in favour of ENCECo, the Court ultimately found that the portion of the proceeds subject to the direction to pay never formed part of Quinsam's bankrupt estate. They were therefore not available to satisfy the claims of the Province in relation to Quinsam's closure, reclamation and remediation obligations.

Conclusion

Although the secured creditor prevailed in this instance, the findings from the Court regarding the applicability of *Redwater* are concerning as they seem to suggest what many case commentaries on *Redwater* have; that through its decision in *Redwater*,the Supreme Court of Canada in effect gave a super-priority to environmental obligations owed by a debtor over all other creditors. *Quinsam* is yet another chapter in the turbulent intersection between insolvency law and the environment.

For further commentary on the perils and pitfalls of such a super-priority, please see our prior publication on the *Redwater* decision.

[1] *British Columbia (Attorney General v Quinsam Coal Corporation*, 2020 BCSC 640 at para 107 [*Quinsam*].

[2] *Quinsam*, at paras 5 and 109.

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