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UNIVERSITY OF CALGARY

Rethinking Environmental Obligations in Corporate Insolvencies: What New Role for Lenders?

by

Daniel Onyeje Ebegbodi

A THESIS

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Abstract

Environmental reclamation obligations are statutory mechanisms designed to regulate environmental protection by corporate entities. Bankruptcy laws on the other hand are meant to offer insolvent corporations an opportunity to reorganize their affairs, satisfy creditors claims and make a fresh start. In practice, the application of bankruptcy laws can undermine key environmental reclamation objectives, leading many to ask whether a corporation undergoing restructuring with significant outstanding environmental reclamation obligations should be able to commence bankruptcy proceedings to satisfy creditors' claims?

By employing the doctrinal and comparative research methodologies, this research interrogates that inquiry. It argues that, despite the importance of bankruptcy protection for corporations undergoing financial distress, environmental protection should be paramount. Although sustainable finance (SF) instruments have been deployed by banks to enable creditors to mitigate environmental concerns in their investments, the persistent recurrence of environmental reclamation issues in the oil and gas sector particularly during insolvencies, underscores the need for financial investors to strengthen their investment policies to reflect best practices providing the desired protection for the environment.

The research finds that, although SF and environmental, social and governance (ESG) approaches, are commendable, they are insufficient in instilling adequate regulatory impact on the environment compared to judicial control offered by the courts. The thesis concludes that whilst judicial control mechanism is not without concerns, with government's deliberate financial policy and judicial control to complement SF and ESG efforts, ESG and SF mechanisms can be strengthened to compel greater significant influence on best practices in lending.

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I thank my family, my Dad, Mr. Lazarus Onyeje Ebegbodi, for his constant prayers and support. I thank my siblings Edwin, Paul, Philip, and Amos, for their persistent support and encouragements.

Special thanks to God Almighty who made this possible, to him alone I give all the glory.

Dedication

In memory of my late and dearly beloved mother, Mrs. Patricia Onyeje Ebegbodi, for her love and sacrifice and for toiling so tirelessly in ensuring my dreams come true. She, who gave all but asked nothing in return; to her I say, *More is Thy Due, Than More Than All Can Pay!*

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List of Abbreviations

1. AEPA - Alberta Environment and Protected Areas
2. AER - Alberta Energy Regulator
3. ANZ - Australian and New Zealand Banking Group
4. AROs - Asset Retirement Obligations
5. ATB - Alberta Treasury Branches
6. BMO - Bank of Montreal
7. CBA - Canadian Bankers Association
8. CCRA - Climate Change Risk Assessment
9. CFI - Corporate Finance Institute
10. CIBC - Canadian Imperial Bank of Commerce
11. EC - European Community
12. EDC - Expert Development Canada
13. EP - Equator Principles
14. ERA - Environmental Risk Assessment
15. ESG - Environmental, Social and Governance
16. ESRF - Environmental and Social Risk Management Framework
17. EU - European Union
18. FIs - Financial Institutions
19. GHG - Greenhouse Gases
20. GRI - Global Reporting Initiative
21. GSIA - Global Sustainable Investment Alliance
22. HLEG - High Level Expert Group
23. ICMA - International Capital Market Association

24. UNFCCC	-	United Nations Framework Convention on Climate Change
25. ILO	-	International Labour Organization
26. ISO	-	International Organisation for Standardization
27. LMA	-	Loan Market Association
28. MAS	-	Monetary Authority of Singapore
29. NZBA	-	Net-Zero Banking Alliance
30. OECD	-	Organisation for Economic Co-operation and Development
31. OSFI	-	Office of the Superintendent of Financial Institutions
32. PCAF	-	Partnership for Carbon Accounting Financials
33. PPP	-	Polluter-Pays Principle
34. RBC	-	Royal Bank of Canada
35. REC	-	Recognized Environmental Conditions
36. SA	-	Security Agreement
37. SASB	-	Sustainability Accounting Standards Board
38. SCC	-	Supreme Court of Canada
39. SF	-	Sustainable Financing
40. SRI	-	Socially Responsible Investment
41. TCFD	-	Task Force on Climate-related Financial Disclosure
42. UNEP	-	United Nations Environnent Program
43. UNICEF	-	United Nations Children's Fund
44. UNPRI	-	United Nations Principles for Responsible Investment
45. WCED	-	World Commission on Environment and Development

INTRODUCTION

Sustainable financing (SF) is conceived as an investment strategy that seeks to integrate environmental and social concerns into investment decision-making.[1] Although this technique is designed to enable investors to integrate environmental, social and governance (ESG) measures in their investment choices, while preventing borrowers from externalizing their production cost upon the public, there are doubts whether these objectives are being fully achieved.[2]

Bankruptcy, when used properly, serves the dual purpose of providing creditors an opportunity for fair and orderly distribution of a bankrupt's estate and presents an opportunity to make a fresh start.[3] Likewise, corporate restructuring provides struggling companies a second chance to achieve profitability and fulfill their public and private obligations.[4] However, these important financial tools can also be used to achieve more nefarious ends.[5] Evidence has shown that bankruptcy and insolvency proceedings are undermining responsible business practices.[6]

The Supreme Court of Canada (SCC) released its decision in *Orphan Well Association v Grant Thornton Ltd* [*Redwater*] in 2019.[7] This seminal case, combined with several lower court decisions,[8] have established risks to SF and ESG strategies designed by banks to support efforts to

[1] Friederike Preu & Benjamin Richardson, "German Socially Responsible Investment: Barriers and Opportunities" (2011) 12 German LJ 865 at 866.
[2] Gail Henderson, "Making Corporations Environmentally Responsible: The Limits of Responsible Investing" (2012) 13 German LJ 1412 at 1415 [Henderson].
[3] Roderick J. Wood, *Bankruptcy and Insolvency Law*, 2nd ed (Toronto: Irwin Law, 2015) at 2 [R Wood].
[4] *Ibid.*
[5] Joshua Macey & Jackson Salovaara, "Bankruptcy as a Bailout: Coal Company Insolvency and the Erosion of Federal Law" (2019) 71 Stan L Rev 879 at 883.
[6] *Ibid*.
[7] *Orphan Well Association v Grant Thorton Ltd* [2019] 1 S.C.R. 150 [*Redwater*].
[8] They include *Manitok Energy Inc (Re),* [2022] ABCA 117 [*Manitok*]; *PricewaterhouseCoopers Inc. v Perpetual Energy* [2022] ABCA 111[*Perpetual Energy*]; *Orphan Well Association v Trident Exploration Corp,* [2022] ABKB 839 [*Trident*]; *Qualex-Landmark Towers Inc v 12-10 Capital Corp,* [2024] ABCA 115, rev'g *Qualex-Landmark Towers Inc v 12-10 Capital Corp,* [2023] ABKB 109 [*Qualex* (KB)]; and *Mantle Materials Group Ltd v Travelers Capital Corp* [2023] ABCA 339 (CA), aff'g *Re Mantle Materials Gro up Ltd* [2023] ABKB 488 [*Mantle* (KB)].

encourage borrowers to meeting their ESG obligations.[9] Whilst *Redwater* and subsequent decisions lay emphasis on environmental protection, ESG and SF measures on the other hand, focus more on maximizing investment returns for shareholders.[10]

This thesis undertakes a comprehensive analysis of the concept of SF and how financial institutions (FIs) in Canada approach ESG measures in mitigating environmental risks. It begins by analyzing the lending process and bankruptcy rules along with their impact on lending and the environment. After a critical analysis of judicial decisions and how they provide control measures for environmental protection, the research uncovers how bankruptcy laws are exploited by corporations to evade environmental rules. It offers a comparative analysis between SF and ESG measures declared by banks and judicial control through *Redwater* and their impact on the environment. After an explorative analysis, the research finds that although ESG measures proffered by banks have limited regulatory impact on environmental protection, the *Redwater* decision offers more profound regulatory control.

a) Research Problem

Although bankruptcy and insolvency laws seek to maximize returns for creditors by ensuring fair distribution of the debtor's assets to satisfy secured debts,[11] provincial environmental regulations require insolvent corporations to clean up environmental messes that may have occurred during their operational life known as Asset Retirement Obligations (AROs) ahead of satisfying creditors' claims.[12] This issue has received the attention of Canadian courts raising the

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[9] Eric Appelt & Sean Parker, "Get Your Priority Right: Case Law Update on the Intersection of Creditor Claims and Environmental Obligations" (05 September 2023), online: *Mclennan Ross* https://www.mross.com/what-we-think/article/get-your-priorities-straight-case-law-update-on-the-intersection-of-creditor-claims-and-environmental-obligations.

[10] Benjamin Richardson, "Climate Finance and its Governance: Moving to a low Carbon Economy Through Socially Responsible Financing?" (2009) 58 Intn'l & Com LQ 597 at 598 [Richardson].

[11] R Wood, *supra* note 3.

[12] See the *Pipeline Act*, RSA 2000 c P-15 ss 23-26 [PLA], *Oil and Gas Conservation Act,* RSA 2000, c O-6, ss 27-30 [OGCA].

question who should bear the cleanup costs.[13]

Attempts by banks to close this loophole through SF have yielded uncertain results as most SF and ESG approaches adopted by them are centered on mitigating risks that impact the financial returns on their investments rather than ensuring environmental protection.[14] In addition, lenders are also careless since their borrowers can ultimately leverage bankruptcy laws to walk away from environmental liability.[15] Research shows that lenders remain willing to extend credit to companies with significant outstanding AROs despite being aware of these obligations.[16]

Following the persistent recurrence of environmental reclamation issues, particularly with firms in the oil and gas sector, there are doubts whether ESG and SF measures in Canada reflect global best practices in lending capable of providing the required protection for the environment. On this basis, judicial control through *Redwater* offers more profound impact on environmental protection that impinges more on creditors than debtors, rather than ESG and SF measures proclaimed by banks. While the judicial approach is not without concerns, this thesis contends that with the intervention of government through deliberate financial policy to complement judicial efforts, ESG and SF approaches can be strengthened to yield better regulatory results both for the financial sector and the environment. Further analysis of this issue is covered in chapter four.

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[13] See generally Anna Lund, "Lousy Dentists, Bad Drivers, and Abandoned Oil Wells: A New Approach to Reconciling Provincial Regulatory Regimes with Federal Insolvency Law" (2017) 80 Sask L Rev 157, *Redwater*, *supra* note 7, and *Newfoundland and Labrador v AbitibiBowater Inc* [2012] 3 SCR 443 [*Abitibi*].
[14] Henderson, *supra* note 2 at 1420.
[15] *Redwater, supra* note 7 at para 118.
[16] Benjamin Richardson, "Can Socially Responsible Investment Provide a Means of Environmental Regulation?" (2009) 35 Mona L Rev 262 at 263. See also *Redwater, supra* note 7, and *Mantle, supra* note 8. In both cases, the court pointed out that the lenders were aware of their borrower's enormous outstanding environmental reclamation obligations but went ahead with the financing.

b) Research Question

In a bid to address this problem, this thesis has developed the following research questions:

i) To what extent have SF and ESG measures declared by banks assisted financial investors in Canada in mitigating environmental risks and ensuring environmental protection through the investments they finance?

ii) Have bankruptcy laws enabled firms to internalize the costs of their production during restructuring or served as a conduit for companies to evade environmental rules?

In answering these research questions, this thesis will explore the concept of SF and the various approaches adopted by Canadian banks in integrating SF into investments. It will critically analyze the decisions of the Canadian courts on environmental reclamation obligations through a financial services lens and mirror how these decisions impact on lending. Based on this premise, the research will render a comparative analysis between the regulatory impact of ESG and SF practices on the environment and judicial control through *Redwater*. It will further interrogate which control mechanism offers better regulatory impact on the lending system, or the environment and why.

The research will also interrogate whether bankruptcy laws are used by firms to advance the course of environmental protection during reorganization or manipulated to thwart it. In doing so, the research will render detailed analysis of how corporations engage in this practice and inquire whether the objectives of bankruptcy laws have fostered environmental objectives. Based on its findings, the research will identify measures through which stakeholders and the government could collaborate to strengthen environmental protection mechanisms through the investment market.

The reason for this approach is twofold: first, to uphold environmental protection, which is crucial for public safety and societal wellbeing; and second, to create an investment environment system that sustains environmental objectives and promotes intergenerational equity.[17]

SF is an ethical investment strategy that focuses on reducing environmental risks, creates long-term stakeholder value,[18] and establish measures that seek to address how finance, investment and lending interact with economic, social and environmental factors for effective transition to a net-zero economy.[19] Apart from integrating corporate governance with ESG concerns,[20] SF is designed to integrate how financial investors could act ethically by prioritizing environmentally, just and ecologically sustainable future over the maximization of profits.[21]

c) Research Methodology

This thesis will adopt doctrinal and comparative methods to answer the research questions. In doing so, reliance will be placed on primary and secondary source materials. The primary source will be statutes such as the *Bankruptcy and Insolvency Act,*[22] the *Companies Creditors Arrangement Act* (*CCAA*),[23] the *Oil and Gas Conservation Act* (*OGCA*),[24] the *Pipeline Act* (*PLA)*,[25] amongst others, and judicial decisions. Secondary sources such as books and articles are explored to support the primary materials. The comparative approach will focus on Canadian SF

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[17] Anna Lund, "Elaborate Imagining: Rethinking Environmental Obligations in Canadian Insolvency Law" (2021) 71 UTLJ 302 at 320.
[18] Michael Vandenberg, "Private Environmental Governance'' (2013) 99 Cornel L Rev 129.
[19] Monetary Authority of Singapore (MAS), "Sustainability Report 2021/2022," online:https://www.mas.gov.sg/-/media/mas-media-library/publications/sustainability-report/2022/mas-sustainability-report-20212022-updated.pdf.
[20] Alex Nicholls, "Sustainable Finance: A Primer and Recent Development" (last visited 16 March 2023) at 2, online (pdf): https://www.adb.org/sites/default/files/institutional-document/691951/ado2021bp-sustainable-finance.pdf.
[21] Richardson, *supra* note 10.
[22] *Bankruptcy and Insolvency Act,* RSC 1985, c B-3, s 2 [BIA].
[23] *Companies Creditors Arrangement Act*, RSC 1985, c C-36 [CCAA].
[24] *OGCA, supra* note 12.
[25] *PLA, supra* note 12.

and ESG practices and judicial approaches towards environmental regulation and examine which measure imposes greater impact on the environment.

The research methodology also applies theory. In particular, the polluter-pays principle (PPP). The theoretical perspective lays a foundational brick to build the thesis and explores why regulatory frameworks should ensure only those who pollute the environment are made to pay, rather than externalizing the cost to third parties. A combination of the doctrinal, comparative, and theoretical methods provides a fine synthesis upon which this thesis is based.

d) Thesis Structure

This thesis is made of five chapters. Chapter One offers an understanding of the lending process, and explains the concepts of credit, debt, and security interest. It examines the concept of bankruptcy and traces its historical evolution into contemporary corporate reorganisation in the Canadian insolvency context. In doing so, the chapter examines whether the risks of loan default identified in the chapter is being mitigated through due diligence measures integrated in loan documents.

Chapter Two examines the PPP, provable claim and its interpretation by the courts. It also interrogates who should pay for cleanup costs using the Canadian insolvency context as a springboard. It explores how the objectives of bankruptcy legislations examined in Chapter One are applied by the Canadian courts in the resolution of insolvency disputes and their implications for stakeholders and the environment.

Chapter Three explores the concept of SF, ESG, and the relationship between SF and sustainable development and their application in the Canadian lending context. It uncovers various strategies deployed by Canadian banks in integrating the concept in their investment decisions and analyzes these strategies against the performance of individual banks.

Chapter Four interrogates whether the objectives of bankruptcy laws examined in Chapter One are being exploited by companies to evade environmental rules. The chapter uncovers various strategies deployed by firms to perpetuate this practice during reorganisation. It further examines whether judicial decisions on environmental reclamation obligations examined in chapter two offer greater protections for the environment than ESG and SF measures proclaimed by banks discussed in Chapter Three.

Chapter Five embodies the findings, and conclusions of this thesis. Based on its findings, the chapter concludes that although judicial control may project better environmental protection than ESG and SF measures, complementing both regulatory schemes with a deliberate financial policy framework by government to reflect best practices in lending, will impact more positively on the environment.

CHAPTER ONE

OVERVIEW OF THE LENDING PROCESS, THE CREDIT SYSTEM, DEBT, SECURITY INTEREST, BANKRUPTCY, THE CANADIAN INSOLVENCY REGIME AND ENVIRONMENTAL DUE DILIGENCE

1.1 Overview of the Lending Process

Access to financial capital is crucial for businesses to operate effectively.[1] These businesses often require credit to supplement working capital during periods of limited liquidity.[2] When those holding surplus capital consider the risk of default to be acceptable, they are presented with an opportunity to profit by extending loans to those in need. This exchange is the cornerstone of the credit system.[3]

Corporations can raise capital through individuals and institutional lenders such as banks; banks are traditionally known for the supply of financial capital used for financing commercial projects, start-up ventures or to effect rescues.[4] Banks offer the necessary liquidity to ensure that commercial transactions flow smoothly across the economy when needed.[5] They pool savings of depositors and lend out those savings and make it possible for depositors to earn interest on their savings, diversify lending and provide the technical and expert advice for the management of

[1] Roy Goode, *Principles of Corporate Insolvency Law*, 4th ed (London: Sweet & Maxwell, 2011) at 2 [Goode].
[2] Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law*, (United States: Beard Books, 2021) at 7-8 [Jackson].
[3] Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles,* 3rd ed (United Kingdom: Cambridge University Press, 2017) at 55 [Finch & Milman].
[4] *Ibid* at 55.
[5] Elizabeth Warren et al, *The Law of Debtors and Creditors: Texts, Cases and Problems*, 8th ed (United States: Aspen Publishers, 2020) at 9 [Warren et al].

loans, and serve as the medium through which the credit system achieves the objectives of economic development.[6]

When a person or corporation borrows money from another, a debtor-creditor relationship is created between the parties, and this interaction creates a contractual relationship between the parties; while the party creating the obligation is called the obligor or debtor, the party in whose favour the obligation is created is known as the obligee or creditor.[7]

A debtor is a person or an organisation that agrees to receive money from another party in exchange for a liability to pay back the money obtained in due course; and owes money to that other person or organisation with an agreement to repay with or without interest.[8] Debts can be long-term or short-term. Short term debts are usually repayable within one year and recorded as such under the corporation's current assets; and long term where the debt is repayable within a period above one year.[9]

A creditor on the other hand, is a person or organisation that provides money or loan to another party in exchange for receiving money at some future date with or without interest.[10] Creditors are generally classified as secured or unsecured creditors. Secured creditors offer loans in exchange for the debtor's assets pledged as collateral for the loan. While unsecured creditors do not require any collateral property from their debtors in exchange for the loan granted, in the event of default, they can only lay claim to the debtor's assets or any portion of it to satisfy the debt.[11]

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[6] *Ibid*.
[7] Charles F. Trower, *The Law of Debtor and Creditor: To Which is Subjoined a Table of Courts in England and Wales for the Recovery of Debts* (London: V. & R. Stevens & Sons, 1860) at 2.
[8] Corporate Finance Institute (CFI), "Debtor vs Creditor" (22 December 2022), online: *CFI* https://corporatefinanceinstitute.com/resources/commercial-lending/debtor-vs-creditor.
[9] *Ibid.*
[10] *Ibid.*
[11] *Ibid.*

The borrowing of money and the extension of credit facilitates the formulation of a critical document executed by the parties broadly referred to as a promissory note, which is an enforceable promise by the debtor to repay the creditor the principal amount owed over the agreed period of time together with the accrued interest.[12] A borrower may enter into a contractual arrangement for the extension of credit up to a certain approved limit or by an approved line of credit loan called a revolving credit which allows the borrower to withdraw on a line as may be required or for the purchase of goods and services with payment made after the delivery of the goods or performance of the service.[13]

Before a lender lends money or extends credit to a borrower, the lender must be sure to evaluate the borrower's credit report to determine the credit worthiness of the borrower; a credit report is a compilation of the debt history and bill payment record of the borrower.[14] Most business debts such as debts related to the routine purchase of goods are unsecured.[15] A creditor may also request security from the debtor, empowering the creditor to take possession of designated assets of the borrower, sell them, and apply proceeds towards the satisfaction of the debts in the case of default.[16] Ergo, to secure a debt simply means designated assets of the debtor act as a guarantee against the risk of default.[17]

As commercial activities have evolved, lenders have devised ingenious means of protecting themselves from the insolvency of their borrowers.[18] In certain jurisdictions like the United States, Australia and Canada, security legislations consider the economic function of title reservation and

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[12] Stephen P. Parsons, *The ABC of Debts: A Case Study Approach to Debtor Creditor Relations and Bankruptcy Law*, 4th ed (New York: Walters Kluwer, 2017) at 18 [Parsons].
[13] *Ibid* at 19.
[14] *Ibid* at 24.
[15] *Ibid.*
[16] *Ibid* at 25.
[17] Jerrold Mundis, *How to Get out of Debt, Stay Out of Debt and Live Prosperously: Based on the Proven Principles and Techniques of Debtor's Anonymous*, (New York: Bantam Books, 2012) at 19.
[18] Goode, *supra* note 1 at 6.

certain forms of leasing as a means of security on the ground that while the creditor may be the legal owner, the debtor becomes the economic owner and is therefore to be regarded as the person granting its property as security for the loan in the event of the default.[19]

1.2 Nature and Functions of Credit

The extension of credit from a lender to a borrower arises where the obligation to pay becomes due. Consequently, credit can be described as the contractual deferment of debt which has its historical existence prior to the evolution of financial institutions.[20] Viewed from this perspective, credit facilitates the smooth running and expansion of business and affords the corporation an opportunity to increase profit by engaging in diverse business interests without limitation from the paucity of funds; the higher the ratio of borrowed funds to shareholders' funds, the higher the profits, provided the business earnings exceed the cost of servicing the loans.[21] However, where business activities become unprofitable, the obligation to continue servicing the debt increases losses which may potentially result in business collapse; thus, the inability of corporations to access credit could impact negatively on the viability of the corporation to remain in business.[22]

For individuals, credit serves as a medium to strengthen the consumption patterns by means of borrowing against future income; and for corporations, it facilitates the mechanism of financing and investment decisions making.[23] A bank that lends money is a creditor just as a trader who extends credit on instalments; the solvency or insolvency of the debtor raises the question of who amongst the debtor creditors' claims should be satisfied first.[24] Creditors claims are satisfied

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[19] *Ibid*.
[20] *Ibid* at 1.
[21] *Ibid.*
[22] *Ibid* at 3.
[23] Jackson, *supra* note 2.
[24] *Ibid* at 7-9.

according to their ranking in relation to the pledged assets which is mainly determined by the time the creditor acquires a security in the debtor's assets.[25]

Credit typically manifests in three forms: bonds, loans, and deferred payment plans.[26] Bonds are instruments through which corporations or governments secure investment funds, offering investors regular interests and the returns of the initial investment at a predetermined date.[27] The nature of loans has been previously elaborated. Meanwhile, deferred payment plans are agreements to delay payments, not classified as loans, permitting businesses to acquire goods and services before payment and thus providing them with extra operational capital.[28]

1.3 Meaning and Historical Evolution of Debt

The term 'debt' has no fixed legal meaning and can denote duties and liabilities of wide variety; therefore, the best approach is to analyse the various uses in which the word debt has been put.[29] A debt refers to the obligation of one person, enforceable at law, to pay money, tender property, or provide services to another person or entity now or in the future.[30] Debt can mean that which is owed by one person to another particularly, money payable arising from and by reason of a prior promise or contract, but also from and by reason of any other ground of obligation.[31] As previously elaborated, a debtor is a person who owes a debt or liability and the person to whom the debt or liability is owed is called the creditor; a debt can be categorized into a consumer debt or business debt.[32] Whilst consumer debts refer to indebtedness incurred for personal, household, or family purposes such as an apartment lease, home mortgage, car loans, credit card debts

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[25] *Ibid* at 9.
[26] *Ibid.*
[27] *Ibid.*
[28] *Ibid.*
[29] Charles R.B. Dunlop, *Creditor - Debtor Law in Canada,* 2nd ed (Canada: Carswell, 1995) at 11 [Dunlop].
[30] Parsons, *supra* note 12 at 1.
[31] Dunlop, *supra* note 29 at 12.
[32] Parsons, *supra* note 12 at 2.

amongst others; business debts refer to indebtedness incurred for business purposes such as a lease or mortgage on business premises, business obligations for utility bills, insurance premiums, business taxes, employee salaries, money borrowed to acquire business assets or fund the operation of the business amongst others.[33]

The moral and legal obligation is on the debtor to pay his creditor, but in many cases the existence of the obligation to pay must be determined judicially. Hence, a more elaborate definition of the term was provided in the case of *Passaic National Bank C. Co v Eelman*, thus:

> The ordinary legal sense of the term *debt* is an obligation for the payment of money founded upon a contract, express or implied…Its technical meaning at common law was a sum of money due by certain and express agreement – that for which an action in debt or indebtedness would lie…But it is also used in the larger sense of that which one person is bound to pay to another under any form of obligation…that is its general significance…It is a word of large impute: in its popular signification, it includes all that is due to a person under any form of obligation or promise. In the main, distinguishing characteristic of such an obligation is that it is for a sum certain, or a sum readily reducible to a certainty…It is an obligation to pay a sum certain, or a sum which may be ascertained by a simple mathematical calculation from known facts, regardless of whether the liability arises from contract or is implied or imposed by law…Whatever the law enjoins one to pay takes the legal classification of a debt.[34]

From the quote, it is established that, for a debt to exist, a sum must be owed which may be certain or ascertainable by a mathematical calculation from the facts that would exclude unliquidated claims arising out of contract that would only become a debt in the real sense when the amount is fixed by the judgment of a court.[35] Another way of conceiving a debt is to restrict it to financial obligations arising out of contract express or implied.[36]

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[33] *Ibid*.
[34] *Passaic National Bank C. Co v Eelman*, [1936] 183 A. 677 at 678 -70 [Passaic], cited in Dunlop, *supra* note 29 at 13.
[35] Dunlop, *supra* note 29 at 13.
[36] *Ibid.*

In medieval Roman Empire when the concept of commerce was in its early stage, creditors usually applied cruel means to recover debts from their insolvent debtors. The most common form of security was that the person who sold any form of commodity should receive a pledge from the party who bought it and to be restored upon the receipt of payment.[37] This appears to be an ancient mode of security as was the ancient law of France where no pledge was furnished and where the debtor became insolvent, the creditor was allowed to seize the debtor's property with the use of force.[38] The permission to sequestrate the property of the debtor upon default in the loan obligation, gave rise to oppression and disorder resulting in the issuance of Ordinance 1351, prohibiting creditors from seizing the assets of their debtors in the absence of a warrant from a magistrate.[39] In some cases, the debtor may have conducted itself in an uncomplimentary manner by incurring debts which it knew it has no viable means of repaying, or imprudently contracted the debts with the hope of repaying them at the due date. Although a reasonable person would have been prudent enough to know it has no reasonable means of doing so; and the creditor on the other hand, may have lured the debtor into engaging in the transaction with the aim of making extortionate profit out of it.[40]

Debts can be created consensually through loan or extension of credit by a creditor to a debtor, or non-consensually, by a court judgment or governmental mandate. Where the debt is unsecured, the debt is supported by nothing but by the debtor's bare promise to pay, while in a secured debt, the creditor retains the right to the debtor's personal and real assets in addition to the debtor's promise to repay the debt.[41] A debt may be fixed or non-contingent. A fixed or non-

[37] Charles Ellis, *A Treatise on the Law of Debtor and Creditor,* (London: J. Butterworth & Son, 1822) at 35-37.
[38] *Ibid.*
[39] *Ibid.*
[40] *Ibid* at 37-38.
[41] Parsons, *supra* note 12 at 17.

contingent debt is a debt that is owed at the moment without any act needed to be done for it to exist. A contingent debt on the other hand, is dependent on the happening of a particular act or the occurrence of a future event for it to exist.[42]

The common way of satisfying a debt obligation is through payment and payment in this sense denotes the transfer of money or performance of some act in discharge of the monetary obligation.[43] Payment is a consequential act which requires agreement of the debtor and the creditor. A debtor can discharge a debt by payment to the creditor personally, but where the creditor requires the debtor to pay a third party and the debtor subsequently pays that third party, such a payment will be effective to discharge the debt.[44] The rule applies even though the third party is not an actual agent of the creditor to receive payment, the debtor will still succeed if it can establish that the creditor held out the payee as having authority.[45]

Where the contract is silent regarding the place where payment is to be made, the debtor must seek out and pay the creditor at its place of business or residence provided one of them is within jurisdiction.[46] However, the above rule will be inapplicable where a place of performance is specified in the contract either expressly or by implication and the circumstances of each case.[47]

Where a debtor owes two or more debts to the same creditor, the question is to which of the debts should the payment be appropriated? The rule is that when a debtor is making a payment to its creditor, it may appropriate the money as it pleases, and the creditor must apply it. Accordingly, where the debtor is unable to make the appropriation at the time the payment was made, the right of application devolves on the creditor.[48] The appropriation whether express or

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[42] *Ibid* at 2.
[43] Dunlop, *supra* note 29 at 18.
[44] *Ibid* at 20-21.
[45] *Ibid* at 21.
[46] *Ibid* at 20.
[47] *Ibid*.
[48] *Ibid* at 23.

implied should be communicated to the other party;[49] and once appropriation has been made, the party who made it cannot subsequently resile from it.[50]

1.4 Security Interest

A security interest is an interest granted by a debtor to a creditor in real or personal property of the debtor authorizing the creditor to repossess and sell the collateralized property to satisfy the debt obligation in the event of default.[51] When a debtor borrows money from a creditor, the creditor requires some form of protection (security) for the money lent and in return, obtains a security interest in the debtor's assets should the debtor default in repayment, and with the aim of excluding all third party rights to the collateral property.[52] A collateral is a property or asset upon which a lender's security interest is granted to secure the loan obligation.[53] The risk of the debtor disposing off the secured assets to third parties explains why the parties should enter into a security agreement (SA) to secure the interest of the creditor in the debtor's assets.[54] The SA is an agreement entered into by a borrower and its lender using the debtor's assets as a pledge to cover the loan extended to the borrower; such an agreement is usually required prior to the extension of credit to cover operational expenses and cashflow operations of the corporation.[55] The SA attaches a security interest on a debtor's asset and for a security interest to be attached, the SA needs to be valid and binding on the parties.[56] A written SA is the best way to establish that the debtor granted a security interest in the collateral property; and for a secured lender to have a security interest, the

[49] *Ibid* at 24.
[50] *Ibid.*
[51] Parsons, *supra* note 12 at 25.
[52] Section 10 (1) *Personal Property Security Act*, RSA 2000 c P-7 [PPSA] [Alberta].
[53] Parsons, *supra* note 12 at 25.
[54] *PPSA*, *supr*a note 52, s 10 (1) (2) (a) (d) (i) - (v).
[55] Margaret Buchan et al, *Canadian Business Law*, 2nd ed (Toronto: Montgomery Publications, 2012) at 370 [Buchan et al].
[56] *PPSA, supra* note 52.

SA must grant a security interest and identify the collateral to which the interest is granted.[57] The creation and attachment of a security interest requires that the debtor must have rights in the property designated as collateral and must have powers to transfer those rights as the debtor cannot have a security interest in an asset it has no ownership interest in. Thus, the creditor must give value in exchange for the grant of interest in the collateralized property, and the debtor must also execute an SA containing an adequate description of the collateralized property.[58]

The security interest granted in a collateral extends not only to the named collateral, but also to proceeds of that collateral; although the SA usually states that proceeds of the collateral are subject to the creditor's interest, security interests are automatically attached to the proceeds of the collateral whether or not it was so stipulated in the agreement.[59] A security interest would attach to an after-acquired property of the debtor provided the debtor acquires an interest in it, and need not execute a fresh SA to get the attachment done; the SA can also apply to secure future advancement of credit or other indebtedness of the debtor other than the specific debt being secured.[60]

The creditor may proceed to perfect its security interest in the debtor's pledged assets which serves as a notice to the public of its interest in the collateral; the creditor can also perfect its security by taking physical possession of the pledged assets or by noting its interest in the certificate of title.[61] Where a debtor pledges the same asset as security for loans obtained from more than one lender, the earlier lender who had taken steps to register or perfect its security interest, takes priority over the latter lender in taking over the collateral in satisfaction of the debt.[62]

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[57] *Ibid.*
[58] Parsons, *supra* note 12 at 25.
[59] *PPSA, supra* note 52, s 12 (1) (a) (b) (c).
[60] Parsons, *supra* note 12 at 29-31.
[61] *PPSA, supra* note 52, ss 58 & 59.
[62] Buchan et al, *supra* note 55 at 371.

For the creditor's interest to be practically effective, the interest must be perfected; meaning that the creditor becomes the secured party.[63] For a security interest to be perfected, it must have attached to the collateral and the secured party must ensure all steps required for the perfection have been met.[64] Attachment ensures the security interest is enforceable against the debtor, while perfection protects the security interest against competing third party-claims; a security interest attaches to the asset when (i) value is given; (ii) the debtor has rights in the collateral; and (iii) the security interest becomes enforceable against the parties (unless the parties agreed to postpone the time of enforcement in the agreement).[65]

Although the perfection of the creditor's security interest may have less significance in the determination of liability between the debtor and the creditor, it is of greater relevance where there is competing interest by a third party laying claim to the collateral property, or a secured creditor who was granted a security interest in the same collateral; where two or more creditors hold a security interest in the same collateral, priority belongs to the holder of the security interest that was first perfected.[66]

1.5 Concept and History of Bankruptcy

Bankruptcy or insolvency in a corporate context means the inability of a corporation to pay its debts or fulfil its financial obligations to its creditors as they fall due;[67] or where the aggregate of its assets is not, on a fair valuation, sufficient, or if disposed of at a fairly conducted sale under a legal process, would be insufficient to meet the payment of all its obligations.[68] Derived from the Italian phrase *"banca rotta"* (broken bench), illustrates how the bench of the Italian merchant

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[63] *PPSA, supra* note 52, s 19.
[64] *Ibid,* s 19 (a) (b).
[65] *Ibid,* s 12.
[66] Parsons, *supra* note 12 at 32.
[67] Roderick J. Wood, *Bankruptcy and Insolvency Law*, 2nd ed (Toronto: Irwin Law, 2015) at 2 [R Wood].
[68] *Bankruptcy and Insolvency Act,* RSC 1985, c B-3, s 2 [BIA].

would be broken if they fail to pay their debts when they fall due.[69] Insolvency deals primarily with a debtor's inability to pay rather than a debtor's unwillingness to pay.[70] Thus, it arises where the debtor does not have sufficient asset to satisfy the claims of its creditors.[71]

Under Canadian law, a bankrupt is regarded as a person who has; (i) made an assignment under the *Bankruptcy and Insolvency Act* [*BIA*] for the benefit of creditors; (ii) unsuccessfully attempted a financial restructuring under the *BIA*; or (iii) is the subject of a bankruptcy order made under the *BIA*.[72] A debtor may become bankrupt either voluntarily or involuntarily; a creditor can initiate involuntary bankruptcy proceedings by applying to court for an order declaring that the debtor has committed an act of bankruptcy which requires the appointment of a trustee in bankruptcy.[73] The aim of the bankruptcy order is to vest the debtor's assets in the trustee for the benefit of the debtor's creditors and as a result, the trustee steps into the shoes of the debtor in relation to the assets.[74] Consequently, the rights of the trustee in the debtor's estate are subject to the rights of secured creditors under a perfected personal property security interest; whilst bankruptcy acts as a stay of all proceedings initiated by unsecured creditors against the bankrupt, secured creditors are allowed to exercise the right of repossession and disposition under the SA.[75]

In some pre-modern societies, a debtor had to pay their debt in full either with their property or with their person.[76] Under the Hammurabi Code, the King of Babylon empowered creditors to levy a pledge called *niputum* where a debtor failed to liquidate their debt as it fell

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[69] Warren et al, *supra* note 5 at 22.
[70] R Wood, *supra* note 67 at 2.
[71] *Ibid*.
[72] *BIA*, *supra* note 68, ss 2 (1), 57 (a), 16 (2) (a) and 63 (4).
[73] Kevin P. McElcheran, *Commercial Insolvency in Canada,* 4th ed (Canada: Lexis Nexis, 2019) at 1.
[74] *Ibid*.
[75] *Ibid*.
[76] Stephanie Ben-Ishai & Thomas Telfer, *Bankruptcy and Insolvency Law in Canada: Cases, Materials and Problems* (Toronto: Irwin Law, 2019) at 5 [Ben-Ishai & Telfer].

due.[77] Although the debtor's movable properties such as plough, grain and oxen could be excluded from sequestration, the creditor could conscript the debtor's wife, child or slave to work for the creditor until the debt was satisfied.[78]

In Ancient Greece, peasants could not foreclose on their properties as they were disadvantaged over the rich.[79] In 590 BC, Aristotle mounted an ideological condemnation of *usury* (extortionate lending), the Greek populist leaders issued a decree to release citizens from debts owed to their despised money lenders which later led to the emergence of the debtor protection theory.[80] Around the period of XII Tables of the Romans in 451 BC, a debtor who is unable to pay his debt was compelled to do so.[81] Although imprisonment was not abolished, the Romans developed a pragmatic procedure in preparing an assignment for the benefit of creditors which perhaps originated from a decree issued by Julius Caesar in form of a statue in 17 AD; although the assignment did not discharge the debtor of his debt, it exonerated him from arrest, imprisonment, slavery and loss of civil rights.[82] Thus, assignment was available only as of right to the debtor as what was required was a declaration by the debtor to his creditors through a letter that serves as an equivalent to the contemporary judgment enforcement procedure where unpaid creditors could have their debtor's assets sold for the benefit of all creditors in satisfaction of the debt.[83]

In early Roman bankruptcy procedures, the rights of creditors were treated as a pledge or attachment on the debtor's assets; bankruptcy was revived in Western Europe in the 13th century

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[77] *Ibid* at 6.
[78] *Ibid.*
[79] *Ibid.*
[80] Warren et al, *supra* note 5 at 26.
[81] *Ibid.*
[82] *Ibid* at 26 - 27.
[83] *Ibid* at 27.

first in the Renaissance Northern Italian cities, and later in Champagne and Brie.[84] Following the promulgation of *the law of Twelve Tables* and the *Edict of the Praetor*, the harshness of the old law was mitigated as creditors' rights over debtors were drastically reduced, thus marking the development of debtors' rights over creditors.[85]

At common law, a creditor must undergo a rigorous procedure to obtain an attachment of their debtor's property as execution cannot be levied against the debtor's entire estate, but only against the property listed in the writ.[86] In 1705, there was need to rehabilitate debtors, thus, a debtor who was a merchant could get a discharge of all their indebtedness provided they surrendered all their property and complied with statutory regulations.[87] Bankruptcy afforded an honest debtor the means of escaping the excruciating burden of debt, but dealt decisively with fraudulent bankrupts.[88] Although it was the Northern European credit economy that marked the emergence of banks, the evolution of banks was made feasible through the use of money as a medium of exchange; money in this context includes both coins and paper money; whilst the former existed from ancient times, the latter typically embodies a promise in exchange for gold.[89] This transitioned into a primary driver of credit as bank creditors have practically replaced trade creditors as the dominant creditors in bankruptcy.[90]

1.5.1 Causes and Effects of Bankruptcy

Bankruptcy has a pervasive impact on the legal and economic systems in relation to the enormous efforts exerted in preventing or managing it; the regulatory regime governing financial institutions creates a different dimension for controlling the attacks that threaten the credit

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[84] *Ibid*
[85] Ben-Ishai & Telfer, *supra* note 76 at 7.
[86] *Ibid*.
[87] *Ibid.*
[88] R Wood, *supra* note 67 at 31.
[89] Warren et al, *supra* note 5 at 28.
[90] *Ibid*.

system.[91] In contrast, the risk of bankruptcy is paramount considering that the fundamental objective of commercial transactions is to ensure repayment as the seller may retain title in the asset or goods in order to mitigate the risk of the buyer's insolvency.[92]

In construction contracts, provisions are made for insolvency protections such as vesting of title, retentions, dual payment and contract bonds; for leases, provisions are made for insolvency in the event of default permitting termination on the insolvency of the lessee.[93] In employment law, the priority of employees for their wages underscores policy objectives for reducing payments to address the impact of insolvency.[94] Similarly, the non-financial clauses in bank credit agreements are designed to protect against insolvency, this includes creditor equity clauses, negative pledge and cross-default clauses. These tools serve as shock mitigants in cases of default or financial distress.[95] The rationale for these protections is that where a counterparty is solvent, default can be remedied through damages or specific performance, the creditor has a fallback; conversely, where the counterparty is insolvent, the creditor has nothing to fall back on.[96]

The causes of bankruptcy have been traced to misfortune or mismanagement of borrowers; mismanagement includes overborrowing, poor product, too many employees, inadequate financial and costs controls, lack of preparedness for business cycles, uncommitted short-term borrowings vulnerable to business recessions and thoughtless financial ventures and acquisitions.[97] Misfortune outside the control of an insolvent corporation can be an uncommon contributing factor such as increased interest rate, currency depreciation, unpredictable economic collapses and natural

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[91] Philip R. Wood, *Principles of International Insolvency*, 2nd ed (London: Sweet & Maxwell, 2007) at 10-13 [P Wood].
[92] *Ibid.*
[93] *Ibid.*
[94] *Ibid* at 15.
[95] *Ibid.*
[96] *Ibid.*
[97] *Ibid* at 16.

disasters.[98] These factors emanate from causes such as government inefficiency; misfortune includes reasonable assumption of risk as all business activities have an inherent risk element.[99] Some bankruptcies are caused by fraud, embezzlement by top management staff, financial non-disclosure, or inflation of non-existing assets; others include isolated events such as improper insurance of risk and the unexpected failure of a major debtor resulting in a major risk with a ripple effect on other corporations.[100]

1.5.2 Aims and Objectives of Bankruptcy Law

One major goal which bankruptcy law seeks to achieve is to install a legal regime for the orderly realization and collection of the debtor's assets according to the claims of creditors.[101] These objectives can broadly be categorized into two: liquidation and rescue. Whilst liquidation seeks to ensure the debtor's assets are distributed in a fair and equitable manner to creditors, rescue aims at preserving the corporation as a going concern by persuading creditors to accept less of the total debt owed (restructuring and compromise) to enable the insolvent corporation to make a fresh start.[102]

The realization and distribution of the debtor's estate equitably and fairly in line with the scheme of distribution is a major policy objective of insolvency legislations.[103] Provisions that seek to reduce the value of the bankrupt's interest in the estate have been held to be inoperative as they violate the public policy doctrine of fair and equitable distribution amongst creditors.[104] Providing an orderly and efficient means of realizing on the debtor's estate by determining

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[98] *Ibid* at 17.
[99] *Ibid.*
[100] *Ibid.*
[101] Finch & Milman, *supra* note 3 at 9.
[102] R Wood, *supra* note 67 at 4.
[103] Frank Bennett, *Bennett on Bankruptcy*, 10th ed (Toronto: CCH Canadian Ltd, 2008) at 32.
[104] *Ibid*.

legitimate debts and liabilities and applying the proceeds of disposition to those debts, along with discharging the bankrupt from the liabilities to enable it to make a new start, is of paramount importance to bankruptcy law.[105] These can only be achieved if existing and potential bankruptcy proceedings of the bankrupt's creditors are stayed and creditors are able to satisfy the trustees of the validity of their claims. Once the nature and extent of the bankrupt's indebtedness are established, the bankrupt's estate is distributed commensurably against those debts based on the scheme of priorities provided by law.[106] Ensuring the process of distribution is administered fairly and honestly affords the bankrupt an opportunity to retain the surplus.[107] The more assets the debtor is allowed to keep, the better the debtor's start becomes; in contrast, the debtor's retention of the assets reduces the amount of creditor's recovery in satisfaction of the claims against the debtor.[108]

Bankruptcy legislations seek to maximize the value of the debtor's estate and ensure the maximization of returns to creditors. By eliminating individual creditor's claims against the debtor's assets, it facilitates the collective interests of creditors by providing an enforcement mechanism where the debtor's estate is administered to satisfy creditors' claims and maximize returns.[109] The aim of maximizing returns to creditors underscores the fundamental assumption underlying the collective approach.[110] The collective scheme prevents the depletion of the debtor's assets which would have defeated the purpose of the legislation if individual grabs were allowed

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[105] *Ibid*.
[106] *Ibid.*
[107] Finch & Milman, *supra* note 3 at 27.
[108] Douglas J. Whaley & Jeffrey W. Morris, *Problems and Materials on Debtor and Creditor Law,* 4th ed (New York: Aspen Publishers, 2009) at 2.
[109] Goode, *supra* note 1 at 61.
[110] *Ibid.*

to reign supreme.[111] Thus, bankruptcy law is concerned primarily about the maximization of the value of a given pool of assets and not how the law should allocate entitlement to the pool.[112]

The provision of rankings for creditors' claims has been a cardinal objective of bankruptcy legislations; the ranking system provided by insolvency law has facilitated a legal framework where creditors' claims are satisfied by ensuring that the bankrupt's estates are distributed in order of priority.[113]

A cardinal goal of bankruptcy legislations is to ensure insolvent corporations recover from financial distress and continue to operate as a going concern. Using rescue as a recovery tool, bankruptcy legislations provide a platform where the affairs of insolvent corporations could be managed, administer and control its own affairs and eventually be restored to solvency.[114] Rescue is a reorganization and restructuring scheme aimed at enabling insolvent corporations reorganize their affairs with an understanding with their creditors as the value of the debtor's assets may not be sufficient to satisfy all competing claims of creditors.[115] Where difficulties encountered by a corporation is temporary and its business operations are still virile, the preservation of the ownership of the corporation and its business entity becomes the most prudent.[116]

Bankruptcy seeks to ascertain the causes of insolvency and decide what measures should be deployed to discharge the undesirable conduct of debtors and creditors by enforcing the settlement of debts.[117] It enforces business standards and commercial integrity in order to sustain confidence in the insolvency regime by uncovering assets concealed from creditors and ascertain

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[111] Jackson, *supra* note 2 at 9 & 20.
[112] Finch & Milman, *supra* note 3 at 27.
[113] *Ibid* at 2.
[114] Jackson, *supra* note 2 at 2.
[115] Andrew R. Keay & Peter Walton, *Insolvency Law: Corporate and Personal*, 4th ed (Bristol: LexisNexis, 2017) at 137.
[116] Rebecca Parry, *Corporate Rescue* (London: Sweet & Maxwell, 2008) at 2.
[117] Finch & Milman, *supra* note 3 at 27.

the validity of creditors' claims while uncovering the circumstances of business failure; it also offers a framework to produce practical solutions to commercial and financial problems in a flexible and comprehensive manner.[118]

Apart from ensuring a timely, efficient, and impartial resolution of insolvency and striking a balance between liquidation and reorganization, bankruptcy law provides market certainty to facilitate economic stability and growth; it recognizes creditors' rights and establish clear rules for ranking of priority claims.[119] These objectives are designed to increase the efficiency, predictability and transparency of the insolvency process and ensure the availability of assets to satisfy creditors' claims whilst reducing the cost of credit.[120]

1.6 Outline of the Canadian Insolvency Regime

The insolvency regime in Canada at the federal level is governed by the *BIA*[121] and *CCAA.*[122] Other enactments such as the *Environmental Protection and Enhancement Act,*[123] *the OGCA,*[124] *the PLA,*[125] and the *Surface Rights Act*,[126] will also be considered in their area of relevance during the analysis in this thesis.

The aim of the Canadian insolvency regime is to offer the corporation an opportunity to make a fresh start, ensure fairness to creditors and finality in insolvency proceedings for the debtor, afford creditors an opportunity to be part of the insolvency process and share in the estate

[118] *Ibid* at 27.
[119] R Wood, *supra* note 67 at 4 - 5.
[120] *Ibid* at 5.
[121] *BIA, supra* note 68.
[122] *Companies Creditors Arrangement Act*, RSC 1985, c C-36 [CCAA].
[123] *Environmental Protection and Enhancement Act*, RSA 2000, c E-12 [EPEA].
[124] *Oil and Gas Conservation Act,* RSA 2000, c O-6, ss 27-30 [OGCA].
[125] *Pipeline Act*, RSA 2000 c P-15 ss 23-26 [PLA].
[126] *Surface Rights Act*, R.S.A. 2000, c S-24 [SRA].

proceeds.[127] It also maximises returns for creditors,[128] uncovers the causes of insolvency and ensures equal distribution of losses.[129]

Broadly, the primary objective of the *BIA* is to ensure the insolvent corporation's financial rehabilitation and the equitable distribution of the bankrupt assets among creditors.[130] But where it becomes impossible for the insolvent corporation to recover from bankruptcy, only the latter objective applies.[131] Similarly, the *CCAA* provides for "a variety of objectives including ensuring a timely, efficient and impartial resolution of the debtor's insolvency, preserving and maximizing the value of the debtor's assets, ensuring the fair and equitable treatment of claims against a debtor and protecting public interest".[132] However, where reorganisation is impossible, a liquidation that preserves the on-going business operations of the corporation becomes the relevant concern.[133] The *CCAA* fulfils its overall objectives by creating a special supervisory role for judges.[134] The *CCAA* makes provision for the appointment of a monitor who is saddled with the responsibility to report the debtor's financial activities to the court.[135] The *BIA* also makes provision for insolvent corporations to reorganise their businesses by reaching an understanding with creditors.[136] Where reorganisation under the *CCAA* fails, the *BIA* scheme of liquidation and distribution applies.[137] The equitable distribution of claims to creditors is made possible through the priority scheme created by statute.[138] This priority provision includes secured claims which may be subject to some

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[127] *Newfoundland and Labrador v AbitibiBowater Inc* [2012] 3 SCR 443 at para 35 [*Abitibi*].
[128] Jackson, *supra* note 2 at 7 - 8.
[129] Elizabeth Warren, "Bankruptcy Policy" (1987) 54 Univ Chic L Rev 40 at 778.
[130] 9354-9186 *Québec inc v Callidus Capital Corp*, 2020 SCC 10 at paras 46 - 47
[131] *Ibid.*
[132] *Ibid.*
[133] *Ibid.*
[134] *Ibid.*
[135] *CCAA*, *supra* note 122, s11.7.
[136] *BIA*, *supra* note 68, s 50.
[137] *Century Services inc v Canada (AG)*, 2010 SCC 60 at para 23.
[138] *BIA*, *supra* note 68, s 141.

exceptions.[139] The priority preference accorded to a variety of claims in the insolvency process is facilitated by the intention of Parliament.[140]

Having identified that the risk of default is the main reason lenders impose measures to recoup their security interest as exemplified in classical lending processes earlier examined, debtors were directly impacted as creditors-imposed recovery measures considered harsh and unfriendly.[141] As time progressed, lenders developed new strategies to guard against default risks from their borrowers. Given that the timely repayment of a loan is a major concern for commercial lenders, the assurance that the collateral is tangible enough to secure the borrower's obligation in the event of default, occupies the focus of due diligence.[142] Although FIs have been viewed as contributors to environmental problems by providing capital to firms whose activities pollute the environment,[143] environmental issues have imposed major risks to creditors including impacting on the ability of their borrowers to repay the loan and the value of the collateral.[144] These risks could range from credit risk, direct/legal risk, regulatory and reputational risks. Whilst credit risks relate to environmental problems that impinge on the borrower's ability to repay the loan and its impact on the asset securing the loan,[145] legal risks arise where the lender assumes ownership or takes possession of the borrower's assets.[146] Reputational risk is linked with the relationship of the corporation whose business activities are considered to be harmful by the public, to the

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[139] *Ibid*, s 136.
[140] *Alberta Attorney General v Moloney,* 2015 SCC 51 at para 35.
[141] Ben-Ishai & Telfer, *supra* note 76 at 7.
[142] Mathew Kimball "Environmental Strategies for the Real Estate Lender" (1991) 17 Real Est Fin 13 [Kimball].
[143] Benjamin Richardson, *Socially Responsible investment Law: Regulating the Unseen Polluters* (New York: Oxford University Press, 2008) at 2 - 3.
[144] Michael Powell, "Avoiding Lender Liability for Environmental Contamination" (07 March 2018), online: *GFR Law* https://www.gfrlaw.com/what-we-do/insights/avoiding-lender-liability-environmental-contamination [Powell].
[145] David Carse, "Environmental Issues and Their Implications for Financial Institutions in Hong Kong" (Address delivered at the Conference on Environmental Risk Management for Hong Kong Financial Institutions, Hong Kong, 29 November 2000) [unpublished] online: https://www.bis.org/review/r001129c.pdf.
[146] Powell, *supra* note 144.

contaminating asset.[147] The odium associated with the contaminated property is extended to the lender due to the nexus between the lender and the property securing the loan.[148] Regulatory risk arises from failure to comply with securities and financial services disclosure requirements.[149]

These factors have impacted negatively on the performance of financial investors where environmental related issues impact on loan defaults.[150] Although the cost of remediating a contaminated property may impact negatively on the borrower's ability to repay the loan, the lender must exercise some practical steps to mitigate these risks as they may impact negatively on its security interest.[151] These mitigating strategies are examined below.

1.7 Environmental Due Diligence

Absent deliberate government policy framework, lack of thorough due diligence and poor ethical finance practices by FIs may have contributed to the increase in environmental reclamation issues in Alberta.[152] Due diligence within the context of lending is the standard of conduct and degree of diligence necessary to resolve all important issues facing a transaction.[153] It includes two essential components: first, a focus on relevant factors and second, applying the degree of due diligence appropriate for the relevant transaction. Failure to capture these two milestones would render the due diligence outcome ineffective and unable to identify the transaction risks it intended

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[147] *Ibid.*
[148] *Ibid.*
[149] Janis Sarra, "Climate-Related Legal Risks for Financial institutions: Executive Brief" (August 2021) at 1, online (pdf): *Global Risk Initiative* https://ccli.ubc.ca/wp-content/uploads/2021/08/Climate-related-legal-risks-for-financial-institutions-Executive-brief.pdf.
[150] Dongmei Qu, "Lender Liability of Commercial Banks in Environmental Tort: Focusing on American Law" (2010) 3 J Pol & L at 94.
[151] Powell, *supra* note 144.
[152] See *Mantle Materials Group Ltd v Travelers Capital Corp* [2023] ABCA 339 (CA), aff'g *Re Mantle Materials Group Ltd* [2023] ABKB 488 at paras 42 - 43 (KB) [*Mantle*].
[153] Kymn Harp, "Give Them Their Due: Due Diligence in Commercial Real Estate Transactions" (2011) 25 Prob & Pty at 40.

to guard against.[154] Before proceeding with the environmental due diligence process, the lender must develop a due diligence plan based on the nature of the transaction and the borrower's kind of business activity. This should cover areas such as potential sources of environmental risks, relevant environmental regulation, present and past environmental records of the borrower, nature of the collateral and availability of insurance.[155] Because the borrower's asset may not disclose potential signs of environmental hazard at the commencement of the loan transaction, innocuous looking properties have later turned out to trigger future environmental problems.[156] Thorough due diligence requires the lender to look beyond the borrower's financial status to include a deeper understanding of regulatory factors that may not only impact on the borrower's ability to repay the loan, but on the lender's liability.[157] The due diligence process may take the following forms:

(a) Investigating the Borrower's Business History and Compliance with Environmental Regulations

To comprehensively evaluate the borrower, a prudent lender must scrutinize the borrower's business to assess the level of exposure to environmental risks and its history of compliance with environmental regulations;[158] this also extends to accessing the borrower's records evidencing ownership of the collateral.[159]

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[154] *Ibid* at 42.
[155] Robert Whetzel & Todd Coomes, *Commercial Real Estate Loans: Environmental due Diligence for Lenders* (United States: Practical Law Publishing, 2013), at 2-3, online (pdf): https://www.rlf.com/wp-content/uploads/2020/05/6989_Commercial-Real-Estate-Loans-Environmental-Due-Diligence-for-Lenders-3-525-2072.pdf [Whetzel & Coomes].
[156] Mitchell Bell et al, "Environmental Due Diligence in Real Estate Lending Transactions and Conveyances" (1998) 25 Bull Sec Corp Banking & Bus L 1 at 2 [Bell et al].
[157] Kimball, *supra* note 142 at 18.
[158] *Ibid* at 18 - 20.
[159] Brett Sullivan, "The Devil is in the Details: Due Diligence in Commercial Real Estate Transactions" (2016) 33 GP Solo 35 at 36.

(b) Investigating the Collateral

A financial investor contemplating extending credit to a borrower must be prudent enough to conduct due diligence on the property provided by the borrower as security for the loan.[160] In reaching this decision, the lender must determine whether accepting real property is suitable or an alternative exists; the lender must also inquire into prior ownership of the property and the jurisdiction where the property is situate to detect prior environmental defects including evidence of distress in the topography of the property, contaminated soil, leaking pipes, valves, and turbid surface water, distressed areas, noxious odours and wastes.[161] The on-site assessment determines whether it is safe to proceed with the transaction from an environmental standard perspective.[162] It should also reveal waste oil management practices, underground and above ground storage tanks, raw materials management practices, pollution control equipment, onsite waste disposal management systems, amongst others.[163]

(c) Drafting the Loan Agreement

Whilst the loan agreement constitutes a critical component containing salient provisions of the loan transaction, it is imperative to commit the borrower towards fulfilling environmental obligations.[164] The document should be worded to contain clauses that exculpate the lender from potential future environmental liabilities.[165] Where due diligence discloses potential environmental risks, the lender should incorporate contractual clauses such as indemnification

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[160] *Ibid* at 18.
[161] Bell et al, *supra* note 156 at 11 - 12.
[162] Whetzel & Coomes, *supra* note 155 at 3.
[163] Bell et al, *supra* note 156 at 12 - 13. In this context, it is imperative to add that, although the oil reserves may be used in secure debt financing, the AROs related to the brownfield cleanup become material to repayment. Thus, the due diligence of costs remains germane.
[164] Kimball, *supra* note 142 at 19.
[165] Powell, *supra* note 144 at.

from a guarantor and opening an escrow account to cover the cost of potential environmental claims.[166] A lender's loan document should be ambitious enough to contain the following factors:

(i) Environmental Audit

Environmental Audit undertaken by an independent environmental consultant should constitute a major covenant in the loan document.[167] The environmental audit must be conducted by an environmental audit consultant; an environmental consultant is a professional who possesses sufficient education, training, and experience necessary to exercise professional judgment to develop opinions and conclusions regarding conditions indicative of releases or threatened releases on, at, in, or to a property sufficient to meet the requirements of the rule.[168] The audit should entail an investigation of the borrower's environmental compliance; a corporation basically performs a compliance audit to determine if its existing operations are in compliance with applicable environmental requirements by comparing those operations against a checklist designed for the kind of business the firm is engaged in.[169] The report should identify potential environmental concerns and the cost of remediation as may be required by regulatory authorities. This should be made available to the lender in advance to afford it sufficient time to review and make informed decision regarding the loan request.[170] The lender should be made a third-party beneficiary to any contract between the environmental consultant and the borrower as this would afford the lender the right of claim against the environmental consultant where the environmental audit turns out awry.[171] Where the consultant is hired at the behest of the borrower, the lender must retain its own

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[166] *Ibid.*
[167] Kimball, *supra* note 142 at 19.
[168] Joseph Forte, "Environmental Due Diligence: A Guide to Liability Risk Management in Real Estate Transactions'' (2007) 42 Real Pty, Prob & TJ 443 at 481 [Forte].
[169] Jeff Civins, "Environmental Law Concerns in Real Estate Transactions" (1990) 43 Southwtn LJ 819 at 829-830.
[170] Kimball, *supra* note 142 at 19.
[171] Philip Schworer & Catherine White, "Environmental Problems and Their Effect on Lending Institutions" (1999) 18 Northn Kent L Rev 175 at 192 [Schworer & White].

environmental consultant to review the findings of the borrower's environmental consultant.[172] The primary role of the consultant is to identify and evaluate potential environmental risks and their impact on the secured assets and recommend ways of mitigating those risks.[173] The environmental audit comes in phases; whilst the Phase I assessment inquires into the previous ownership and use of the property to identify Recognized Environmental Conditions (REC) that may affect the property, impose liability on the parties and determine whether the conditions require further investigation to elicit environmental information necessary to negotiate the terms and conditions of the loan, the Phase II is required only where Phase I identifies a REC, which requires further investigation by the consultant.[174]

(ii) Representations and Warranties

The loan document must contain representations, warranties, and covenants to guard against liabilities that may arise from the borrower's business.[175] Consequently, care should be taken to ensure the clauses are properly worded to absolve the lender directly or indirectly from any environmental liability should the borrower become insolvent.[176]

(iii) Notice of Violation

The borrower should be made to covenant that it has no notice of violating any environmental regulation, pending or potential, and undertake to provide such notice to the lender at any time it arises during the loan period.[177] The representations should contain a condition

[172] Whetzel & Coomes, *supra* note 155 at 3.
[173] *Ibid.*
[174] *Ibid* at 4 & 8.
[175] Kimball, *supra* note 142 at 20.
[176] *Ibid.* Whilst this may be relevant, it does not confer priority to the lender over the debtor's estate during bankruptcy proceedings.
[177] Forte, *supra* note 168 at 477.

requiring the borrower to furnish the lender with requisite notice of any release of hazardous substances or contamination with the premises where business activities take place.[178]

(iv) Compliance With Relevant Statutes and Disposal of Hazardous Wastes

The borrower should be made to covenant on the type of activity it intends to carry out on the property and undertake to comply with relevant regulations including compliance with present and future legislations.[179] The lender should also ensure the borrower covenants to properly dispose all hazardous wastes and substances as required by relevant federal and provincial regulations.[180] This is necessary to ensure responsibility for such disposal and the potential liability arising therefrom are not borne by the lender.[181]

(v) Indemnification

The borrower must covenant to undertake to indemnify the lender against all losses, damage, liability, and costs that may be incurred by the lender for breach of any covenant, representations, or warranties.[182] The lender should consider accepting personal guarantees of the borrower's principals as additional protection; and this should exclude any personal liability extenuating or exculpating provisions in the loan documents.[183]

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[178] *Ibid.*
[179] Kimball, *supra* note 142 at 20.
[180] *Ibid.*
[181] *Ibid.*
[182] Schworer & White, *supra* note 171 at 193.
[183] Forte, *supra* note 168 at 477. Personal liability exculpation provisions in this context refer to clauses in the loan contract that may diminish the ability of the lender to proceed against the principal shareholders of the borrower. As earlier noted, although these contractual provisions do not confer priority to the lender over the debtor's estate during bankruptcy proceedings, the personal guarantees act as additional security measures that enable the lender to commence recovery processes against the principal officers of the borrower outside the insolvency scheme.

(i) Environmental Right of Inspection

The loan documents should contain a clause permitting the lender to enter the borrower's business premises to conduct periodic inspections; this is to ensure the lender is satisfied that the borrower's operations are in consonance with regulatory standards.[184] Where the lender suspects the borrower is experiencing financing difficulties making it impossible to fulfil its loan obligations or compromising compliance with environmental standards, it becomes prudent for the lender to engage an independent environmental consultant from the bank's approved list of consultants or an internal auditor to recall the loan and activate recovery measures.[185]

1.8 Conclusion

This chapter has examined the key concepts of lending, the credit system, and bankruptcy from its historical roots to the Canadian context, thus, providing the reader an idea that forms the basis of discussion in subsequent chapters. It also uncovered lending risks, and how they impact on the borrower and due diligence processes that might be useful to the lender as additional security measures outside the insolvency context. The question of who should pay when these risk factors crystalize into environmental liability and how the Canadian courts apportion this liability among the relevant parties occupy the basis for discussion in the next chapter.

[184] Kimball, *supra* note 142 at 20.
[185] Schworer & White, *supra* note 171 at 193.

CHAPTER TWO

THE POLLUTER-PAYS PRINCIPLE (PPP), PROVABLE CLAIM, APPLICATION OF THE PPP WITHIN THE CANADIAN INSOLVENCY CONTEXT, EMERGING ISSUES, AND IMPLICATIONS FOR STAKEHOLDERS AND THE ENVIRONMENT

2.1 Introduction

This chapter discusses the PPP from its early conception and how it serves as a useful guide in determining liability for clean-up costs. With an explorative analysis of the various strands underlying the theoretical and philosophical perspectives of scholars on the subject, the chapter finds that although the views of proponents may differ, a corollary agrees that the overall objective underlying the principle is that pollution costs should be borne by those who cause them.

Based on this premise, the chapter proceeds to examine how Canadian courts apply the principle in determining liability for cleanup costs earlier stated in Chapter One. After exploring judicial decisions and the reasons behind those decisions, the chapter concludes that although judicial approach may be at variance with the PPP particularly where third parties are made to pay, it offers more impacts on lenders than borrowers thereby making creditors more conscious of the impact of their investments on the environment.

2.2 Concept and Meaning of the PPP

The question of who should pay for cleanup costs when the polluter becomes bankrupt has been at the heart of environmental liability management of oil and gas industries in Canada; the PPP has been used as basis for allocating liability for environmental damage.[1] What follows will focus on examining whether the polluter or a third party should pay for environmental damage. In answering this question, legal writers have shared their views on the matter.

[1] Nickie Vlavianos, "Creating Liability Regime for the Clean-up of Environmental Damage: The Literature" (1999) 9 J Envtal L & P at 150 [Vlavianos].

The PPP is a deeply entrenched principle in environmental law which stipulates that polluting entities are legally and socially responsible for the consequences of their pollution activities. First conceived as an economic theory and later consecrated into environmental law, the principle holds that those who pollute should be made to pay.[2] It seeks to integrate cleanup costs into the polluting entity that created the damage.[3] Pigou asserts that environmental costs should be internalized; otherwise market choices would be disrupted, and improper decisions would arise.[4] It is a cost allocation of environmental harm strategy that seeks to compel polluting firms to bear the costs of their production activities.[5] The PPP is an economic and environmental theory that underpins costs internalization.[6] It is an inherently economic theory turned into a legal theory that has assisted states in making policy decisions.[7]

First birthed by the Organization for Economic Co-operation and Development (OECD) in 1972, and further proclaimed internationally at the Stockholm Conference in Rio de Janeiro in 1992, the PPP posits that those who cause pollution should be made to pay.[8] It is a cost internalization mechanism that ensures that cleanup costs are borne by bodies whose polluting activities triggered the damage.[9] According to Paraschiv, the principle has an economic bearing because in a bid to prevent a situation where pollution costs arising from producing goods are borne by consumers, there is need for those costs to be borne by producers who caused them.[10]

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[2] Allan Keating, "The Polluter Pays Principle in Domestic Law" (2006) 28 Dub Uni LJ 172 at 173 [Keating].
[3] *Ibid.*
[4] Arthur C. Pigou, *The Economics of Welfare,* 4th ed (London: MacMillan, 1932) at 183.
[5] Antonio V. Garcia, "The Viability of the Principle of Polluter-Pays as a Concretion of the Principle of Economic Capacity in the Sustainable Environmental Development" (2019) 6 Tax F J 7 at 8.
[6] Edwin. Woerdman, Alessandra Aruri & Stefano Clo, "Emissions Trading and the Polluter Pays Principle: Do Polluters Pay Under Grandfathering?" (2008) 4 Rev L & Econs 565 at 573.
[7] *Ibid* at 579-580.
[8] Keating, *supra* note 2 at 173.
[9] Daniel-Stefan Paraschiv, "Basic Principles of Liability for the Acts Leading to Environmental Damage" (2015) 9 Agora Int'l LJ Juri Sci 18 at 19.
[10] *Ibid*.

Although the exact definition of the theory remains elusive, the OECD declares:

> The principle to be used for allocating cost of pollution and control measures to encourage rational use of scarce environmental resources and to avoid the distortions in international trade and investment, is called the "polluter pays" principle. This principle means that the polluter should bear the above-mentioned measures decided by public authorities to ensure that the environment is in an acceptable state. In other words, the cost of these measures should be reflected in the cost of goods and services which cause pollution in production and or consumption.[11]

2.2.1 Basis for Liability

Several reasons have been advanced as the basis for adopting the PPP. Larson argues that the disruption of trade by pollution activities could have been responsible for the adoption of the principle.[12] It ensures the cost of abatement is evenly distributed amongst pollutants.[13] Mamlyuk rationalized his position from the economic perspective of taxation holding that, the internalization of cost should be the reason why polluters should be taxed.[14] Nash believes that the principle has a pedagogical effect by encouraging individual responsibility for pollution in a general sense.[15] For him, the inclusion of the principle in the most important and far-reaching international statement of the fundamental principles of environmental law, demonstrates its significance at the global scale.[16]

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[11] OECD, *The Polluter Pays Principle: OECD Analyses and Recommendations,* OECD Environment Monographs (1992) online: https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=OCDE/GD(92)81&docLanguage=En.
[12] Eric Larson, "Why Environmental Liability Regimes in the United States, the European Community and Japan Have Grown Synonymous with the Polluter Pays Principle" (2005) 38 Vand J Transn'l L 541 at 548.
[13] *Ibid*.
[14] Boris N. Mamlyuk, "Analysing the Polluter Pays Principle Through Law and Economics" (2009) 18 Southeastn Envtal LJ 39 at 42.
[15] Jonathan Nash, "Too Much Markets? Conflict Between Tradable Pollution Allowance and Polluter Pays Principle" (2000) 24 Harv Envtal L Rev 465 at 468 & 479.
[16] *Ibid.*

2.2.2 The Polluter or the Public – Who Should Pay?

One critical question that runs through the liability thread is which of the public or the polluter should pay for environmental cleanup costs? The resolution of this question is critical as it runs through the strand of determining the liability cleanups in Canadian jurisprudence.[17] Sureties argues that where the cost of pollution is externalized, the burden of remediation is shifted to the public.[18] Vlavianos holds that it is a matter of policy choice to hold the private sector liable for cleanup costs rather than taxpayers; consequently, attempt should be made to exclude taxpayers from internalizing the burden of environmental cleanup.[19] Conversely, McDonald views the principle from a moral and ethical perspective and questions why a polluter should be made to pay retrospectively for an environmental harm where the actual polluter cannot be found; "if compensating benefits can be found that society or its representatives explicitly or implicitly accepted as compensation for lax or non-existent pollution rules, the case should be made for shared responsibility for site remediation".[20] Globerman and Schwindt view the PPP from an economic standpoint; for them, since the costs of identifying and quantifying third party damages attributable to site contamination are enormous, the polluter who had internalized the costs of pollution and benefitted from it, should be made to pay.[21] Nagle agrees with them and interrogates why the PPP should be extended to include liability for third parties; he concludes that only those who contributed to

[17] Michael A. Marion, Michael G. Massicotte & Jessica L. Duhn, "Canada's Aging Oil & Gas Infrastructure: Who Will Pay? The Public and Private Cost Recovery Frameworks" (2014) 52 Alta L Rev 331 at 332 & 363. See also Alexander Clarkson, "In the Red: Towards a Complete Regime for Cleaning up Environmental Messes in the Face of Bankruptcy" (2011) 69 UT Fac L Rev 31.
[18] Jeff Surtees, "Important Concepts in Environmental Law - Polluter Pays'' (2019) 43 Lawnow 49 at 50.
[19] Vlavianos, *supra* note 1 at 148.
[20] Michael McDonald, "An Inquiry into the Ethics of Retroactive Liability: The Case of British Columbia's Bill 26" (1995) 29 UBC L Rev 63 at 75 - 77.
[21] Steven Globerman & Richard Schwindt, "Economics of Retroactive Liability for Contaminated Sites" (1995) 29 UBC L Rev 27 at 41.

the damage should be made to pay for the cleanup costs as the PPP does not contemplate liability for third parties who did not contribute to the pollution.[22] However, Yates, takes a broader view; according to him, those who caused the damage and those likely to cause it, should be made to pay.[23]

2.2.3 The Polluter, the Beneficiary – Who Should Pay?

This part of the PPP touches on the party who is perceived to have benefitted from a firm's polluting activity by financing it business operations. In this context, the question has been asked whether a corporate investor can become liable for the polluting activity of a business firm by providing capital to fund the firm's business even though it did not take part in the pollution? Saxe believes that once a party benefits from a pollution activity whether the public or a corporate entity, it should be made to pay.[24]

However, Crowley and Thompson took a slightly different view; for them, there is no reason why the public should pay considering that those who benefitted from the pollution activities are the polluters themselves as the basis for imposing liability on the polluter is to match benefits with costs; since the polluter benefitted economically from the pollution, the polluter itself should bear the cleanup costs; but should not do so retrospectively.[25] While Unger, added that, although the beneficiary-pay approach may be compelling in the Alberta regulatory context for recognising that polluting activities do not operate in isolation, the problem lies in discerning the appropriate nexus between a given benefit and environmental costs.[26] According to him, benefits

[22] John Nagle, "CERCLA, Causation and Responsibility" (1994) 78 Minn L Rev 1493 at 1529.
[23] John B. Yates, "Unilateral and Multilateral Approaches to Environmental Problems" (1971) 21 UTLJ 182 at 191.
[24] Dianne Saxe, "Retrospective Liability for Environmental Contamination" (1992) 71 Can Bar Rev 492 at 506.
[25] Ruth Crowley and Fred Thompson, "Retroactive Liability Superfund and the Regulation of Contaminated Sites in British Columbia" (1995) 29 UBC L Rev 87 at 111.
[26] Jason Unger, *Clean Slate, Contaminated Land: The Untidy Intersection of Insolvency and the Polluter Pays Principle and Recommended Reforms to the Bankruptcy and Insolvency Act and the Companies Creditors Arrangement Act* (Edmonton: Environmental Law Centre, 2020) at 13 [Unger].

from firms flow to multiple recipients from the public purse through taxation; therefore, quantifying the relative benefit of a company's operations across creditors may be feasible, but the broader calculation of public benefit remains uncertain.[27]

2.2.4 Where the Polluter Becomes Insolvent, Who Pays?

Another significant question running through the liability net is, who bears liability for environmental damage where the polluter becomes insolvent? Gergen contends that, where the polluter is bankrupt and has no alternative of reducing the liability burden, the PPP becomes worthless; meaning that it amounts to an unfair way of allocating liability where third party financial investors like banks and financial institutions ("deep pockets"), who provided funding to borrowing firms ("empty pockets") are made to pay the cost of environmental harm caused by financially distressed corporations.[28] According to Gergen, this approach is problematic as the most financially endowed party is confronted with environmental claims to the exclusion of the financially less viable parties; this creates a situation where the more financially attractive parties are over-deterred whilst the financially distressed party becomes less-deterred.[29]

Conversely, providing the wealthier party the right to recover from other potentially liable parties becomes less useful where those other parties lack the financial capacity to satisfy environmental claims.[30] This limitation is further compounded by other legal rules which seek to protect the less financially viable parties from actual or *ex-post* liability.[31]

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[27] *Ibid.*
[28] Michael Gergen, "The Failed Promise of the Polluter Pays Principle: An Economic Analysis of the Landowner Liability for Hazardous Waste" (1994) 69 New York Uni L Rev 624 at 673 [Gergen].
[29] *Ibid.*
[30] *Ibid*.
[31] *Ibid* at 674.

Similarly, Adshead contends that making the most financially viable party responsible for environmental claims rather than the polluter, is faulty.[32] The financially viable party in this context broadly refers to private financial investors who provide funding for borrowing firms whose industrial operations give rise to pollution.[33] Although Richardson holds a contrary view and believes that corporate financial investors should bear the cost of cleanup for financing their borrower's activity that gave rise to the pollution,[34] Adshead holds that, the allocation of financial responsibility to private corporate investors raises a real challenge in the application of the PPP as this will impact third parties rather than the polluter.[35] For instance, under the regime of the Alberta Energy Regulator (AER), assets of a polluter with significant environmental liabilities are tailored towards satisfying environmental obligations ahead of creditors' claims.[36]

In a slightly similar fashion, Corriero argues that where the owner of a pollution site did not partake in the pollution activity, it should not be held liable for cleanup costs as that would be contrary to the tenets of the PPP.[37]

The general view from the above is that the objective of the PPP is to ensure the cost of cleanup is borne by those who caused the damage. Therefore, making third parties, whether third-party creditors or the public, bear the cost of environmental damage defeats the core objectives of

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[32] Julie Adshead, "Application and Development of the Polluter Pays Principle Across Jurisdictions in Liability for Marine Pollution: The Tales of the Erika and the Prestige" (2018) 30 J Envtal L 425 at 429 [Adshead].
[33] *Ibid.*
[34] Benjamin Richardson, *Socially Responsible Investment Law: Regulating the Unseen Polluters* (New York: Oxford University Press, 2008) at 3 & 4.
[35] Adshead, *supra* note 32 at 429.
[36] Unger, *supra* note 26 at 7 & 13. Also see *Orphan Well Association v Grant Thorton Ltd* [2019] 1 SCR 150 at para 46 [*Redwater*].
[37] Valeria Corriero, "The Social Environmental Function of Property and the EU Polluter Pays Principle: The Compatibility Between Italian and European Law" (2016) 2 Italian LJ 479 at 490.

the PPP. Thus, a spectrum of opinion by legal scholars agrees that the polluter who benefitted from the pollution activity should pay.[38]

2.3 Provable Claim

The question has been asked whether environmental orders issued by a regulatory body are provable claims that should be compromised in restructuring under the *CCAA*? The resolution of this question is paramount in determining whether the regulator issuing an environmental order is wearing the hat of a creditor even though it is garbed in the garment of an officer enforcing a public duty. Both the majority and minority opinion in *Abitibi* had differing perspectives on this matter. As a rule, regulatory orders are not provable claims unless they are monetary in nature and provable by a creditor.[39] A creditor has been defined as a person having a provable claim.[40] Thus, for there to be a claim there must be a creditor.[41] The *CCAA* defines a claim as "any indebtedness, liability, or obligation…that…would be a debt provable in bankruptcy within the meaning of section 2 of the *Bankruptcy and Insolvency Act*''.[42] Section 2 of the *BIA* provides that a "claim provable in bankruptcy, provable claim, or claim provable includes any claim or liability provable in proceedings under this *Act* by a creditor".[43] This provision is complemented by sections 121 (1) of the *BIA* and 135 (1.1) of the *CCAA*. Section 121(1) of the *BIA* provides thus:

> All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.[44]

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[38] See for example Gergen, *supra* note 28 and Adshead, *supra* note 32.
[39] *Newfoundland and Labrador v AbitibiBowater Inc* [2012] 3 SCR 443 at para 78 [*Abitibi*].
[40] *Bankruptcy and Insolvency Act,* RSC 1985, c B-3, s 2 [*BIA*].
[41] *Abitibi*, *supra* note 39, at para 78.
[42] *Companies Creditors Arrangement Act*, RSC 1985, c C-36, s 2 (1) [*CCAA*].
[43] *BIA*, *supra* note 40, s 2.
[44] *Ibid*, s 121(1).

Section 135 (1.1) provides that "the trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation".[45] Section 11.8(9) of the *CCAA* provides that "a claim against a debtor company for the cost of remedying any environmental condition or environmental damage affecting real property of the company, shall be a claim under this *Act*, whether the condition arose or the damage occurred before or after the date on which proceedings under this *Act* were commenced".[46]

Where environmental orders are not framed in monetary terms, the duty of the court is to determine whether the claim would eventually be subject to the claim process.[47] In this context, the court must determine whether the facts of the case disclose an inference that the environmental obligation would ripen into a financial liability owed to a regulatory body that issued the order.[48]

2.3.1 Examining the PPP Within the Context of Canadian Insolvency Law

As earlier noted in Chapter One, it is imperative to examine how the Canadian courts have fared in applying the PPP in determining when a regulatory obligation becomes a provable claim. Although the concept of provable claim is at the heart of Canadian insolvency law, at the commencement of insolvency proceedings, a regulator with a provable claim is stayed from enforcing it and the debtor can compromise the claim provable in the insolvency proceedings. However, a non-provable obligation is incapable of being released from insolvency proceedings and as a result, the regulator to whom a non-provable obligation is owed can still enforce it regardless of the insolvency proceedings.[49] Two Canadian cases will be explored to examine how

[45] *Ibid*, s 135(1.1).
[46] *CCAA*, *supra* note 42, s 11.8(9).
[47] *Abitibi*, *supra* note 39, at para 3.
[48] *Ibid*.
[49] Anna Lund, "Lousy Dentists, Bad Drivers, and Abandoned Oil Wells: A New Approach to Reconciling Provincial Regulatory Regimes with Federal Insolvency Law" (2017) 80 Sask L Rev 157 at 158.

the courts have fared in taking a decision on the matter and the reasons for those decisions. In *Abitibi*, the question was whether the environmental protection orders issued by the province of Newfoundland and Labrador were provable claims under the *CCAA*? To examine this issue, the facts of *Abitibi* are apposite and examined below.

2.3.2 Background Facts of *Abitibi* Case

AbitibiBowater Inc (the company) operates a paper and pulp business in the province of Newfoundland and Labrador.[50] Due to financial difficulties, the company announced closure of its mill in the province and filed for arbitration under the *North American Free Trade Agreement* (NAFTA).[51] Shortly after the closure, the province enacted the *Abitibi Consolidated Rights and Assets Act,*[52] and expropriated the company's property, denying it access to legal remedy.[53] The province issued orders under the *Environmental Protection Act*, (*EPA* orders),[54] requiring the company to remediate the industrial sites.[55] On the same day it issued the *EPA* orders, the province brought a motion for a declaration that the company's proposed reorganisation under the *CCAA* did not foreclose the province from enforcing the *EPA* orders as regulatory obligations, could not be considered claims under the *CCAA* and as a result, could not be stayed.[56] The company opposed the motion and argued that the *EPA* orders were stayed and subject to the claims procedure order

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[50] *Abitibi, supra* note 39 at para 5.
[51] *Ibid* at para 8. *NAFTA* is a free trade zone document for bilateral relationship between Mexico, United States and Canada. However, *NAFTA* has been replaced by the Canada-United States-Mexico Agreement (*CUSMA*) or US-Mexico-Canada Agreement (*USMCA*) which came into force on July 1, 2020. See International Trade Administration, "The US-Mexico-Canada Agreement (USMCA) Entered into Force on July 21, 2020, Replacing the North American Free Trade Agreement (NAFTA)" (last visited 10 December 2023), online: *International Trade Administration* https://www.trade.gov/north-american-free-trade-agreement-nafta, https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement. This document will be referred to as *CUSMA* throughout this thesis. See Carson International, "What is USMCA/CUSMA and What Does it Stand for?" (17 July 2020), online: *Carson International* https://www.carson.ca/2020/07/usmca-vs-nafta-whats-the-difference/.
[52] *Abitibi-Consolidated Rights and Assets Act*, SNL 2008, c A-1.01 [*Abitibi Act*]
[53] *Abitibi*, *supra* note 39 at para 6.
[54] *Environmental Protection Act*, SNL 2002, c E-14.2 [*EPA*].
[55] *Abitibi, supra* note 39 at para 9.
[56] *Ibid* at para 10.

as the *EPA* orders were monetary in nature and as a result, fell within a 'claim' in the claims procedure order.[57]

2.3.3 The Decision

Gascon J. of the Quebec Superior Court, dismissed the province's motion and declared the *EPA* orders stayed.[58] On appeal, the Court of Appeal upheld the findings of the Quebec's superior court and dismissed the appeal.[59] On further appeal to the SCC, the court found that the stay order did not affect monetary orders.[60] In reaching this decision, Deschamps J. formulated three-pronged tests to determine whether the *EPA* orders constituted provable claims that could be compromised under the *CCAA*: first, there must be a debt, a liability or an obligation to a creditor, second, the debt, liability or obligation must be incurred before the debtor becomes bankrupt; and third, it must be possible to attach a monetary value to the debt, liability, or obligation.[61] On the first prong, the court found that, where a regulatory body exercises its enforcement powers against a debtor, it identifies itself as a creditor.[62] On the second part, the court noted that the creditor's claim will be exempt from the single proceedings requirement if the debtor's obligation has not arisen during the time limit for inclusion in the insolvency process.[63] On the third prong, the court found that where a regulatory body frames its orders in monetary terms and claims an amount that is owed at the relevant date, what is being claimed constitutes an indebtedness which falls within the meaning of a claim.[64]

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[57] *Ibid* at para 11.
[58] *Ibid* at para 12.
[59] *Ibid* at para 13.
[60] *Ibid* at para 17.
[61] *Ibid* at paras 25-27.
[62] *Ibid* at para 27.
[63] *Ibid* at para 29.
[64] *Ibid.*

In the context of insolvency, there must be sufficient indications that the regulatory body that issued the orders will ultimately perform the remediation work and assert a monetary claim to have its costs reimbursed; if there is sufficient certainty in this regard, the court will conclude that the *EPA* order can be subjected to the insolvency process.[65] Having identified that the province acted as a creditor, the court concluded that if it was sufficiently certain that the *EPA* orders would eventually result in a monetary claim, then it becomes a provable claim.[66]

2.3.4 Applying the PPP

On the PPP, the province argued that treating a regulatory order as a claim in an insolvency proceeding extinguished the debtor's environmental obligations thereby undermining the PPP. The court found that subjecting an order to the claims process does not extinguish the debtor's environmental obligation, just as subjecting creditors' claims to that process does not extinguish the debtor's obligation to pay its debts as full compliance with orders monetary in nature will shift the cost of remediation to third-party creditors.[67] In the insolvency context, the court noted that accepting the province's position will result in the acceptance of a third-party-pay principle in place of the PPP.[68]

2.3.5 The Dissent

McLachlin C.J. and LeBel J. dissented; while McLachlin found that absent evidential records showing that the province would perform the remediation work, the *EPA* orders were not monetary claims that could be compromised and subjected to the claim process as environmental remediation orders impose regulatory obligations on the corporation to clean up the pollution;[69]

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[65] *Ibid* at para 36.
[66] *Ibid* at para 40.
[67] *Ibid*.
[68] *Ibid*.
[69] *Ibid* at paras 65 - 67.

LeBel disagreed with the McLachlin's formulation of the sufficient certainty test and preferred to adopt that offered by Deschamps.[70] He however agreed with McLachlin that regulatory obligations cannot be compromised, but are duties owed to the public.[71] But where the province does the remediation work itself, or it is sufficiently certain that it will do the work, the environmental obligations can be reduced to monetary claims that can be compromised under the *CCAA*.[72]

However, the findings of the court and the *Abitibi* test were modified in *Redwater* which took a different view on the *Abitibi* test and applied the PPP in ways that produced different results. To examine this issue, the facts of *Redwater*, are stated below.

2.3.6 Background Facts of *Redwater* Case

Redwater Energy Corporation (Redwater Energy), a public company with a registered office in Alberta, obtained funds from ATB Financial to be secured by Redwater Energy's present and future assets. At the time of obtaining the loan, ATB Financial was aware of significant AROs associated with Redwater Energy's assets.[73] Later, Redwater Energy started experiencing financial difficulties leaving outstanding indebtedness to ATB Financial to the tune of $5.1 million, prompting ATB Financial to appoint Grant Thornton Limited (the trustee) as a trustee.[74] Although the corporation owned 84 wells, 7 facilities and 36 pipelines when the trustee was appointed, 19 of the wells and facilities were productive, whilst 72 were inactive.[75] While Redwater Energy's net value of assets was negative, the trustee found that the cost of Redwater Energy's AROs in respect of the inactive wells would exceed the value of the active wells, making it impossible to

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[70] *Ibid* at paras 99 -101.
[71] *Ibid* at para 73.
[72] *Ibid*.
[73] *Redwater*, *supra* note 36 at para 46.
[74] *Ibid*.
[75] *Ibid* at para 48.

distribute proceeds to Redwater Energy's creditors after satisfying regulatory obligations.[76] Although the trustee abandoned and disclaimed the inactive wells in order to evade fulfilling regulatory obligations, the AER considered the disclaimed assets an environmental hazard which had to be remediated.[77] The trustee proceeded to sell the active wells and sought a court order preventing the AER from refusing to approve the transfer of licenses for the active wells.[78]

2.3.7 The Decision

Applying the *Abitibi* test, the chambers judge found that, although it was not sufficiently certain that the AER would perform the abandonment orders and assert a monetary claim for reimbursement, the situation met the third element of the test since the abandonment orders were "intrinsically financial" in a technical sense.[79] On appeal, the Court of Appeal upheld the findings of the chambers judge and dismissed the appeal.[80] On further appeal, the SCC allowed the appeal and found that, bankruptcy is not a license to disregard rules and since the AER is not asserting claims provable in bankruptcy, the corporation must comply with environmental obligations.[81] Applying the *Abitibi* test to determine when an environmental obligation translates into a provable claim, the SCC found that, whilst the second prong of the test was satisfied, the first and the third deserved some modifications. For the first test, the court stated that the AER is not a creditor as it acted in the public interest in issuing the abandonment orders as public obligations are not provable claims that can be compromised in bankruptcy.[82] The court distinguished the facts of *Abitibi* with the present case and stated that the facts in that case were unique and, after expropriating the

[76] *Ibid* at paras 49 - 50.
[77] *Ibid* at para 51.
[78] *Ibid* at para 52.
[79] *Ibid* at 55.
[80] *Ibid* at para paras 57 - 58.
[81] *Ibid* at paras 118 & 160.
[82] *Ibid* at paras 122 - 220.

company's property, the province never intended to perform the remediation work, but rather sought a claim that could be used to offset *Abitibi*'s *NAFTA* claim.[83] By contrast, in *Redwater*, the AER was acting in a *bona fide* capacity with no intent of monetary benefits but to ensure environmental protection for the benefit of the public.[84] Neither the AER nor the government of Alberta stood to benefit financially from the enforcement of these obligations; rather, they were public duties owed by the public to fellow citizens.[85]

On the third prong of the test, the court found that it was not sufficiently certain that the AER would perform the remediation work and advance a claim for monetary reimbursement as such, the claim was too remote and speculative to be included in the insolvency process.[86] On the PPP, the court noted that the Alberta regulatory scheme is designed to align with the PPP by assigning the responsibility of remediating environmental harm to those who cause it; it has the tendency to make firms conscious of environmental protection in their business activities.[87] In this sense, the court was of the view that allowing the trustee to abandon and disclaim the inactive assets would leave the cost of remediation to be borne by the Alberta public and taxpayers.[88]

2.3.8 The Dissent

On the *Abitibi* test, the dissent found that the first and the third prongs were satisfied. On the first prong, Côté J. determined that the AER acted as a creditor in respect of Redwater Energy's estate.[89] On the third prong, the dissent found that since it was certain that the AER or OWA would

[83] *Ibid* at para 125.
[84] *Ibid*.
[85] *Ibid* at para 135.
[86] *Ibid* at para 142.
[87] *Ibid* at para 29
[88] *Ibid*.
[89] *Ibid* at para 253.

perform the abandonment and reclamation and assert a monetary claim for reimbursement, the third part of the test was satisfied.[90]

On the PPP, the dissent wondered which outcome would optimally balance environmental protection and economic development as enforcing AER's environmental orders would on the one hand, displace Redwater Energy's estate leaving no recovery for creditors. On the other hand, allowing the trustee to disclaim the non-producing wells and preventing the AER from enforcing environmental obligations, raised the question of who should pay for remediating the land.[91] The dissent concluded that preventing the trustee from disclaiming the inactive wells displaced the PPP in favour of a lender-pays regime in which responsibility for the bankrupt's liabilities is transferred to the estate creditors.[92]

The above showed that the application of the PPP by Canadian courts has produced opposite results, leading to the emergence of two opposing camps. Whilst this thesis is not concerned about the merits of the postulations in both strands, it is noted that whether the position in *Redwater* or *Abitibi* applies, a third party still pays. Allowing the trustee to disclaim the inactive assets, transfers the cost of remediation to the public (third-party). Also, preventing the trustee from disclaiming the inactive wells transfers the cost of remediation to third-party creditors. Therefore, in either way the PPP is applied under the current regulatory framework in Canada, a third party still pays.

As earlier shown, the goal of the PPP is to ensure that those who pollute the environment are made to pay. Environmental cleanups are a natural consequence of operating activities in the oil and gas sector; whilst provincial regulations are designed to ensure the cost of remediation is

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[90] *Ibid.*
[91] *Ibid* at para 289.
[92] *Ibid* at para 291.

borne by polluters themselves, this result is only feasible where the polluter is solvent. Where the polluter becomes insolvent, the costs of remediation are shifted to either third-party creditors or to the public.[93]

2.4 Current Trends and Emerging Issues: Post-*Redwater* Prognosis

After the SCC released its decision in *Redwater* in 2019, subsequent decisions have emerged. These decisions touch on the same regulatory issues raised in *Redwater* and the courts have boldly affirmed the position of the law in *Redwater*. Whilst this is the case, this thesis finds that the emergence of these decisions indicates that the mischief which the current regulatory regime seeks to cure remains unabated.[94] Therefore, there is need to address this issue from the very source.[95]

Whilst recent decisions reaffirm the statement of law in *Redwater*, several have made novel contributions to the jurisprudence in a variety of ways, thus broadening the scope of the law. This enlarged status makes it imperative for financial investors to redouble efforts in strengthening their lending decisions, as there will no longer be an escape routes where their borrower's activities constitute a threat to public safety.[96] Several cases are examined below.

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[93] Jassmine Girgis, "Lessons from *Redwater*: Discard the AbitibiBowater Test and Legislate Super Priority for the Regulator" (01 March 2019) at 1, online (pdf): *ABlawg* *https://ablawg.ca/wp-content/uploads/2019/02/Blog_JG_Discard_AbitibiBowater_Test_Legislate_Super_Priority_for_Regulator_Feb2019.pdf*.

[94] See for instance *Mantle Materials Group Ltd v Travelers Capital Corp* [2023] ABCA 339 (CA), aff'g *Re Mantle Materials Group Ltd* [2023] ABKB 488 at paras 42-43 (KB) [*Mantle*], where the lender knew that the borrower had significant outstanding environmental reclamation obligations but proceeded to provide funding as was the case in *Redwater*.

[95] Gail Henderson, "Making Corporations Environmentally Responsible: The Limits of Responsible Investing" (2012) 13 German LJ 1412 at 1415.

[96] Eric Appelt & Sean Parker, "Get Your Priority Right: Case Law Update on the Intersection of Creditor Claims and Environmental Obligations" (05 September 2023), online: *Mclennan Ross* https://www.mross.com/what-we-think/article/get-your-priorities-straight-case-law-update-on-the-intersection-of-creditor-claims-and-environmental-obligations.

On February 10, 2022, the Alberta Court of Appeal in *PricewaterhouseCoopers Inc. v Perpetual Energy,*[97] determined that end-of-life obligations constitute an integral part of the value of a licensed asset which tends to reduce the value of the estate at the time of sale.[98] The court likened AROs to the asbestos in the walls of a house which will sooner or later be rectified and someone has to pay for it.[99]

The following month in the same year, the same court in *Manitok Energy Inc (Re),*[100] was called upon to determine whether end-of-life obligations associated with assets unrelated to the environmental condition could be applied to satisfy environmental obligations ahead of builders' lien claims? In that case, two building contractors provided services to Manitok Energy, prior to the latter's insolvency and they remained unpaid since 2018.[101] It was found that Manitok Energy had significant outstanding AROs and wanted to disclaim the inactive assets and sell the useful assets before the AER issued the enforcement orders.[102] The two lien holders claimed they had priority over Manitok Energy's creditors and the AER and as a result, their claim should be satisfied first.[103] Applying *Redwater*, the court found that if licensees are allowed to avoid abandonment and reclamation obligations by converting value assets into cash before an enforcement order is issued, there would rarely ever be related assets proceeds to satisfy reclamation obligations.[104] On that basis, the court concluded that the issue of unrelated assets to the business of oil and gas can be "left for another day".[105]

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[97] *PricewaterhouseCoopers Inc. v Perpetual Energy* [2022] ABCA 111[*Perpetual Energy*].
[98] *Ibid* at para 52.
[99] *Ibid* at para 54.
[100] *Manitok Energy Inc (Re),* [2022] ABCA 117 [*Manitok*].
[101] *Ibid* at paras 2 - 3.
[102] *Ibid* at paras 5 - 6.
[103] *Ibid.*
[104] *Ibid* at paras 29 - 30.
[105] *Ibid* at para 36.

In September 2022, the Alberta Court of Kings Bench in *Orphan Well Association v Trident Exploration Corp,*[106] was invited to resolve the priority contest between two public entities outside the priority scheme. In that case, Trident Exploration went into insolvency due to financial difficulties and offered all its useful assets for sale.[107] At the time of sale, Trident Exploration had significant outstanding AROs.[108] The question before the court was whether the obligation to pay municipal taxes confers priority on municipal governments over the priority of the AER? The court found that environmental obligations are not monetary obligations that can be reduced to provable claims. Whilst the AER acts as a safety net in ensuring those obligations are satisfied for public safety, the cost is not levied to generate revenue for the regulatory body. Municipal taxes, on the other hand, are raised to generate revenue for the municipality.[109] Therefore, the AER's priority must be satisfied before distribution to anyone else.[110] On the PPP, the court noted that liability had shifted from a polluter-pay to an everyone-pays regime as all those who had suffered financial losses in the insolvency of the corporation had been made to pay in one way or the other.[111]

Also, in *Qualex-Landmark Towers Inc v 12-10 Capital Corp,*[112] the court was called upon to determine whether the duty to enforce environmental obligations conferred on an environmental regulator might extend to a private citizen? In that case, Capital Corp owned the 12-10 property (the property) which caused some contamination that affected the property of Qualex Landmark Towers.[113] The Alberta Environment and Protected Areas Board (AEPA) issued a remediation

[106] *Orphan Well Association v Trident Exploration Corp,* [2022] ABKB 839 [*Trident*].
[107] *Ibid* at para 5.
[108] *Ibid* at paras 3 - 5.
[109] *Ibid* at paras 62 - 63.
[110] *Ibid* at para 66.
[111] *Ibid*.
[112] *Qualex-Landmark Towers Inc v 12-10 Capital Corp,* [2024] ABCA 115, rev'g *Qualex-Landmark Towers Inc v 12-10 Capital Corp,* [2023] ABKB 109 [*Qualex* (KB)].
[113] *Ibid* at paras 12 - 13.

order which Capital Corp did not comply with.[114] Meanwhile, Capital Corp had mortgaged the property to secure credit facilities from multiple lenders.[115] The Alberta Court of Kings Bench found that since environmental remediation obligation is a public duty owed to fellow citizens,[116] it does not matter whether the AER enforces that duty against a corporation in a formal insolvency proceedings as private citizens can enforce such claims on behalf of the AER.[117] On Appeal, the Court of Appeal set aside the findings of the Chambers Judge and found that the super-priority status conferred on the regulator by *Redwater,* does not extend to private citizens.[118] Private litigation is not equivalent to regulation in the public interest.[119]

And in October 2023, the Alberta Court of Kings Bench in *Mantle Material Group Ltd*,[120] was called upon to determine whether environmental obligations can be satisfied from the proceeds of assets unrelated to the environmental condition? In that case, Mantle Material Group (Mantle Group) obtained $1.7 million loan from Travelers Capital Corp (Travelers) for the purchase of working equipment, which also serves as security for the loan.[121] Due to financial difficulties, Mantle Group filed for restructuring to enable it comply with environmental remediation orders.[122] On whether Travelers should be allowed to realise from its security prior to completion of the remediation work by Mantle Group, Feasby J found that its entire assets including unrelated assets must be applied to satisfy environmental obligations ahead of creditor's claims; the assets of a corporation must not be treated as falling into different pools, as all assets

[114] *Ibid* at para 64.
[115] *Ibid* at para 33.
[116] *Ibid* at para 78.
[117] *Ibid* at para 89.
[118] *Ibid* at paras 22-24 (CA).
[119] *Ibid* at para 26.
[120]*Mantle, supra* note 94.
[121] *Ibid* at para 12.
[122] *Ibid* at para 17.

must be treated collectively to answer for the reclamation obligations.[123] Following *Manitok*, the court noted that the issue of unrelated assets in the oil and gas business will be left for another day.[124] On appeal, the Court of Appeal dismissed the appeal and found that environmental reclamation obligations are binding on the bankrupt estate and that obligation is not tied to the type of assets; although the distinction between assets unrelated to the oil and gas business was not drawn in *Redwater* and *Manitok*, that distinction was not relevant in this case.[125]

Whilst *Redwater* and *Manitok* took the position that all oil and gas assets must be treated as related to the environmental condition that attached to some of the oil and gas assets, *Trident* and *Mantle* extended that principle to include other assets used in the oil and gas business even though they were not directly involved in oil and gas production. Once unrelated assets are used for the business operations of the firm, they must be applied to satisfy environmental reclamation obligations.[126] On whether a lender should proceed to fund a borrower's business operations where there is evidence of significant environmental risk and outstanding environmental obligations, the court noted that a prudent lender who has conducted due diligence prior to entering the loan agreement should have the opportunity of weighing the risks before making lending decisions; since Travelers failed to do so, it cannot realise on its security until the remediation work is concluded.[127]

Whilst the above cases uncover the evolving state of the law, this thesis finds that, there is an increased need for lenders to strengthen their lending decisions. Although *Redwater* created some uncertainty regarding the realisation of a creditor's security interest when reclamation

[123] *Ibid* at paras 25 & 31.
[124] *Ibid* at para 34.
[125] *Ibid* at paras 20 – 25 (CA).
[126] *Ibid*
[127] *Ibid*, per Feasby J at paras 42 – 43 (KB).

obligations arise, the question of which assets should be applied to satisfy this obligation broadens this uncertainty.[128] In *Redwater* and *Mantle*, the courts pointed out that secured lenders in both cases were fully aware of their borrower's significant and outstanding environmental obligations, but still went ahead to provide funding.[129] On this basis, it is best for lenders in both cases to decline funding and order the borrower to make good its environmental condition before making a loan request as the Australian and New Zealand Banking Group did in Australia.[130] It strongly casts doubts about the potency of environmental risk abatement measures initiated by Canadian banks in their investments such as SF and ESG, this issue will be addressed later in Chapter Four.

2.4.1 Implications for Stakeholders and the Environment

Apart from ensuring borrowing firms cultivate environmental compliance practices, *Redwater* and decisions after it compel a strong environmental compliance culture among creditors. This is because creditors now stand to lose their security interest where borrowing firms become insolvent as the value of the estate will be applied to satisfy environmental obligations in priority.[131]

The decisions place strong emphasis on thorough due diligence and sound ethical lending practices on lenders when making lending decisions particularly to companies whose activities have the potential of involving significant environmental obligations. Where due diligence reveals environmental risks, this could serve as a red flag for a prudent lender to make an informed

[128] Jassmine Girgis, "What are Unrelated Assets When it Comes to Environmental Reclamation Obligations? The Lending Industry Needs to Know" (15 November 2023) at 3 - 5, online (pdf): *Ablawg* https://ablawg.ca/wp-content/uploads/2023/11/Blog_JG_Mantle.pdf [Girgis].
[129] See *Mantle*, *supra* note 94 at paras 42 - 43, and *Redwater*, *supra* note 36 at para 46.
[130] Benjamin Richardson, "Can Socially Responsible Investment Provide a Means of Environmental Regulation?" (2009) 35 Mona L Rev 262 at 264 - 265. In 2008, the ANZ bank was approached to fund Gunns Ltd ('Gunns'), a pulp mill in Tasmania to the tune of $1.4 billion. Having examined the environmental condition of the project, together with the negative publicity associated with it, the ANZ publicly declined to fund the project and decided to uphold high environmental standards and due diligence.
[131] Victor Kroeger, "After Redwater: What Now?" (07 February 2019), online: *MNP Debt* https://mnpdebt.ca/en/corporate/resources/blog/after-redwater-what-now [Kroeger].

decision.[132] This becomes imperative as super-priority in the environmental context has sprung beyond the realm of the oil and gas sector.[133]

The outcome of these decisions creates a regime that makes a third party pay contrary to the PPP. When a corporation becomes insolvent, either the lender or the public shoulders the environmental remediation burden even though they may not be responsible for their creation.[134] With limited assets available, these decisions favour the public, leaving creditors unexpectedly vulnerable to liabilities, and thereby altering the perceived risk of borrowers and escalating the cost of financing.[135]

There is also the potential of hindering the appointment of trustees in insolvency proceedings as there may not be funds to defray administrative costs.[136] Creditors may not wish to utilize formal insolvency proceedings where the AROs attached to the bankrupt's estate outweighs the potential value of the assets and the certainty of the trustee's fees may not be secured as no economic value may be derivable from the estate.[137] The question whether trustees would want to embark on such fruitless economic exercise is outside the scope of this thesis.[138]

The super-priority imposed by *Redwater* and decisions after it overrides the priority scheme which creditors have covenanted to when the loan agreement was executed. By displacing this priority, these decisions have lowered the predictability and certainty that the market economy

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[132] Aditya Badami, "Seismic Shift for Lenders to the Resource Sector: Supreme Court of Canada Rules That a Company's Environmental Liabilities Can Rank in Priority to Secured Debt" (April 2019), online: *Norton Rose Fulbright* https://www.nortonrosefulbright.com/en-ca/knowledge/publications/438efb98/seismic-shift-for-lenders-restructuring-news [Badami].

[133] Adam Maerov, Talia Gordner & Ryan Johnson, "Environmental Obligations Trump Lenders: The Trend Continues" (08 November 2023), online: *McMillan* https://mcmillan.ca/insights/publications/environmental-obligations-trump-lenders-the-trend-continues/ [Maerov, Gordner & Johnson].

[134] *Redwater*, *supra* note 36 at para 291.

[135] Kroeger, *supra* note 131.

[136] *Ibid.*

[137] Badami, *supra* note 132.

[138] Tom Cumming and Caireen Hanert, "Redwater Ruling's Implications for Oil and Gas Lending" (25 March 2019), online: *Canadian Lawyer* https://www.canadianlawyermag.com/inhouse/news/opinion/redwater-rulings-implications-for-oil-and-gas-lending/275975.

seeks to preserve and further heightens the tension about the availability of credit, future loans, and security interests.[139] The impact is not limited to oil and gas firms or secured lenders, but extends to municipalities, lien claimants and to all situations where environmental obligations owed to the public are not satisfied.[140]

Finally, as will be shown in Chapter Four, the decisions serve as a caution for lending investors to take potential environmental risks that may be associated with their borrower's business and ethical practices designed to mitigate those risks such as SF and ESG rules seriously.[141]

2.5 Conclusion

This chapter examined the judicial approach of Canadian courts towards environmental obligations and application of the PPP within the context of insolvency. After exploring the cases, the chapter finds that although environmental obligations remain sacrosanct in Canadian jurisprudence, *Redwater* has come to instill stronger regulatory control on the environment. FIs are beginning to realize that prioritizing environmental obligations is no longer a matter of choice as assets unrelated to the environmental obligations can still be applied to satisfy remediation obligations ahead of creditors' claims even when they have been converted into cash.[142] Where the competing claim is from a government institution like a municipal tax authority, environmental obligation still takes priority.[143] Only an environmental regulator has the powers to enforce environmental reclamation obligations for the public good; such powers are not available to private

[139] Jassmine Girgis, "Environmental Obligations Enforced Between Private Parties: The Extension of Redwater" (15 May 2023) at 3 & 4, online (pdf): *ABlawg* https://ablawg.ca/wp-content/uploads/2023/05/Blog_JG_Qualex.pdf.
[140] Maerov, Gordner & Johnson, *supra* note 133.
[141] Eric Appelt & Sean Parker, "Get Your Priorities Straight: Case Law Update on the Intersection of Creditor Claims and Environmental Obligations" online: *Mondaq* https://www.mondaq.com/canada/environmental-law/1363238/get-your-priorities-straight--case-law-update-on-the-intersection-of-creditor-claims-and-environmental-obligations.
[142] See *Redwater*, *supra* note 36, *Manitok*, *supra* note 100.
[143] *Trident*, *supra* note 106.

litigants.[144] Mortgagees in the real estate sector are also not exempted from this priority status extended to the environment.[145] An explanation of ESG and SF measures, and how they are applied by Canadian banks in investment practices, is set out in the following chapter.

[144] *Qualex, supra* note 112.
[145] *Mantle*, *supra* note 94.

CHAPTER THREE

CONCEPT AND HISTORY OF SF AND ITS APPLICATION IN THE CANADIAN LENDING CONTEXT

3.1 Introduction

This chapter examines the concept of SF and how it relates to sustainability. It traces the historical evolution of the concept and examines how it relates to sustainable development within the lending context. The chapter explores various strategies deployed by investment institutions in Canada in consecrating the concept and undertakes an analysis of how Canadian banks integrate it in their investment decisions.

3.2 Concept of SF

SF is an emerging term that has continued to gain prominence in recent times.[1] Also known as socially responsible investment (SRI), among other terms,[2] SF seeks to integrate environmental and social concerns into investment decision-making and aims at creating positive social change, mitigating environmental damage and incorporating ethical beliefs in lending decisions.[3] Whilst it seeks to reconcile ESG concerns with financial performance, it focuses on integrating ESG criteria into financial investment processes in the pursuit of long-term portfolio returns.[4] Based on this

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[1] CMS Green Governance, "Sustainable Finance" (last visited 16 March 2023), online: *CMS law* https://cms.law/en/media/local/cms-dsb/files/other/sustainable-finance.

[2] Cara Musciano, "Is Your Socially Responsible Investment Fund Green or Greedy?: How a Standard ESG Disclosure Framework can Inform Investors and Prevent Greenwashing" (2022) 57 Georgia L Rev 423 at 429 [Musciano]. Each of SF, SRI, Impact Investment (II), and Sustainable Investment (SI) will be used interchangeably in this work.

[3] Friederike Preu & Benjamin Richardson, "German Socially Responsible Investment: Barriers and Opportunities" (2011) 12 German LJ 865 at 866 [Preu & Richardson].

[4] Danyelle Guyat, "Corporate Social Responsibility: The Case of Long-term and Responsible Investment" in Alan Lewis, ed, *The Cambridge Handbook of Psychology and Economic Behaviour* (Cambridge: Cambridge University Press, 2012) at 157.

premise, SF can be described as an investment strategy that aligns with financial and ethical criteria; that is, an investment with a financial benefit and a non-financial interest.[5]

A sustainable business creates long-term stakeholder value by addressing environmental, social, and economic opportunities and risks critical to a corporation,[6] and establishes policy measures that seek to address how finance, investment and lending interact with economic, social and environmental factors and serve as an enabler for effective transition to a net-zero economy.[7] Although not a new concept in the green finance parlance, it has become a useful tool for integrating corporate governance with ESG concerns.[8]

A sustainable business recognizes the importance of people, planet, and profits (the 3Ps). People embody customers, employees and the society; planet includes a sustainable use of natural resources for present and future benefits; and profit exemplifies value designed to promote the continuity of the organization's service delivery.[9] The 3Ps indicates that a sustainable investment must embody these components, as an investment may be socially and economically viable, but ecologically useless.[10]

From an economic perspective, sustainable investment requires that profits are accrued based on long-term production and investment strategies as against short-term profit

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[5] Michael Knoll, "Ethical Screening in Modern Financial Markets: The Conflicting Claims of Undying Socially Responsible Investment" (2002) 57 Bus LJ 681 [Knoll].

[6] Michael P. Vandenberg, "Private Environmental Governance'' (2013) 99 Cornell L Rev 129.

[7] Monetary Authority of Singapore (MAS), "Sustainability Report 2021/2022," online:https://www.mas.gov.sg/-/media/mas-media-library/publications/sustainability-report/2022/mas-sustainability-report-20212022-updated.pdf.

[8] Alex Nicholls, "Sustainable Finance: A Primer and Recent Development" (last visited 16 March 2023) at 2, online (pdf): https://www.adb.org/sites/default/files/institutional-document/691951/ado2021bp-sustainable-finance.pdf [Nicholls].

[9] Marcel Jeucken, *Sustainable Finance and Banking: The Financial Sector and the Future of the Planet,* 1st ed (London: Earthscan Publications, 2001) at 43.

[10] *Ibid,* this is why most SF and ESG measures proclaimed by banks are largely conceived as greenwashing with little or no practical utilitarian impact on the environment. See Musciano, *supra* note 2; this will be discussed later in chapter four.

maximization; profits from investments are responsibly related to the actual increase of economic value; and profits are not based on corruption.[11] From an ecological viewpoint, sustainable investments require profit-making that aligns with an increase in resource productivity, the feasibility of global and domestic systems, and investments in renewable resources.[12] From a social-cultural dimension, sustainable investment requires that profit making corresponds with the development of human capital, the development of social capital and the development of cultural capital.[13] The web of SF covers a wide range of structures that create normative principles and standards with a roadmap for desired results broadly classified into four categories:[14] first, the Collevecchio Declaration on Financial Institutions (the Collevecchio Declaration),[15] and the United Nations Principles for Responsible Investment (UNPRI).[16] Second, the Equator Principles (EP),[17] and the Global Reporting Initiative (GRI).[18] Third, is the International Organization for Standardization ISO 1400.[19] The fourth includes the use of external entities to evaluate environmental performance such as the Dow Jones Sustainability Index.[20]

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[11] Timo Busch, Rob Bauer & Marc Orlitzky, "Sustainable Development and Financial Markets: Old Paths and New Avenues" (2016) 55 Bus & Soc 303 at 309.
[12] *Ibid.*
[13] *Ibid.*
[14] Benjamin Richardson, "Can Socially Responsible Investment Provide a Means of Environmental Regulation?" (2009) 35 Mona L Rev 262 at 263.
[15] Collevecchio Declaration on Financial Institutions and Sustainability, "The Role and Responsibility of Financial Institutions" (2003) at 2, online (pdf): http://www.okobank.hu/doc/collevecchio_declaration.pdf.
[16] UNPRI, "Sustainable Financial System" (last visited 08 April 2023), online: *UNPRI* https://www.unpri.org/sustainability-issues/sustainable-markets/sustainable-financial-system. Both the Collevecchio Declaration and the UNPRI provide standards that guide the ESG performance of institutional investors.
[17] EP, "A Financial Industry Benchmark for Determining, Assessing and Making Environmental and Social Risks Projects" (last visited 08 April 2023), online: *Equator Principles* https://equator-principles.com.
[18] GRI, "The Global Leader for Impact Reporting" (last visited 08 April 2023), online: *global reporting* https://www.globalreporting.org. The EP and the GRI provide strategies for reporting environmental standards.
[19] ISO 14001:2015, "Environmental Management Systems: Requirements with Guidance for Use" (2021), online: *ISO* https://www.iso.org/standard/60857.html. This organisation outlines policy frameworks to enable entities manage environmental and social risks.
[20] S & P Dow Jones Indices, "Dow Jones Sustainability World Index" (last visited 05 May 2023), online: *spglobal* https://www.spglobal.com/spdji/en/indices/esg/dow-jones-sustainability-world-index/#overview.

From the above, it is established that SF is designed to integrate how financial investors could act ethically by prioritizing an environmentally, just and ecologically sustainable future over the maximization of corporate financial returns.[21] It facilitates a just transition to a greener economy by ensuring that high-carbon-polluting sectors produce net benefits for the society through community engagements.[22] Rooted in the three pillars of people, planet and profit, SF underscores the need for financial investors to engage in their borrowers' businesses that consider the welfare of the environment whilst making profits.[23]

Another critical component of SF is impact investment which transforms capital into creative enterprises that address social market failures through the provision of welfare services including health and education and excludes corporations that engage in social inequality.[24]

The argument for SF is sustained by the finding that, in seeking to maximize investment returns, financial investors concerned with their customers' ESG would act as gatekeepers in monitoring the firms' environmental performance by compelling management to work consistently in mitigating the company's environmental risk portfolio.[25] For an investment to qualify as environmentally responsible, stakeholders must consider environmental factors ranging from climate change, natural conservation, human rights and ethical concerns that touch on public

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[21] Benjamin Richardson, "Climate Finance and its Governance: Moving to a low Carbon Economy Through Socially Responsible Financing?" (2009) 58 Intn'l & Comp LQ 597 at 598.
[22] Nick Robins, "Financing a Just Transition: How to Connect the Environmental and Social Dimensions of Structural Change" in Paul Fisher, ed, *Making the Financial System Sustainable* (Cambridge: Cambridge University Press, 2020) at 35 & 39.
[23] Beate Sjafjell & Christopher Bruner, "Corporations and Sustainability" in Beate Sjafjell & Christopher Bruner, eds, *The Cambridge Handbook of Corporate Law*, *Corporate Governance and Sustainability* (Cambridge: Cambridge University Press, 2019) at 7.
[24] Nicholls, *supra* note 8 at 8.
[25] Gail Henderson, "Making Corporations Environmentally Responsible: The Limits of Responsible Investing" (2012) 13 German LJ 1412 at 1414 [Henderson].

policy.[26] Its key features are long-term investing embodying how financial decisions consider ESG factors.[27]

3.3 Historical Evolution of SF

The history of SF dates to the 19th century when some religious institutions started screening their investments against actions they considered sinful and as a result, extricated themselves from corporations dealing in tobacco, gambling, military weapons amongst others.[28] In 1928, some ecclesiastical groups in Boston established the Pioneer Fund which enabled them to avoid the supposed 'sinful' industries.[29] Following the growing opposition to apartheid in South Africa against the backdrop of the Vietnam war, SF started gaining prominence.[30]

Originally known as ethical investment, SF started with anti-slavery campaigns of the Quakers during the 1700s and subsequently, developed into investment initiatives that called for investment boycotts against firms that engaged in anti-social activities such as the selling of unethical products, abuse of human rights, or failing to mitigate greenhouse gas (GHG) emissions.[31]

The ability of lending institutions to promote a sustainable economy was first identified by the ethical group movement during the 1970s in Western Europe, where several financial organizations championed a deliberate investment drive towards sustaining environmental, social

[26] Preu & Richardson, *supra* note 3 at 868.
[27] Benjamin Richardson, "Aligning Social Investing with Nature's Timescales" in Sjafjell & Bruner, *supra* note 23 at 571.
[28] Knoll, *supra* note 5 at 684.
[29] *Ibid.*
[30] Dionysia Katelouzou & Alice Klettner, "Sustainable Finance and Stewardship: Unlocking Stewardship's Sustainability Potential" in Dionysia Katelouzou & Dan Punchniak, eds, *Global Shareholder Stewardship* (Cambridge: Cambridge University Press, 2022) 551-555 [Katelouzou & Klettner].
[31] Benjamin Richardson, "Putting Ethics into Environmental Law: Fiduciary Duties for Ethical Investment" (2008) 48 Osgoode LJ 243 at 246.

and ethical principles.[32] The tendency of private financial investors to become major actors for environmental and social development is no longer new.[33] Thus, the European Union's Fifth Economic Action Plan;[34] and the United Nations Environment Program (UNEP)[35] evidence this reality.

In 1970, few financial entities began a deliberate investment drive towards environmental, social, and ethical principles.[36] From the 1980s to the 90s, the burgeoning of financial markets increased household wealth in investment schemes such as pension plans and mutual funds, thus, attracting the opportunity for individuals to utilize investment tools to promote environmental performance.[37] The need for financial investors to consider themselves major drivers for environmental and social development started increasing.[38] However, present day conception of SF tasks investors to strike a balance between environmental protection against profitability as the persistent emphasis on shareholder value maximization limits the capacity of responsible investment to improve environmental performance.[39]

[32] Benjamin J. Richardson, "Financing Environmental Change: A New Role for Canadian Environmental Law" (2003) 49 McGill LJ 145 at 153 [Richardson].
[33] *Ibid.*
[34] The European Community (EC), "Fifth European Community Environment Programme: Towards Sustainability" (01 February 1993), online: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:l28062.
[35] United Nations Environment Programme (UNEP), "Statement by Financial Institutions on the Environment and Sustainable Development" (May 1997), online (pdf): https://www.unepfi.org/fileadmin/statements/fi/fi_statement_en.pdf.
[36] Richardson, *supra* note 32 at 153.
[37] *Ibid*.
[38] *Ibid.*
[39] Henderson, *supra* note 25 at 1420.

3.4 Relationship Between SF and Sustainable Development

Sustainable Development is a widespread concept that seeks to ensure that economic growth does not diminish the capacity of the natural environment to meet the needs of the future.[40] Although the term "sustainability" defies precise definition, "Sustainable Development" appears to rest on three pillars of environmental, economic and social welfare.[41] SF on the other hand, is a universal effort aimed at achieving sustainable development by creating a stable and resilient financial system into decision-making; it integrates ESG factors and compels financial investors to transition to sustainability by transferring environmental risks and opportunities into investment decision making.[42]

The 1987 Brundtland Report on the Environment and Development (Brundtland Report) views sustainable development as the "development that meets the needs of the present without compromising the ability of future generations to meet their own needs".[43] Years after the Brundtland Report, the concept of SF has attracted attention in global economies.[44]

FIs have a huge role to play in promoting ambitious adoption of environmental and social safeguards through deliberate efforts in declining investments that impact negatively on the environment.[45] Thus, sustainable development includes sustainable production and sustainable

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[40] Benjamin Richardson, *Socially Responsible investment Law: Regulating the Unseen Polluters* (New York: Oxford University Press, 2008) at 2.

[41] Amelia Browne, "Explainer: What is Sustainability and Why is it Important?" (26 October 2022), online: *earth.org* https://earth.org/what-is-sustainability.

[42] Katelouzou & Klettner, *supra* note 30 at 551 - 552.

[43] World Commission on Environment and Development (WCED), Our Common Future, U.N. Doc. A/42/427 (4 August 1987), https://sustainabledevelopment.un.org/milestones/wced.

[44] Smita Nakhooda, Frances Seymour & Ahmed Sabina, "Financing Sustainable Development" (2009) 39 Envtal L Rep News & Analysis at 10316 [Nakhooda, Seymour & Sabina].

[45] *Ibid* at 10317.

consumption. This means that, whilst the production of goods and services must address all principal human needs by improving the quality of life, the utilization of natural resources and production of hazardous substances must be reduced to preserve the needs of future generations.[46] Viewed from this lens, SF embodies investment decision-making initiative that takes into account of ESG factors in an economic project to mitigates climate crises through sustainable social human factors and protection practices.[47] A sustainable investment must therefore encompass financial services that integrate ESG parameters into business or investment actions for a sustainable advantage for clients and societies.[48]

Consequently, the European Union (EU) established the EU High Level Expert Group (HLEG) on sustainable finance to develop a comprehensive roadmap on sustainable finance; and declares:

> For the financial system, sustainability has a dual imperative. The first is to ensure that environmental, social and governance factors are at the heart of financial decision-making. The second is to mobilize capital to help solve society's key challenges that require long-term finance: creating jobs, especially for young people, improving education and retirement finance, tackling inequality, and accelerating the shift to a decarbonized and resource efficient economy.[49]

From the above, it is established that, apart from highlighting the contribution of finance to sustainable economic inclusion and climate change mitigation, SF also seeks to strengthen financial stability by incorporating ESG considerations into corporate and financial decision-

[46] *Ibid* at 10316.
[47] Rebecca Bakken, "What is Sustainable Finance and Why is it Important?" (09 Aug 2021); online: *HES* https://extension.harvard.edu/blog/what-is-sustainable-finance-and-why-is-it-important [Bakken].
[48] Akagh Kumar & Vandana Chauhan, "Sustainable Finance" (2021) 4 Int'l JL Magt & Human 1015 at 1016.
[49] EU High-Level Expert Group on Sustainable Finance, "Financing a Sustainable European Economy: Interim Report, July 2017" (July 2017) at 8, online (pdf) https://finance.ec.europa.eu/system/files/2017-07/170713-sustainable-finance-report_en.pdf.

making.[50] Accordingly, SF has been categorized as an important investment tool for two basic reasons. First, good business practices have transitioned from prioritization of profits to recognizing the protection of the environment where business activities take place.[51] Second, whilst traditional business operations have centered on maximization of profits at the expense of nature and society, the sustainability drive is therefore designed to replace the trend with a sustainable future.[52]

3.5 Sustainable Investment Strategies

As an investment strategy, SF emphasizes integrating ESG criteria into investment decisions including portfolio selection and management.[53] Consequently, the Global Sustainable Investment Alliance (GSIA),[54] itemizes seven strategies for sustainable investing; first, by Negative/Exclusionary Screening, which includes the exclusion of unsavory products such as gambling, tobacco, weapon trading amongst others from investment portfolios.[55] A negative screening is risk screened based against a wide range of non-financial performance indices that cut across ESG guidelines to modify long-term risk profile of high carbon intensity corporations.[56] Although this strategy is dominant in Europe with an estimated USD 19.8 trillion invested globally,[57] such screening prevents ESG high-risk investments such as high carbon intensity and facilitates internal organizational structures processes and practices.[58]

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[50] The EU High-Level Group on Sustainable Finance, "Financing a Sustainable European Economy: Financial Report 2018" (2018) at 6, online (pdf): https://finance.ec.europa.eu/system/files/2018-01/180131-sustainable-finance-final-report_en.pdf.
[51] Bakken, *supra* note 47.
[52] *Ibid.*
[53] Katelouzou & Klettner, *supra* note 30 at 558.
[54] GSIA, "2018 Global Sustainable Investment Review" (2018) at 7, online (pdf): http://www.gsi-alliance.org/wp-content/uploads/2019/06/GSIR_Review2018F.pdf.
[55] *Ibid.*
[56] Nicholls, *supra* note 8 at 4.
[57] Katelouzou & Klettner, *supra* note 30 at 558.
[58] Nicholls, *supra* note 8 at 6.

Second, Positive/Best-in-Class Screening, which involves investing in sectors or projects with positive ESG performance that aligns with industry stakeholders.[59] A positive screen focuses on providing additional capital and high-level impact for corporations; in doing so, it facilitates additional contribution towards sustainable development goals and high impact investment decisions.[60] Whilst negative screens are used to exclude firms engaged in certain industry practices considered inimical or unethical, positive screens are deployed to identify businesses that facilitate a sustainable environmental future.[61]

Third, by ESG Integration, investment decisions attracted global attention with USD 17.5 trillion in world economies. Although the method of implementation in entities varies,[62] it relies on ESG analysis to promote corporate objectives through ESG related goals to achieve investment returns.[63] It is founded on the belief that corporations must incorporate ESG criteria into their investment decisions with the aim of mitigating risk and maximizing profits both on a business and ethical case; tailored towards sustainable development.[64]

Fourth, by Corporate Engagement and Shareholder Activism, this strategy embodies the use of shareholder action to influence corporate behaviour.[65] It focuses on stakeholder finance initiatives that adhere to environmental standards with the aim of integrating defined social purposes into corporate governance structures.[66] Stakeholders finance relates to the impact of

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[59] GSIA, *supra* note 54.
[60] Nicholls, *supra* note 8 at 4.
[61] James Giuseppi, "Assessing the Tripple Bottom Line: The Social and Environmental Practices in the European Banking Sector" in Jan Bouma, Marcel Jeucken & Leon Klinkers, eds, *Sustainable Banking: The Greening of Finance* (New York: Routledge, 2017) at 96.
[62] Katelouzou & Klettner, *supra* note 30.
[63] Musciano, *supra* note 2 at 444.
[64] Benjamin Richardson, "Keeping Ethical Investment Ethical: Regulatory Issues for Investing for Sustainability" (2009) 87 J Bus Ethics 555 at 560.
[65] GSIA, *supra* note 54.
[66] Nicholls, *supra* note 8 at 11.

investment on a firm's corporate governance structure and extends to the impact directives of green finance.[67] Popular in Japan with over USD 9.8 trillion investment, it includes shareholder engagement, information gathering, monitoring and dialogue with institutional investors.[68]

Fifth, through Norms-Based Screening, which involves screening of investments based on minimum standards of business practices in consonance with international principles issued by international bodies such as the United Nations (UN), the United Nations Children Emergency Fund (UNICEF), the International Labour Organisation (ILO) and the OECD amongst others.[69]

Sixth, using Impact/Community Investing, includes investment tailored towards solving environmental or social problems in the community.[70] Impact investing has been described as investments made with the aim of generating positive social and environmental impact with financial returns, and optimizes risks returns and impact to benefit people and the planet; it does so through setting social and environmental objectives by measuring achievements.[71] It focuses on promoting projects that would impact positively on rural communities and businesses with environmental and social objectives.[72]

And seventh, through Green Finance, this focuses on converting capital into innovative enterprises aimed at addressing climate-related issues and dispenses with corporations that perpetrate climate-related risks.[73] It involves investment in project specifically related to sustainability such as green technology, agriculture, and clean energy.[74]

[67] *Ibid.*
[68] Katelouzou & Klettner, *supra* note 30.
[69] GSIA, *supra* note 54.
[70] *Ibid.*
[71] Nicholls, *supra* note 8 at 9.
[72] GSIA, *supra* note 54.
[73] Nicholls, *supra* note 8 at 6.
[74] GSIA, *supra* note 54.

Green investments occupy prime position in the policies of corporations that adhere to environmentally sustainable utilization of natural resources, renewable energy, biodiversity and energy efficiency as well as pollution control and prevention; the green finance market is largely dominated by green bonds.[75] Green bonds are in six different forms which include corporate bonds issued by corporate entities to finance asset acquisition; asset-backed securities collateralized by specific projects; project bonds backed by projects which an investor has direct exposure to the risk of the project; sovereign bonds issued by international financial institutions; municipal bonds issued by municipal governments; and finance sector bonds issued by financial institutions to raise capital to finance loans/lending to green initiatives.[76]

The UNPRI, outlines six core principles to guide corporate investment behaviour as follows: to incorporate ESG issues into investment analysis and decision-making processes; to be active owners, and to incorporate ESG issues into ownership policies and practices; seek appropriate disclosure on ESG issues by the entities into investments; and to promote acceptance and further implementation of the principles.[77]

Similarly, the Collevecchio Declaration outlines six commitment principles to guide FIs in their lending-decisions as follows:

First, by Commitment to Sustainability, this requires financial investors to look beyond profit maximization and focus on ESG sustainability; this would enable them to fully integrate ecological, social and economic considerations into corporate strategies.[78]

[75] Nicholls, *supra* note 8 at 6.
[76] *Ibid* at 7.
[77] UNPRI, "An Investor Initiative in Partnership with UNEP Finance Initiative and the UN Global Compact: A Blueprint for Responsible Investment" (last visited 07 August 2023), online: *UNPRI* https://www.unpri.org/download?ac=10948.
[78] The Collevecchio Declaration, *supra* note 15.

Second, by Commitment to 'Do No Harm'; this requires FIs to adopt prudent precautionary measures to prevent and minimize environmental and social risks in their lending decisions and in the business of their borrowers.[79]

Third, through Commitment to Responsibility; this means that institutional investors are expected to be ready to bear full responsibility for the environmental and social impacts of their investments.[80]

Fourth, through Commitment to Accountability; this requires financial investors to be accountable to their stakeholders particularly those created by the activities they finance.[81]

Fifth, by Commitment to Transparency; this requires financial investors to exhibit transparency in their dealings to stakeholders, not only through regular and standard disclosure, but by their response to stakeholders' needs.[82]

And sixth, through Commitment to Sustainable Market and Governance; this requires that lending institutions must play active role in ensuring that financial markets foster environmental sustainability by supporting public policies and other regulatory mechanisms.[83]

Also, the Basel Core Principles (BIS 2019) set out basic guidelines for effective banking, these include: regulatory capital requirements for credit; market and operational risks processes through which supervisors could evaluate how FIs are effectively managing their investment risks and actions taken in respect to the assessment.[84] The guidelines also include: disclosure

[79] *Ibid.*
[80] *Ibid.*
[81] *Ibid.*
[82] *Ibid.*
[83] *Ibid.*
[84] Bank for International Settlements, "The Basel Framework: Core Principles for Effective Banking Supervision" (15 December 2019), online: *BIS* https://www.bis.org/basel_framework/.

requirements for banks to publish details of their investment risks with the aim of strengthening investment discipline; regulating the limits of losses lenders could face in the event of a counterparty business failure or insolvency; and minimum standards required to reduce system risks.[85] The Basel Core Principles provide a comprehensive standard for establishing solid foundation for the regulation, supervision, governance and risk management of the banking sector.[86] ESG guidelines and analysis facilitate sustainable development goals to achieve corporate objectives and investment returns.[87] An investment strategy rooted on core principles of responsible lending and impact investment, embodies positive impact with a commitment for positive results.[88]

Although FIs have been making efforts to address environmental risks in their investment decisions in the past, present realities show that traditional approaches aimed at mitigating these risks are insufficient, as potential risk factors hitherto considered inconsequential, are steadily becoming material.[89]

3.6 Outline of SF Practices in Canada

Canadian banks recognize that environmental sustainability occupies a central position in the banks' businesses and social responsibility efforts and as a result, they are committed to addressing environmental risks to mitigate their impacts on businesses and the environment, and to promote economic growth achieving a net-zero target by 2050 in line with the Paris

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[85] *Ibid.*
[86] Nina Seega & Andrew Voysey, "Environmental Risk Analysis by Financial Institutions" in Fisher, *supra* note 22 at 123 [Seega & Voysey].
[87] Musciano, *supra* note 2 at 438-439.
[88] Flavia Micilotta, "Transparency and Accountability Standards for Sustainable and Responsible Investments" in Fisher, *supra* note 22 at 115.
[89] Seega & Voysey, *supra* note 86 at 123.

Agreement.[90] Consequently, they have pledged financial commitments to support green finance initiatives; instituted bank-led strategies to limit GHG emissions; collaborated to finance the transition to a low carbon economy; implemented climate-related disclosures as prescribed by the Task Force on Climate-related Financial Disclosures (TCFD); issued green bonds to finance green projects designed to link ESG criteria to bank group performance and executive pay; partnered with the Net-Zero Banking Alliance (NZBA); and created the Centre for Climate-Aligned Finance to promote green finance initiatives among financial institutions in Canada.[91]

Although Canadian banks have internal sustainability and green finance structures in their various policy frameworks, they have taken initiatives to integrate ESG criteria in their lending decisions as means of mitigating credit risks. They recognize that considering ESG factors with proper financial metrics can result in better decision making for lenders.[92] This may also lead to better outcomes for the society and the planet as ESG criteria provide more tools, data and insights that assist banks to better understand the risks and opportunities in contemporary business environment.[93] As ESG concerns continue to gain prominence in the financial services sector, lenders in Canada are beginning to view the integration of these instruments as a critical component in their lending decisions.[94]

[90] Government of Canada, "Canada's 2021 Nationally Determined Contribution Under the Paris Agreement" (12 July 2021) at 3 - 4, online (pdf): https://unfccc.int/sites/default/files/NDC/2022-06/Canada%27s%20Enhanced%20NDC%20Submission1_FINAL%20EN.pdf. See also Canadian Bankers Association, "Banks in Canada Committed to Net-Zero Economy by 2050" (27 October 2023) online: *CBA* https://cba.ca/banks-in-canada-committed-to-a-net-zero-economy-by-2050.

[91] UNEP, "Net Zero Banking Alliance" (last visited 08 October 2023), online: *UNEP*, https://www.unepfi.org/net-zero-banking/.

[92] Sarah Thompson, "RBC's Commitment to Sustainable Finance" (last visited 08 December 2023), online: https://www.rbc.com/community-social-impact/climate/sustainable-finance-framework/index.html.

[93] *Ibid.*

[94] Dentons, "Sustainable Finance in Canada" (20 April 2021), online: https://www.dentons.com/en/insights/articles/2021/april/20/sustainable-finance-in-canada.

To achieve a net-zero economy, Canadian banks explore green products such as green loans and sustainability bonds. While green loans are offered to finance sustainable projects through the Loan Market Association (LMA) and the International Capital Market Association (ICMA), sustainability bonds are designed to promote projects that have ESG benefits that align with the ICMA guidelines.[95] The Sustainability Accounting Standards Board (SASB),[96] and the GRI,[97] are major agencies through which Canadian financial investors perform ESG reporting processes.[98] In 2018, the Expert Panel on Sustainable Finance was invited to make recommendations on how sustainable financing could be enhanced in Canada.[99] In 2019, the panel made a recommendation to establish a Sustainable Finance Action Council to assist the government of Canada in implementing green finance initiatives.[100]

Thus, FIs in Canada have been proclaimed to integrate environmental risks factors in their corporate lending to prevent financial loss, improve credit risk prediction, prevent loan defaults and provide financial benefits for lenders.[101] Investment through loans is a major business strategy for banks and failure to manage the risks that emanate from the loan may impact on their borrower's ability to repay the debt.[102] Since environmental risks influence credit risks as a borrower with low environmental performance is likely to attract higher environmental liability,

[95] LMA, "Green Loan Principles: Supporting Environmentally Sustainable Economic Activity" (December 2018) at 1- 4, online (pdf): https://www.lma.eu.com/application/files/9115/4452/5458/741_LM_Green_Loan_Principles_Booklet_V8.pdf
[96] SASB Standards, (last visited 08 December 2023), online: https://sasb.org.
[97] GRI, *supra* note 18.
[98] Dentons, *supra* note 94.
[99] Government of Canada, "Expert Panel on Sustainable Finance" (14 June 2019), online: *Government of Canada* https://www.canada.ca/en/environment-climate-change/services/climate-change/expert-panel-sustainable-finance.html.
[100] Government of Canada, "Final Report of the Expert Panel: Mobilizing Finance for Sustainable Growth" (14 June 2019), online: *Government of Canada* https://www.canada.ca/en/environment-climate-change/services/climate-change/expert-panel-sustainable-finance.html.
[101] Olaf Weber, *Sustainability and Environmental Risk Management in Canadian Banks and Financial Services Institutions: A Global Comparative Study* (Canada: Export Development Canada, 2010), at 3.
[102] Olaf Weber, "Environmental Credit Risk Management in Banks and Financial Services Institutions" (2012) 21 Bus Strat & Envtal at 248 [Weber].

lending institutions assess the environmental credit risks of their clients and how they should be managed in their credit portfolios.[103] Where the collateral securing the loan is contaminated, the impact affects the economic value of the asset which increases the risk of financial loss in the event of default. Changes in environmental regulations create costs of compliance for borrowers as the lender may impose higher loan conditions which may dissuade smaller borrowing firms from accessing credit.[104] Apart from producing positive credit rating, the integration of standard environmental risk assessment measures in the lending process is a precautionary measure for the business sector and the society.[105] Consequently, Canadian banks with equity of more than $1 billion are required to publish a public accountability statement which is regularly reviewed by the government of Canada department of public finance to promote the credibility of financial institutions in Canada.[106] How then have Canadian Banks been integrating ESG factors in their corporate lending? An overview of how five Canadian major banks integrate ESG criteria in their lending processes is examined below.

3.6.1 Royal Bank of Canada

The Royal Bank of Canada (RBC) enforces credit risk principles and environmental risk procedures in its loan appraisal processes. RBC has taken the initiative to integrate ESG criteria in their lending decisions with a view to balancing investment with the environment.[107] The bank deploys certain criteria in its sustainability framework which include eligibility criteria, reporting, ESG and risk management; ESG risk management occupies an integral part of the bank's

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[103] *Ibid* at 249.
[104] *Ibid.*
[105] *Ibid.*
[106] *Ibid* at 251.
[107] RBC, "Climate: Balancing the Needs of the People and the Planet" (February 2022), online: *RBC* https://www.rbc.com/community-social-impact/climate/index.html.

sustainability approach through the bank's risk awareness culture.[108] The bank adopts three basic principles in implementing ESG objectives such as transparency, governance and oversight. On transparency, the bank is committed to transparency and disclosure reported on key performance metrics since 2003 in line with the standards laid by the TCFD.[109] On governance and oversight, the board provides oversight over strategic approaches to environmental and social risk issues and established a Climate Strategy Steering Committee.[110] In 2022, the board approved RBC's Climate Blueprint, designed to measure and monitor climate action plan and the progress to achieving its net-zero emissions in lending practices by 2050.[111] The bank earmarked $84.8 billion through a sustainable finance framework to demonstrate commitment to ESG performance.[112] The transition to a net-zero economy is overseen by four committees of the board such as the Governance Committee, the Risk Committee, the Audit Committee and the Human Resources Committee; these committees are responsible for implementing climate-related issues within their purview. For instance, the Governance Committee addresses the board on ESG-related issues and provides oversight for the board. The Risk Committee manages material and potential risks through the Enterprise Risk Appetite Framework; while the Audit and Human Resources Committees cover the bank's ESG reporting and disclosures and lending performance evaluation criteria for chief executives in line with the bank's climate blueprint frameworks.[113]

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[108] RBC, "Sustainable Finance Framework: Our Approach and Methodology for Sustainable Finance" (26 October 2022) at 19, online (pdf): https://www.rbc.com/community-social-impact/_assets-custom/pdf/sustainable-finance-framework.PDF.

[109] RBC, "Climate Blueprint: Our Role in Building a Sustainable Future" (lasty visited December 08 2023) at 3, online (pdf): https://www.rbc.com/community-sustainability/_assets-custom/pdf/RBC-Climate-Blueprint.pdfm [RBC Climate Blueprint].

[110] *Ibid.*

[111] RBC, *supra* note 107.

[112] RBC, "Climate Report 2022: Guided by the Recommendations of the Task Force on Climate-related Financial Disclosures" online (pdf): https://www.rbc.com/community-social-impact/_assets-custom/pdf/RBC-Climate-Report-2022.PDF [RBC Climate Report 2022].

[113] *Ibid* at 10 -11.

To demonstrate its commitment to SF, the bank provided $500 billion to support clients' ESG goals by 2050; disclosed 2030 interim targets for lending in high GHG emission sectors such as oil and gas, power generation and automotives; collaborated with borrowers in high-emission sectors to report their emissions to the bank and disclosed measures to reduce them.[114] As part of its stress-testing and risk analysis measures, the bank integrated climate and physical risks factors with particular consideration of their impacts on lending for better monitoring and improved performance.[115] Apart from engaging in their borrower's risk assessment, RBC deploys a risk management framework for identifying, assessing, measuring, monitoring and reporting environmental risks and implements measures towards managing and mitigating them.[116] For instance, in 2008, the bank identified environmental risk as an emerging risk; in 2020, it identified climate risk as a significant risk to the bank; in 2021, it collaborated with the Partnership for Carbon Accounting Financials (PCAF) to monitor emissions from its lending activities.[117] By 2025, the bank projects to provide $500 billion to support sustainability projects, reduce GHG emissions from its borrowers' operations by 70%; provide $100 million to support technology projects through tech-for-nature initiatives; collaborate with clients in high-emission sectors to report their GHG emissions to the bank and disclose reduction plans.[118] By 2030, the bank aims to achieve its interim emissions reduction target for lending in the oil and gas, power generation and automotive sectors in line with the NZBA standards;[119] review its emission reduction targets by

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[114] *Ibid* at 7.
[115] *Ibid* at 30.
[116] RBC, "Risk Management at RBC Financial Group" (4 September 2002) at 1-21, online: http://www.rbc.com/investisseurs/pdf/rbc_slides_risk_management.pdf.
[117] PCAF, "The Global GHG Accounting and Reporting Standard for the Financial Industry" (last visited December 08 2023), online: https://carbonaccountingfinancials.com/en/standard#the-global-ghg-accounting-and-reporting-standard-for-the-financial-industry.
[118] RBC Climate Report 2022, *supra* note 112 at 7.
[119] The NZBA institutes policy framework to guide financial investors transition to net-zero emissions by 2050 through its climate action plan by 2050; these standards are principles founded on responsible investment.

every five years based on current industry practices and complete net-zero issues in its lending practices by 2050.[120]

3.6.2 Bank of Montreal

The Bank of Montreal (BMO) is reported to subject its borrowers to its environmental credit risk management processes.[121] The bank explores a responsible lending practice with strategic instruments designed to facilitate informed decision making.[122] BMO recognises the nexus between sustainable development and corporate long-term investing and considers integrating environmental risk factors in its credit risk assessment process.[123] Consequently, in 2022, the bank created a roadmap to invest $300 billion in sustainable investments by 2025 and collaborated with the government of Canada to launch $5 billion green bond investment in line with Canada's ESG goals.[124] Further, the bank partnered with Export Development Canada (EDC) to assist carbon intensive firms transition to net-zero emission by 2050.[125] As the first financial institution to offer an EDC sustainable financing guarantee,[126] the bank provided an initial sustainable finance fund of $1billion to promote green investment initiatives.[127]

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[120] *Ibid.*
[121] BMO Financial Group, "192nd Annual Report 2009" at 48, online (pdf): https://www.bmo.com/ci/ar2009/downloads/bmo_ar2009.pdf.
[122] BMO Financial Group, "193RDnd Annual Report 2010 at 28, online (pdf): https://www.bmo.com/ir/archive/en/bmo_ar2010.pdf.
[123] BMO Financial Group, "2022 Annual Report to Shareholders" (2022) at 10, online (pdf): https://www.bmo.com/ir/archive/en/bmo_ar2022.pdf [BMO Financial Group, Annual Report 2022].
[124] *Ibid.*
[125] *Ibid.*
[126] *Ibid.* The Sustainable financing guarantee is a product offered by the EDC Sustainable Financing Program designed to provide SF solutions to Canadian businesses and enable them transition from carbon-intensive operating firms to emission reducing entities.
[127] *Ibid.*

3.6.3 Canadian Imperial Bank of Commerce

The Canadian Imperial Bank of Commerce (CIBC) offers environmental risk management processes in its lending decision. Using its credit risk management program, the bank disclosed that managing environmental risk occupies a vital component of its lending decision, as the risk identification and measurement frameworks are designed to monitor business portfolios, assess risks associated with lending and credit exposures.[128] The bank publishes measures deployed to integrate environmental risks into lending decisions and how those risks are assessed based on certain risk management criteria such as loan amount, the borrower's industry sector, and whether the asset securing the loan is a collateral security.[129] Recognising that managing environmental risks is material to its lending business, CIBC conducts periodic environmental risk assessment and renders annual report containing its commitment to reducing climate-related financial risks and its ambition to achieve net-zero in lending by 2050; anchored on four pillars which include promoting sustainable investment, reforming operations, encouraging consumer behaviour and assisting borrowers reduce emissions from production activities.[130]

In 2022, the bank achieved 22% emission reduction and aims to reduce total GHG emissions in its lending portfolio by 30% by 2028 as against its 2018 baseline; it contributed 45% renewable energy initiative to achieve its 2024 carbon neutrality target and aims to launch emission reduction strategies through its $9 million investment in energy optimization programs across Canada.[131] The bank also integrated Carbon Risk Scoring Methodology in its risk assessment

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[128] CIBC, "2010 Annual Report" at 66, online (pdf): https://www.cibc.com/content/dam/about_cibc/investor_relations/pdfs/annual_reports/2010/ar10-en.pdf.
[129] Weber, *supra* note 102 at 255.
[130] CIBC, "2022 Climate Report: Update on Task Force on Climate-related Financial Disclosure and Progress Towards our Net-Zero Ambition" (2022) at 4, online (pdf): https://www.cibc.com/content/dam/about_cibc/corporate_responsibility/pdfs/cibc-2022-climate-report-en.pdf. [CIBC 2022 Climate Report].
[131] *Ibid.*

process in commercial lending to facilitate the transition to a low-carbon economy for sustainable future.[132] CIBC aims to deploy $300 billion in green finance by 2030;[133] and strives to mobilize $300 billion in capital to promote sustainable investment projects.[134]

3.6.4 Scotiabank

Scotia bank maintains an environmental lending policy that seeks to identify and incorporate environmental risk into corporate lending practices; this extends to investigating the environmental compliance level of its borrowers or counterparty business operators as well as assets securing the loan.[135] The bank initiates guidelines on climate change mitigation and due diligence measures to be utilized where environmental risks impact on its borrowers' business.[136] Scotiabank institutes a risk management framework to identify, assess, measure, monitor, manage and mitigate ESG risks based on its risk management framework; its environmental risk management policy covers five basic principles such as compliance with environmental regulations, prioritize initiatives designed to enable the transition to low-carbon economy, integrate environmental risk assessment into lending procedures and publicly reporting the bank's environmental performance.[137]

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[132] *Ibid*. The Carbon Risk Scoring Methodology is a risk management framework that provides the bank the ability to identify and understand its borrower's emission profile in their business activities.
[133] *Ibid* at 15.
[134] *Ibid.*
[135] Weber, *supra* note 102 at 256.
[136] *Ibid.*
[137] Scotiabank, "Overview of ESG Risk Framework and Policy" (last visited 08 December 2023) at 1 & 2, online (pdf): https://www.scotiabank.com/content/dam/scotiabank/corporate/Documents/Scotiabank_Overview_of_ESG_Risk_Framework_and_Policy.pdf [Scotiabank Risk Framework].

The bank's approach towards managing ESG issues covers a broad range of interrelated principles such as Scotiabank Code of Conduct,[138] and Global Human Rights Statements.[139] Whilst the code of conduct embodies principles that guide and motivate actions that highlight compliance with regulations; transparency and accountability covers honesty, integrity and equity.[140] On its lending decision, the bank integrates ESG due diligence, credit due diligence and loan appraisal processes through its Environmental Risk Assessment (ERA) and the Climate Change Risk Assessment (CCRA). While the CCRA requires lenders to engage directly with borrowers on climate-related risks and evaluate their impacts on lending, the ERA is designed to identify significant environmental risks that may impact on the borrower's business and potential measures initiated to mitigate them.[141] The bank's ESG approach covers four major pillars such as Environmental Action, Economic Resilience, Inclusive Society and Leadership and Governance; guided by these principles, Scotiabank integrates ESG measures, products and solutions to assist borrowing clients achieve their GHG emissions goals.[142] In 2022, Scotiabank injected $96 billion in climate-related financing to achieve $350 billion emission reduction target; generated $35.3 billion in sustainable finance investing such as green lending and sustainable-linked bonds; achieved 29% reduction of GHG emissions in its lending portfolio and offered $2 million to

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[138] Scotiabank, "Code of Conduct" (last visited 08 December 2023), online (pdf): https://www.scotiabank.com/content/dam/scotiabank/canada/en/documents/about/Code_of_Conduct_EN.pdf.

[139] Scotiabank, "Global Human Rights Statements" (last visited 08 December 2023), online (pdf): https://www.scotiabank.com/content/dam/scotiabank/canada/common/documents/Scotiabank_Human_Rights_Statement.pdf.

[140] Scotiabank Risk Framework, *supra* note 137 at 1.

[141] *Ibid* at 2.

[142] Scotiabank, "2022 ESG Report" (last visited 08 December 2023) at 8 - 9, online (pdf) https://www.scotiabank.com/content/dam/scotiabank/corporate/Documents/Scotiabank_2022_ESG_Report_Final.pdf.

organisations engaged in decarbonization through the Scotiabank $100 million Net-Zero Research Fund.[143]

3.6.5 Toronto Dominion Bank

The Toronto Dominion Bank (TD bank) incorporates environmental social and credit factors in its lending practices and considers its potential impacts on short-term, medium-term and long-term investments. For instance, in 2009, the bank identified climate change as a global environmental and economic risk and considered incorporating it into business strategies as their effect may impose direct or indirect impacts on investment.[144] The bank identifies and assesses environmental risks through its environmental risk management system and reporting, and projects to finance $100 billion green projects by 2030.[145] TD bank deploys a wide range of climate-related metrics in areas such as finance and investment, business operations and community development with focus on reducing GHG emissions, mitigate environmental risk and promote green investment.[146] The bank implements a risk management policy through its Enterprise, Environmental and Social Risk Management Framework (ESRF) to assist the bank and its counterparty manage environmental and climate-related financial risks.[147] Although, the bank may have measures in place to assess, monitor and evaluate the potential impact of environmental regulations on its lending and those of its borrowers particularly those in the carbon intensive

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[143] Scotiabank, News Release, "Scotiabank Releases its 2022 ESG Report, Highlighting Efforts to Advance Sustainability and ESG Performance" (10 March 2023), online: https://scotiabank.investorroom.com/2023-03-10-Scotiabank-releases-its-2022-ESG-Report,-highlighting-efforts-to-advance-sustainability-and-ESG-performance.
[144] TD Bank, "Summary of TD's Progress in Meeting Climate-related Risks and Opportunities" (last visited 08 December 2023), online (pdf): https://www.td.com/content/dam/tdcom/canada/about-td/pdf/esg/2017/2017-td-summary-progress-in-managing-climate-risks.pdf.
[145] *Ibid.*
[146] *Ibid.*
[147] TD Bank Group, "Climate Change 2021" (online (pdf): https://www.td.com/content/dam/tdcom/canada/about-td/pdf/esg/2021/2021-cdp-submission.pdf.

industry, this may translate into credit and reputational risks if not properly managed.[148] Consequently, a review of the bank's lending portfolio reveals that exposure of the bank to high risk investment is imposed by the GHG emissions of its clients in the oil and gas, power generation and mining sectors.[149]

3.7 Analysis of Banks Initiatives and Concluding Thoughts

The above explained various initiatives deployed by Canadian banks in integrating SF and ESG measures in their investment decisions. A closer look at these strategies reveals some level of convergence in some areas and divergence in some other areas. Whilst some banks demonstrate strength in certain areas, others exhibit weakness. For instance, on convergence, most banks examined appear to report their GHG emissions in their lending portfolios and disclosed measures to reduce them.[150] In terms of collaboration with stakeholders, RBC and BMO stand out; for example, BMO collaborated with the government of Canada to launch $5 billion investment and partnered with the EDC to assist carbon intensive companies transition to net-zero emission by 2050.[151] Similarly, RBC partnered with PCAF to monitor emissions from its lending.[152] Overall, the various banks examined integrate ESG and SF measures in their lending.

However, on divergence, there appears to be some level of overlap. For instance, in terms of loan monitoring, RBC appears to have more robust initiatives compared to other banks. By deploying its climate blueprint to monitor and measure climate action plan,[153] RBC adopts stress-testing risk analysis to assess the physical and climate-related risks on its lending; and ties its risk

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[148] *Ibid.*
[149] Weber, *supra* note 102 at 257.
[150] For instance, RBC and Scotiabank are reported to implement this measure.
[151] BMO Financial Group, Annual Report 2022, *supra* note 123.
[152] PCAF, *supra* note 117.
[153] RBC Climate Blueprint, *supra* note 109.

assessment and mitigation evaluation criteria to board executive pay.[154] These measures are plausible. On investigating counterparty environmental compliance, Scotiabank takes the lead; although RBC is reported to be engaged in this practice as well, Scotiabank's policy guidelines on climate change mitigation and due diligence practices in relation to its borrower's business, make the bank a stand-out player in environmental risk management on financial investments.[155] Apart from integrating credit due diligence and loan appraisal processes through its ERA, Scotiabank's CCRA facilitated the bank's engagement with its borrowers on climate-related risks and their impact on client businesses and lending.[156]

Another bank that displays significant strength on periodic environmental risk assessment and reporting is CIBC. Apart from integrating ESG measures on its loan portfolio, CIBC renders annual report containing the bank's commitment to reduce climate-related risks based on the four pillars of sustainable development, operation efficiency, sustaining consumer behaviour and assisting borrowers reduce emissions from production; whilst other banks may also engage in this practice, this embodies a critical area where CIBC exemplifies significant strength.[157]

Although TD bank incorporates ESG criteria in its investments and deploys measures to evaluate the potential impact of environmental regulations on its lending and those of its borrowers, the exposure of the bank to high-risk investments particularly from clients in the oil and gas, automotive and mining sectors, casts doubt on the efficacy of the bank's ESG and SF measures.[158] TD bank's ESG initiatives, particularly in relation to counterparty, are not robust enough; consequently, the bank should deepen its due diligence efforts to cut across all sectors of

[154] RBC Climate Report 2022, *supra* note 112 at 30.
[155] Weber, *supra* note 102 at 256.
[156] Scotiabank Risk Framework, *supra* note 137 at 2.
[157] CIBC 2022 Climate Report, *supra* note 130.
[158] Weber, *supra* note 102 at 257.

its corporate policy to include management board as exemplified by RBC. The bank's continued lending to high emission sectors is of significant concern; and on this basis, this thesis finds that, absent tangible measures to address this concern, the best approach is for the bank to decline funding to those sectors. In this way, the borrowing entities may be compelled to rectify their environmental standing and records when doing so appears to be the only option for accessing credit.[159]

So far, the records indicate that Canadian banks recognise the significance of managing environmental risks in financial investments and the need to transition to a low-carbon economy to bolster the resilience of the financial sector to achieve net-zero by 2050 in line with the Paris Agreement.[160] Whatever form sustainable development takes, banking institutions can either be active drivers or stumbling blocks to it, depending on the approach they adopt.[161] However, despite these measures, it remains unclear whether these steps have yielded significant practical impacts for the environment. This issue and more would be considered in the following chapter.

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[159] Benjamin Richardson, "Can Socially Responsible Investment Provide a Means of Environmental Regulation?" (2009) 35 Mona L Rev 262 at 264-265.

[160] United Nations Climate Change, "The Paris Agreement" (last visited 27 October 2023), online: *UNFCCC* https://unfccc.int/process-and-meetings/the-paris-agreement. See also CBA, *supra* note 90.

[161] Timo Busch, Rob Bauer & Marc Orlitzky, "Sustainable Development and Financial Markets: Old Paths and New Avenues" (2016) 55 Bus & Soc 303 at 320.

CHAPTER FOUR

MARGINALIZATION OF ENVIRONMENTAL POLICY THROUGH BANKRUPTCY LAWS AND A COMPARISON BETWEEN SF GUIDELINES AND THE REDWATER DECISION AND THEIR IMPACT ON THE ENVIRONMENT

4.1 Introduction

This chapter examines whether the objectives of bankruptcy laws examined in Chapter One are being exploited by corporations to evade reclamation obligations and the potential impact on society. It further interrogates whether ESG and SF measures examined in Chapter Three have been able to address environmental concerns as projected by the various lending institutions in Canada.

Drawing from classical lending and modern banking practices discussed in Chapters One and Two and the risk abatement measures put in place by banks in Chapter Three, the chapter interrogates whether these SF and ESG principles have succeeded in mitigating environmental risks as contemplated; and if not, whether *Redwater* has yielded better regulatory results. The chapter finds that although ESG measures are commendable investment practices, they have failed in instilling a tangible sustainable investment culture in lenders as compared to *Redwater*.

4.2 Marginalization of Environmental Policy Through Bankruptcy Laws

In Chapters One and Two, this research established that bankruptcy laws are designed to assist corporations experiencing financial difficulties to reorganize, satisfy the claims of their creditors and make a fresh start.[1] While these objectives may be lofty, they may be manipulated

[1] Philip R. Wood, *Principles of International Insolvency*, 2nd ed (London: Sweet & Maxwell, 2007) at 4. See also Vanessa Finch & David Milman, *Corporate Insolvency Law: Perspectives and Principles,* 3rd ed (United Kingdom: Cambridge University Press, 2017) at 9, and Roy Goode, *Principles of Corporate Insolvency Law*, 4th ed (London: Sweet & Maxwell, 2011) at 61.

by firms to circumvent environmental regulations. The SCC has stated that bankruptcy is not an excuse to circumvent rules.[2] Where the attainment of bankruptcy objectives impacts negatively on environmental policy, the fresh start policy imposes a price on the public.[3] For instance, if environmental orders are stayed subject to bankruptcy proceedings, the public interest is undermined whilst government awaits the stay to lapse.[4] In contrast, where a stay or disclaimer order is refused, it becomes more probable that the cost of cleanup will be borne by the polluter or the party that benefitted from the pollution rather than the public.[5] Using two basic insolvency mechanisms discussed in Chapter One such as liquidation and rescue, corporations broadly use these tools to evade environmental obligations. For instance, in liquidation, where bankruptcy orders are granted by a court, assets of the firm are sold and proceeds are distributed to creditors at the close of the proceedings; with reorganization or rescue, the company sells its assets and transfers proceeds to creditors to write-off its debts. Thus, the company emerges from bankruptcy under a new name and spins off its assets.[6] Consequently, corporations can leverage these bankruptcy schemes to abandon contaminated assets considered a public burden at the end of their productive lives.[7]

Another common strategy is spinning off riskier assets; for instance, in the United States, Macey and Salovaara explored how coal companies exploited the bankruptcy process by creating Peaboy, Arch Coal and Alpha Natural Resources, subsidiaries used as conduits to discharge significant environmental obligations in a manner that pierces the regulatory scheme.[8] Similarly,

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[2] *Orphan Well Association v Grant Thorton Ltd* [2019] 1 S.C.R. 150 at paras 118 & 160 [*Redwater*].
[3] Jill Losch, "Bankruptcy V. Environmental Obligations: Clash of the Titans" (1991) 52 Louisiana L Rev 150.
[4] *Ibid* at 160.
[5] *Ibid.*
[6] Naveena Sadasivam, "How Bankruptcy Lets oil and gas Companies Evade Cleanup Rules" (07 June 2021), online *Grist* https://grist.org/accountability/oil-gas-bankruptcy-fieldwood-energy-petroshare/ [Sadasivam].
[7] *Ibid.*
[8] Joshua Macey & Jackson Salovaara, "Bankruptcy as a Bailout: Coal Company Insolvency and the Erosion of Federal Law" (2019) 71 Stan L Rev 879 at 883 [Macey & Salovaara].

Sadasivam, explained how Fieldwood Energy (Fieldwood), an offshore oil and gas firm in Mexico, in 2021, attempted to offload over $7 billion environmental liabilities.[9] After declaring bankruptcy, Fieldwood planned to split its assets and move inactive wells into two entities and intended to sell the active assets to a newly incorporated company. It proposed to abandon 1,170 wells, 280 pipelines and 270 drilling facilities, leaving the cost of remediating the inactive wells at public expense.[10] Even though the scheme was ultimately halted by the court, it uncovers how corporations leverage bankruptcy proceedings to undermine the law.[11] Drawing from the Prediction Theory of law which states that a bad person has the tendency to infract rules unless the law imposes sanctions that outweigh the perceived benefit of disobeying the law,[12] companies are not exempt from this principle.[13] By spinning off inactive wells into entities undergoing financial distress, bankruptcy laws allow corporations to shift cleanup costs to taxpayers.[14] By creating multiple companies, firms can ensure that funds are diverted to pay shareholders to fund on-going projects leaving environmental claims unsatisfied.[15]

The Creditors Bargain Theory, which centers on maximizing assets for creditors as discussed in Chapter One has also been used as a circumventing tool. For instance, when parent companies create underfunded subsidiaries and vest them with legal responsibility of the parent company, through corporate personality, corporations carve out productive assets from overwhelming regulatory obligations so that when the underfunded entity liquidates, it becomes impossible to hold the parent company liable for those regulatory obligations. In this way, they

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[9] Sadasivam, *supra* note 6.
[10] *Ibid.*
[11] *Ibid*
[12] Oliver Wendall Holmes, "The Path of the Law" (1897) 10 Harvard L Rev 457 at 459.
[13] See also Jill E. Fisch, "The Bad Man Goes to Washinton: The Effect of Political Influence on Corporate Duty" (2006) 75 Fordham L Rev 1593-1594.
[14] Sadasivam, *supra* note 6.
[15] *Ibid.*

succeed in paying secured creditors without having to satisfy regulatory obligations.[16] This has enabled corporations to externalize cleanup costs to the public despite regulatory measures designed to internalize them. For instance, in *PricewaterhouseCoopers Inc. v Perpetual Energy,*[17] under a reorganization, Perpetual Energy's parent company operated Perpetual Operating Trust and Perpetual Energy Operating Corp (jointly called Perpetual Energy Group) and created another company named Sequoia Resources Corp (Sequoia) which had $5.67 million in assets but assumed over $223 million in liabilities.[18] Perpetual Energy Group rearranged its affairs to move assets into Sequoia (the asset agreement). In an action by the trustees declaring the transaction illegal and at undervalue, the Alberta Court of Appeal found that the asset transaction was conducted between Perpetual Energy Group, the parties were all related and did not intend to deal at arm's length as the structure and pricing of the asset agreement were under the control of the directors and officers of Perpetual Energy Group.[19] Thus, the focus for determining whether the dealing was non-arm's length is on the relationship between the parties to the transaction.[20]

Regulatory obligations are duties designed to be obeyed by corporate entities to internalize pollution costs.[21] Sometimes however, corporations may be required to post performance bonds to ensure the contaminated land is reclaimed upon conclusion of the project; for this to exist, the bond must be sufficient to guarantee the completion of the reclamation for the regulatory authority to undertake the work.[22] The fact that corporations could become insolvent prior to fulfilling reclamation obligations compels the need for financial assurance instruments in the form of

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[16] Macey & Salovaara, *supra* note 8 at 887.
[17] *PricewaterhouseCoopers Inc. v Perpetual Energy* [2022] ABCA 111 [*Perpetual Energy*].
[18] *Ibid* at para 11.
[19] *Ibid* at paras 107-108.
[20] *Ibid* at para 109.
[21] Macey & Salovaara, *supra* note 8 at 888.
[22] *Ibid* at 894.

bonds.[23] These bonds may be useful for two reasons: first, to ensure the land will be reclaimed; second, they enable firms to internalize the cost of their pollution activity.[24] They are to cover for the restoration of the land to its original condition to accommodate another productive life until the end of the production process; the financial assurance evidences the ability of operating firms to pay for their AROs.[25]

These financial assurance instruments could be of three kinds, namely surety bonds, collateral bonds, and self-bonds. A surety bond is a third-party guarantee that indemnifies the regulatory authority where the corporation fails to remediate the land. Collateral bonds require posting of assets as security and allowing the regulatory authority to dispose of the assets and apply the proceeds to reclaim the contaminated site.[26] Self-bonding requires the company to act as guarantor of its own regulatory obligation.[27] It does not guarantee payment of the full cost of remediation, it only expresses commitment to indemnify the regulatory body for the cost of performing the reclamation work; such costs are not to exceed the bond amount.[28] Thus, self-bonding has a limited security value as the corporation may be unable to fulfil its obligations in the event of insolvency.[29]

In sum, corporations can adopt three basic strategies to evade environmental obligations through bankruptcy. First, they may restructure in a manner that enables them to externalize costs. Second, parent companies can spin off subsidiaries with minimal assets but significant environmental liabilities, the parent company transfers its own liabilities into the newly created

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[23] Colin Mackie & Laurel Besco, "Rethinking the Functions of Financial Assurance for End-of-life Obligations" (2020) 50 Envtal L Reptr at 10573 [Mackie & Besco].
[24] Macey & Salovaara, *supra* note 8 at 894.
[25] Mackie & Besco, *supra* note 23 at 10573.
[26] Macey & Salovaara, *supra* note 8 at 894.
[27] *Ibid* at 895.
[28] Bruce Huber, "Negative Value Property" (2021) 98 Washington Uni L Rev 1461 at 1480-1482 [Huber].
[29] Macey & Salovaara, *supra* note 8 at 895.

company. Third, they may overvalue the assets and undervalue their liabilities in order to appear solvent and continue in operation.[30] However, the question of whether SF and ESG measures initiated by lenders or the decision of the court in *Redwater* has been able to block this loophole or improve environmental performance will be considered in the next section.

4.3 Juxtaposing SF, ESG Guidelines with the Redwater Decision and Their Impact on the Environment

In Chapter One, it was established that the credit system enables a debtor to obtain money from a creditor. It also empowers the creditor to obtain a security interest on the borrower's assets as collateral for the loan which enables the creditor to mitigate the risk of default.[31] The risk of loan default explains why lenders impose sustainability measures to lessen environmental risk associated with their borrowers' business, but ultimately to avert financial loss.[32] This shows that financial investors largely engage in ESG campaigns to promote shareholders' value due to the belief that effective management of environmental and social risks is crucial to their financial performance.[33] They may do so, not because of deeply-held ethical convictions, but based on the expectation that managing ESG factors may bolster material effect on long-term investment returns.[34]

Although, as established in Chapter Three, the government of Canada launched the Expert Panel on Sustainable Finance and appointed a Sustainable Finance Action Council to oversee

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[30] See generally, Macey & Salovaara, *supra* note 8 at 883, *Perpetual Energy supra* note 17, Sadasivam, *supra* note 6, and Huber, *supra* note 28 at 1480 -1482.
[31] Stephen P. Parsons, *The ABC of Debts: A Case Study Approach to Debtor Creditor Relations and Bankruptcy Law*, 4th ed (New York: Walters Kluwer, 2017) at 25.
[32] Poonam Puri, "The Future of Stakeholder Interests in Corporate Governance" (2010) 48 Can Bus LJ 427 at 429 - 430.
[33] Craig Mackenzie, "The Scope for Investor Action on Corporate, Social and Environmental Impacts" in Rory Sullivan & Craig Mackenzie, eds, *Responsible Investment* (United Kingdom: Taylor & Francis, 2006) at 22-23.
[34] Gail Henderson, "Making Corporations Environmentally Responsible: The Limits of Responsible Investing" (2012) 13 German LJ 1412 at 1413.

sustainable investment practices, these measures still fall short of expectations.[35] The Canadian approach to ESG practices has broadly been described as "leapfrogging" despite integrating measures in traditional lending since the 1990s (as earlier discussed in Chapter One). Canadian banks have been accused as merely greenwashing. For instance, most lending institutions in Canada publish ESG guidelines, but in practice, they focus more on the impact of climate risk on their investment rather than the impact of their investments on the environment.[36]

This regulatory approach impacts more on the debtor than the lender as most creditors are careless, since they would eventually seek cover under bankruptcy proceedings filed by their borrowers to evade rules.[37] In contrast, an ambitious and stronger regulatory framework would make creditors cautious in their investments, protect borrowers and prevent bankruptcies.[38] The lack of interaction between the Canadian version of SF and environmental regulation in the financial services sector in Canada, and the absence of government regulatory framework to enforce compliance with environmental laws, constitutes a major setback.[39] Although the Office of the Superintendent of Financial Institutions recently published Guidelines on Climate Risk Management for the financial sector, the guide mandates lenders to minimize climate-related risks, and exercise measures towards achieving these objectives.[40] Whilst this is commendable, it however portrays the sustainability approach in Canada as lethargic and laidback; the result would

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[35] Julie Segal, "What is Sustainable Finance and why Should the Canadian Government Regulate it?" (14 January 2022), E*nvironmental Defense* https://environmentaldefence.ca/2022/01/14/what-is-sustainable-finance-and-why-should-the-canadian-government-regulate-it/ [Segal].
[36] *Ibid.*
[37] Macey & Salovaara, *supra* note 8.
[38] Segal, *supra* note 35.
[39] Benjamin J. Richardson, "Financing Environmental Change: A New Role for Canadian Environmental Law" (2003) 49 McGill LJ 145 at 147 [Richardson].
[40] Government of Canada, "Office of the Superintendent of Financial Institutions: Climate Risk Management" (March 2023), *Government of Canada* https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b15-dft.aspx.

have been different if the guide was published earlier than 2023.[41] What is lacking in Canada is the nexus between financial services and a sound government policy framework to support the transition to a low carbon economy; what Canada has presently is an approach that merely addresses ESG from a financial risk perspective.[42]

Another major challenge is implementation. Most proposals issued by the Institute for Sustainable Finance, such as the Expert Panel on Sustainable Finance and the Capital Mobilization Plan, lack implementation.[43] Also, in terms of green bonds, Canada is not a major player as the country is ranked 11th in green bond issuance. The country focuses on transition bonds that finance firms' transition to low carbon emissions with less usefulness as they lack consonance with global best practices; transition bonds adopt weaker sustainability criteria compared to green bonds. Consequently, Canada is perceived as lagging behind in ESG and SF standards.[44]

Although failure to address climate-related risks in the fossil fuel industry is another problem, the fact that the Canadian financial industry is not bold enough to address environmental issues emanating from the financial sector due to the perceived impact on maximization of investment returns, there is presently no policy framework to regulate transition in this sector to a low carbon economy since measures such as carbon capture and storage may impose huge costs.[45] Consequently, it has been established that ESG and sustainability measures have not assisted much in making Canadian banks pay greater attention to long-term environmental performance as they have been criticized for not being transparent enough about the social and environmental impacts

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[41] Olaf Weber, "The Future of Sustainable Finance in Canada" (30 March 2023), online: *The Future of Economy* https://thefutureeconomy.ca/op-eds/sustainable-finance-olaf-weber-university-waterloo/.
[42] *Ibid.*
[43] *Ibid.*
[44] *Ibid*
[45] *Ibid.*

of their lending.[46]

In contrast, judicial control through *Redwater* has produced better results than ESG and SF strategies in regulating environmental protection in the financial sector. As shown in Chapter Two, since the decision in *Redwater,* environmental regulation in the investment sector has attracted more seriousness amongst lenders compared to the situation pre-*Redwater* examined in Chapter One and Chapter Three.[47] Apart from having greater impact on creditors compared to ESG and sustainability measures which have more bearing on debtors, *Redwater* boldly proclaimed that creditors cannot continue to leverage bankruptcy proceedings filed by their borrowers to evade rules designed to protect the environment.[48] The practical effect of *Redwater* is that it compels creditors to enforce environmental obligations more seriously as failure to do so has the potential of impacting the borrower's ability to fulfil the loan obligations.[49] Apart from impacting on the business they finance, creditors can be held vicariously liable for contributing to environmental pollution through projects they finance. For instance, the extension of liability to financiers under the American Superfund contaminated land cleanup regulations practically altered the tenor of banking practices.[50] Whilst ESG and ethical investment schemes are plausible incentives in assisting lenders in mitigating environmental risks, they lack the objective basis for determining what qualifies as ethical or sustainable investment, thus raising questions about whether these schemes have been able to achieve the set objectives.[51]

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[46] John Patridge, "Banks Urged to Disclose Ethical Risks" *The Globe and Mail* (7 November 2002), online https://www.theglobeandmail.com/report-on-business/banks-urged-to-disclose-ethical-risks/article18289842/.
[47] *Redwater, supra* note 2.
[48] *Ibid* at paras 118 & 160.
[49] Richard Gulobow, "Bankruptcy's Effect on Environmental Claims: Should Involuntary Environmental Creditors be Entitled to Non-Dischargeable Super-Priority Creditor Status?" (1993) 3 Univ Miam Bus L Rev 100 at 127.
[50] Richardson, *supra* note 39 at 173.
[51] *Ibid* at 159.

Currently, the only legal instrument compelling financial investors to pay greater attention to environmental concerns is judicial intervention through *Redwater* since bankruptcy laws have been manipulated by firms and creditors to circumvent environmental obligations.[52] For instance, as stated in chapter Two, the SCC declared in *Redwater* that bankruptcy is not an excuse to ignore rules as creditors will not be allowed to disclaim contaminated assets of borrowing firms and offload the cost of remediation to the public.[53]

Applying *Redwater,* the court in *Manitok,* found that reclamation obligations must be satisfied ahead of creditors' claims regardless of whether the assets are related to the environmental condition or not.[54] In *Trident*, the court found that environmental obligations are not monetary claims that can be reduced to provable claims; therefore, they must be satisfied before distribution of proceeds to anyone else.[55] In *Qualex,* the Court of Appeal noted that although environmental reclamation obligations are public duties owed to fellow citizens, the power to enforce such obligations are only exercisable by the regulatory body empowered to do so; such powers do not extend to private litigants.[56] And in *Mantle*, while upholding the decision of the Alberta Court of Kings Bench, the Court of Appeal found that the entire assets of a corporation including unrelated assets must be applied to satisfy environmental claims ahead of creditors.[57]

Therefore, it becomes clear that *Redwater* and the decisions after it have greater significant

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[52] Macey & Salovaara, *supra* note 8.
[53] *Redwater, supra* note 2 at paras 118 & 160.
[54] *Manitok Energy Inc (Re),* [2022] ABCA 117 [*Manitok*].
[55] *Orphan Well Association v Trident Exploration Corp,* [2022] ABKB 839 [*Trident*].
[56] *Qualex-Landmark Towers Inc v 12-10 Capital Corp,* [2024] ABCA 115, rev'g *Qualex-Landmark Towers Inc v 12-10 Capital Corp,* [2023] ABKB 109 [*Qualex* (KB)]. See also Robyn Gurofsky, Jessica Cameron & Anthony Mersich, "Resetting the Boundaries of the Redwater Umbrella: Alberta Court of Appeal Affirms Priority of Mortgages" (10 April 2024), online: *Fasken* https://www.fasken.com/en/knowledge/2024/04/resetting-the-boundaries-of-the-redwater-umbrella, and Denise Bright et al, "Qualex- Landmark: Redwater Scope and Environmental Priority in Alberta" (11 April 2024) at 2-3, online (pdf): https://www.bennettjones.com/Blogs-Section/Qualex-Landmark-Redwater-Scope-and-Environmental-Priority-in-Alberta?pdf=basic&s={860AB744-A566-4313-B354-1496B12E1D79}&d=April%2011,%202024&lang=en.
[57] *Mantle Materials Group Ltd v Travelers Capital Corp* [2023] ABCA 339 (CA), aff'g *Re Mantle Materials Group Ltd* [2023] ABKB 488 at paras 42-43 (KB) [*Mantle*].

influence on best practices in lending than ESG rules declared by banks. While the latter contain declaratory proclamations without much practical impact on the environment, the former imposes liability risk upon creditors; thus, compelling them to protect themselves from the corporate irresponsibility of their borrowers.[58]

By ensuring that financial investments are rooted on sound ethical principles and standards, financial investors can display sound lending practices that reflect global best practices in their businesses and those of their borrowers.[59] With the intervention of the courts through *Redwater*, it is expected that more giant strides will be recorded.[60] The Canadian ESG and sustainability framework has also assumed a corporate social responsibility (CSR) outlook which has been described as a weak strategy that narrows sustainability and the protection of society to an estimation of the positive net value of a company's financial performance.[61] Thus, it established that despite having a robust outlook, the sustainable investment strategy of Canadian banks is of limited value in ensuring environmental protection compared to judicial control offered by the courts.[62]

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[58] Eric Appelt & Sean Parker, "Get Your Priority Right: Case Law Update on the Intersection of Creditor Claims and Environmental Obligations" (05 Septer 2023), online: *McLennan Ross* https://www.mross.com/what-we-think/article/get-your-priorities-straight-case-law-update-on-the-intersection-of-creditor-claims-and-environmental-obligations.

[59] Richardson, *supra* note 39 at 193.

[60] *Ibid.*

[61] Poonam Puri, "Green but not Enough: Sustainability in Canadian Corporate Governance" in Beate Sjafjell & Christopher Bruner, eds, *Corporate Law, Corporate Governance and Sustainability* (Cambridge: Cambridge University Press, 2019) at 146.

[62] *Ibid.*

Chapter Five

Conclusion

In Chapter One, this research explained the credit system and explored how it facilitates economic growth. While doing so, it uncovered the risks inherent in the business of lending and the various means deployed by creditors to recover loans. Borrowers who could not fulfill their financial obligations were in some cases, compelled to invoke bankruptcy proceedings to enable them to reorganize and make a fresh start. While this objective may be attained, it constitutes a stumbling block for creditors since their claims could not be satisfied where their borrowers have outstanding environmental obligations required to be fulfilled ahead of creditors' claims. Chapter Two interrogated this conflict and raised questions around whether the borrower who polluted the environment through its business operations or the creditor who financed the activity should bear the cleanup costs. After an explorative analysis, this research found that although the extension of liability to third-party creditors may have some regulatory impacts by compelling creditors to take environmental issues in their lending seriously, it however seems to be at variance with the PPP which stipulates that those who pollute the environment should be made to pay.

As a way of mitigating environmental risks in their investments, financial investors embraced SF to link their investments with environmental and social goals. Chapter Three evaluated this concept and detailed how it relates to sustainable development and how Canadian banks have fared in integrating this approach in their investments. While this is commendable, this research finds that absent tangible environmental risk abatement and control measures in place, the continued lending to high emission sectors such as oil and gas, automotive and mining should

be de-emphasized.[1]

This research concludes that judicial intervention through *Redwater* has more profound impact on environmental concerns than ESG and sustainability measures declared by banks. While exploring this issue in Chapter Four, this thesis finds that ESG measures declared by Canadian banks are still less than robust. On this basis, this thesis finds that with the intervention of the courts through *Redwater*, this loophole may be blocked particularly with the extension of liability to creditors to cover all secured assets of the estate whether they are related to the environmental condition or not. Thus, the intervention of the court in *Perpetual Energy* is commendable.

As noted in Chapter Four, this research also finds that the regulation of the financial services sector in Canada has not witnessed serious environmental policy and controls by the government.[2] Since environmental issues are becoming serious concerns for lenders,[3] the government could encourage ethical financing through a deliberate regulatory framework.[4]

To achieve greater results, a critical change is required from stakeholders in the form of values, beliefs, and attitudes in instituting a sound investment system.[5] Ethical investment should no longer be a discretionary option for lenders; with the global economy facing grave ecological problems, government policy can be instituted to guide the ethical behavior of financial investors to enable them better assume the responsibility of institutionalizing a sustainable investment culture rather than maximizing profits at societal expense.[6]

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[1] Olaf Weber, "The Future of Sustainable Finance in Canada" (30 March 2023), online: *The Future of Economy* https://thefutureeconomy.ca/op-eds/sustainable-finance-olaf-weber-university-waterloo/.
[2] Benjamin Richardson, "Diffusing Environmental Regulation Through the Financial Services Sector: Reforms in the EU and Other Jurisdictions" (2003) 10 Maast J Europ & Compet L 233 at 250.
[3] Benjamin Richardson, "Environmental Liability and Banks: Recent European Developments" (2002) 17 J Intn'l Ban L 289 at 290.
[4] *Ibid* at 251.
[5] Claudia Kruse & Michael Schmidt, "Sustainable Governance and Leadership" in Paul Fisher, ed, *Making the Financial System Sustainable* (Cambridge: Cambridge University Press, 2020) at 145.
[6] Benjamin Richardson, "Keeping Ethical Investment Ethical: Regulatory Issues for Investing for Sustainability" (2009) 87 J Bus Ethics at 555.

While commending judicial intervention in environmental protection, this thesis further finds that some pronouncements of the courts in certain areas still require clarity. For instance, on the issue of assets 'unrelated' to the environmental condition, the courts in *Manitok,*[7] *Trident*,[8] and *Mantle*,[9] classified assets 'unrelated' as part of assets related to the environmental condition since assets in those cases were used as part of the production activities of the corporation. The courts, preferred to defer the issue of unrelated assets in the oil and gas business "for another day".[10] The clarification of this uncertainty is necessary as lenders may tend to assume assets unrelated are part of related assets in assessing their security interest when projecting their lending decisions.[11]

Finally, in Chapter Two, this thesis also finds that although *Redwater* has made lenders more cautious in their lending, they are yet to fully understand the implementation of that decision. This was exemplified in *Mantle* where the lender saw that the project being financed had significant outstanding environmental liabilities but underestimated the extent of its potential exposure to their borrower's environmental liabilities and proceeded to provide funding.[12] On this basis, this research advocates for a renewed approach. Where due diligence reveals that the borrower has significant outstanding environmental obligations, it is imprudent for a lender to proceed with the investment.[13]

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[7] *Manitok Energy Inc (Re),* [2022] ABCA 117 at para 36 [*Manitok*].
[8] *Orphan Well Association v Trident Exploration Corp,* [2022] ABKB 839 [*Trident*].
[9] *Mantle Materials Group Ltd v Travelers Capital Corp* [2023] ABCA 339 (CA), aff'g *Re Mantle Materials Group Ltd* [2023] ABKB 488 at paras 42-43 (KB) [*Mantle*].
[10] *Manitok, supra* note 7 at para 36.
[11] Jassmine Girgis, "What are Unrelated Assets When it Comes to Environmental Reclamation Obligations? The Lending Industry Needs to Know" (15 November 2023) at 3 - 5, online (pdf): *Ablawg* https://ablawg.ca/wp-content/uploads/2023/11/Blog_JG_Mantle.pdf.
[12] Per Feasby J in *Mantle, supra* note 9 at paras 42 - 43.
[13] As was the position in *Redwater* and *Mantle* earlier examined.

The judicial control mechanism through *Redwater* has introduced a new template in the investment sector in Canada. Apart from instilling a stronger regulatory framework on the environment within the context of the financial market, it has enabled lenders to better understand the impact of their investments on the environment and at the same time, underscores the need for financial investors to pay greater attention to their borrowers' business operations not just at the point of loan extension, but also to monitor compliance after the loan has been granted.[14] It further highlights the need for financial investors to strengthen their SF and ESG measures to reflect global best practices in lending that are capable of withstanding the test of time.[15] With judicial control supplementing government's deliberate financial policy framework, financial investors would be able to improve their environmental performance.[16] Where environmental harm is prevented, the issue of liability may not arise; and where there is no liability, there will be no determination of who pays for cleanup costs. Therefore, balancing these objectives would better enable financial investors in Canada to embrace sustainable investment strategies that reflect best practices in lending.

[14] Michael Ohlrogge, "Bankruptcy and Public Externalities: Evidence from a Natural Experiment" (May 24, 2019), online: *SSRN* https://ssrn.com/abstract=3273486.
[15] *Ibid.*
[16] *Ibid.*

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