

# No Lien for Linear Property Taxes The Alberta Court of Appeal Resolves a Priority

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On February 12, 2019, the Alberta Court of Appeal released its decision in *Northern Sunrise County v Virginia Hills Oil Corp* ("**Virginia Hills**"). The question before the Court was whether municipal property taxes for "linear property" constituted secured claims in insolvency proceedings. The Alberta Court of Appeal rejected this claim, and found that there is no statutory lien for linear property taxes under Alberta's *Municipal Government Act*, RSA 2000, c M-26 (the "**MGA**").

*Virginia Hills* is a significant decision for insolvency professionals, lenders, municipalities and energy companies alike. However, the Court of Appeal also left several questions unanswered, which may be problematic in future insolvencies.

## Background

Virginia Hills Oil Corp. was a small publicly traded oil producer with assets in north central Alberta. Some of its assets were held through its subsidiary Dolomite Energy Inc. (collectively the "**Debtors**"). The Debtors' main secured creditors were the Alberta Treasury Branches and the Bank of Nova Scotia (the "**Banks**"). The Debtors also owned a pipeline that passed through three municipalities (the "**Municipalities**").

By early 2017, the Debtors' owed tens of millions of dollars to the Banks and other creditors. Furthermore, the Debtors owed approximately \$1.1 million to the Municipalities for late "linear" property taxes regarding their pipeline. Under Alberta's *MGA*, municipalities may assess property taxes for "linear property", which is defined as pipelines, wells, telecommunications systems, electric power systems and similar infrastructure located on lands.

On February 13, 2017, Alvarez & Marsal Canada Inc. (the "**Receiver**") was appointed receiver and manager over the Debtors. The Debtors were then placed into bankruptcy in May, 2017.

Eventually, the Receiver sold all or substantially all of the Debtors' property and then applied for directions from the Court of Queen's Bench to distribute the sale proceeds to the Banks in partial satisfaction of their secured claims. On June 20, 2017, the Court of Queen's Bench heard the application and granted the relief sought by the Receiver (the

"Order"). Among other things, the Order also provided that "*the pre-receivership linear tax claims of the Municipalities .... form unsecured claims only.*"

Although the Municipalities had notice of the Receiver's application, the Municipalities did not attend the hearing, did not file any materials, provide proofs of secured claims, or seek a stay of the Order. Ultimately, the Receiver distributed the proceeds to the Banks on July 14, 2017.

However, several days after the distribution one of the Municipalities filed an appeal (the "**Appeal**") of the Order, asserting that the unpaid linear property taxes were secured claims that had equal or higher priority to the claims of the Banks. The other Municipalities later joined the Appeal.

Specifically, the Municipalities appealed on the basis that the unpaid linear property taxes benefited from a statutory lien under the *MGA* over (i) some or all of the Debtors' lands in Alberta, and/or (ii) the Debtors' linear property (i.e. the pipeline). The Municipalities relied on Section 348(d)(i) of the *MGA*, which provides that "*Taxes due to a municipality ... are a special lien ... on land and any improvements to the land, if the tax is a property tax ...*".

### **The Decision of the Court of Appeal**

The primary issue before the Court of Appeal was whether the unpaid linear property taxes benefited from a statutory lien under Section 348 of the *MGA*, and thus, were secured claims in the receivership and bankruptcy.

The Receiver and the Banks opposed the Appeal by arguing that Section 348 applied only to property taxes concerning the actual lands, i.e. to the "non-linear property". Moreover, they argued that, in any case, the Appeal was (i) moot as the sale proceeds had already been distributed by the Receiver (there was nothing now left for the Municipalities), and (ii) an abuse of process as the Municipalities had never previously raised their secured claims with the Chambers Judge or at all in the receivership.

The Court of Appeal dismissed the Appeal and made several findings:

1. **No Mootness.** The Court of Appeal dismissed the mootness argument and held that "*the mere fact that the funds have been distributed by the Receiver does not render moot an appeal*". While not deciding the issue, the Court suggested that monies distributed to a bank could be traced or be declared as being held on constructive trust, should an appeal be allowed.
2. **No Abuse of Process.** The Court of Appeal also dismissed arguments of abuse of process. While the Court recognized that "*taking a position on appeal ... without participating in the hearing can be extremely problematic in the insolvency context where certainty, speed and efficiency are necessary to maximize recovery for everyone*", the Court nevertheless considered the appeal on its merits since it engaged issues of general importance. In the "*exceptional circumstances*" of this case, the Court reasoned there was no abuse of process.
3. **No Lien.** Finally, on the merits, the Court of Appeal sided with the Receiver and

the Banks, and held that Section 348 of the *MGA* did not create a lien for unpaid linear property taxes. The Court came to this conclusion after conducting a detailed interpretation of the *MGA* when read in its "*grammatical and ordinary sense and in harmony with the scheme*". In particular, the Court remarked that under the *MGA* linear property taxes are assessed against the "*operator*" of the linear property, who is not necessarily the owner of the underlying lands or even the linear property itself. Indeed, the Court acknowledged that in the oil and gas sector the operator of a pipeline is often not the owner of the lands. In the result, the Court concluded that there was "*no justification*" to interpret Section 348 as creating a lien over the linear property and/or relevant lands, since doing so would be to attach a lien to property having potentially no relationship to the tax debtor. In reaching this result, the Court of Appeal did not consider the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 ("**BIA**").

Simply put, the Court of Appeal concluded that the Legislature had not intended to create a statutory lien for unpaid linear property taxes, and the Municipalities could not assert any such lien in priority to the secured claims of the Banks or any other of the Debtors' creditors.

## Implications

For receivers, trustees, lenders and Alberta's oil and gas companies, *Virginia Hills* has several important implications (some of which are more positive than others).

a) **Priority of Secured Creditors Protected.** The most important take-away from *Virginia Hills* is that the claims of secured creditors (such as banks) will continue to have priority over linear property taxes in insolvency. This is important since encroachments into the ability of lenders to recover under their security has the potential to make credit more expensive. This could have wider societal ramifications than unpaid property taxes.

The Court of Appeal came to its decision solely by interpreting the *MGA*, and it is therefore open to the Legislature to amend the *MGA*. Further, the Court of Appeal did not appear to include the *BIA* in its analysis and therefore it may be open to others to raise these issues at a later date. In short, the priority contest may be only temporarily resolved.

b) **Clawing Back Distributions.** A more troubling aspect of the Court of Appeal's analysis was the dismissal of the mootness arguments. As noted above, the Court of Appeal specifically found that the "*mere fact*" the sale proceeds had been distributed by the Receiver did not prevent an appeal by the Municipalities, and suggested that proceeds could be traced or declared as being held on trust in other cases.

This should be a cautionary tale for receivers and trustees. In *Virginia Hills*, the Municipality filed the Appeal on the 29th day after the Order, i.e. the day before the time for appealing the Order under the *Alberta Rules of Court* would have lapsed. The practical take-away is that receivers and trustees may wish to refrain from making any distributions, in future cases, until the relevant appeal period has expired, and so to avoid the unhappy scenario of a receiver or trustee having to "claw-back" proceeds paid to a creditor.

c) **Drain on the Estate.** Finally, the Court of Appeal's conclusion that the Appeal

was not an abuse of process is troubling. It goes without saying that insolvency proceedings should be expeditious and efficient in order to maximize recoveries for all stakeholders. This means that where an application in a receivership or bankruptcy is heard, the concerns of all affected stakeholders should be raised, considered and determined. Creditors or other stakeholders should not be entitled to hide in the weeds and only raise submissions at the appellate level. The latter scenario leads to wasted expense, duplication and delay, all of which ultimately erodes the value of the estate. It may also lead to determinations being made without a proper evidentiary record and/or in a forum where not all affected stakeholders can be heard.

Although the Court of Appeal was alive to these concerns, it heard the Appeal because of "*exceptional circumstances*". In order to protect the integrity of insolvency proceedings, it is hoped this practice is truly "*exceptional*"

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