Alberta court finds breach of duty of good faith from party's failure to advance claim in a timely manner

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In the recent decision of *Taber Water Disposal Inc. (Re)*, 2024 ABKB 680 (*Taber Water*), the Alberta Court of King's Bench (the Court) concluded that an Approval and Vesting Order (the AVO) vested a working interest in an oilfield to a purchaser, free and clear, despite a third party's subsequent assertion that it owned the interest in question. *Taber Water* is an important decision as it provides guidance on how and when disputed ownership claims should be adjudicated and interprets and applies the statutory duty of good faith under the *Bankruptcy and Insolvency Act* (the BIA).

Background

Taber Water concerned the BIA proposal proceedings of Taber Water Disposal Inc. and Enerstar Petroleum Corp. (collectively, the Debtors). Pursuant to a court-approved sales process in the proposal proceedings, a third party, 2635672 Alberta Ltd. (the Purchaser), acquired a 45 per cent working interest in an oilfield from the Debtors. The transaction was thereafter approved by the Court, on notice to relevant stakeholders.

Following the AVO, the transaction closed and the Purchaser sent a notice of assignment to the 55 per cent working interest owners and operator of the oilfield, named Whitehaven Beach Capital Corp and Title Shot Oil Inc. (hereafter, the Operator). However, the Operator refused to recognize the Purchaser as a working interest owner, alleging there was nothing for the Debtors to sell to the Purchaser because a third party, Arrow Point Oil & Gas Ltd. (the Third Party), owned the 45 per cent working interest. Notably, the Third Party had been served with all materials for all applications in the proposal proceedings, including the application for the AVO.

Because of the Operator's refusal to recognize the working interest of the Purchaser, the Purchaser applied to the Court for a declaration that it was the owner of the 45 per cent working interest.

The decision

As noted, the central issue before the Court was whether the Purchaser was the owner of the 45 per cent working interest. In the result, Justice Feasby of the Alberta Court concluded the Purchaser owned the 45 per cent working interest.

In reaching this conclusion, the Court considered whether the AVO, which included typical language that the purchased assets were conveyed to the Purchaser free and clear of all "claims", was sufficient to expunge any purported ownership claim by the Third Party. After considering several authorities, including the Ontario Court of Appeal decision in *Third Eye Capital Corporation v Dianor Resources Inc*, 2019 ONCA 508 (*Dianor II*), the Court held that the "law concerning third party ownership claims and vesting orders is unclear". Nevertheless, the Court distilled the following principles from the relevant authorities:

- The common law principle that one cannot sell more one owns (traditionally known as the "*nemo dat*" principle) is not sacrosanct, and statutory exceptions to *nemo dat* exist under the BIA.
- Third party ownership claims are different than other interests in land that derive from the debtor's title, such as mortgages and liens, and should only be vested off in exceptional circumstances by applying the analytical framework set out by the Court of Appeal in *Dianor II*.
- Third party ownership claims should be determined prior to a vesting order being made, or disputed assets should be excluded from the vesting order and a process for determination of the claim should be ordered.
- Where third party ownership claims are not determined prior to a vesting order being made, and the third party had an obligation to advance its claim in the insolvency process, such claims may be extinguished by an appropriately worded vesting order.

Having found that the AVO was not itself dipositive of the application, the Court considered the statutory duty of good faith contained in Section 4.2 of the BIA. That provision, incorporated into the BIA in 2019, empowers the Court to make "any order" it considers appropriate to remedy a lack of good faith.

On this issue, the Court concluded that the duty of good faith applies to third parties in insolvency proceedings who purport to have a claim of ownership over the assets in possession of the debtor and who have notice of the insolvency proceedings. Moreover, Justice Feasby held that the duty of good faith required the Third Party "*to come forward*" with its claim at the AVO application, or beforehand, and the failure to do so was the "*anathema to the efficient administration of the insolvency process*". Accordingly, the Court concluded that the Third Party breached the statutory duty of good faith. The remedy granted for the breach was an "adverse inference" that the Third Party had no ownership claim to the oilfield, and thus, that the Debtors had validly sold the interest to the Purchaser under the transaction approved by the AVO.

Although this analysis was sufficient to resolve the application, the Court went on to also find that the evidence weighed in favour of a finding that the Third Party had no legitimate ownership claim.

Takeaways

Taber Water is a noteworthy decision in respect of several issues. First, it adds to the body of law regarding vesting orders and "ownership" claims, as opposed to the typical creditor claim which is "derived" from the debtor's ownership. *Taber Water* indicates that ownership claims are unlikely to be "vested" off without express language in the sale approval order addressing competing ownership claims.

Second, it is one of the few reported decisions to analyze the statutory duty of good faith under the BIA and fashion a remedy for a breach of the duty of good faith. In particular, the decision highlights the flexibility of the good faith provision and remedy.

Third, it highlights the need for parties in insolvency proceedings to take steps to protect their interests and not "lie in the weeds". The Court identified delay and inaction as "anathema" to the proper functioning of insolvency proceedings.

Finally, the Court reiterated the importance of vesting orders and affirmed the modern reality that vesting orders are "essential to maximizing returns for creditors". At a general level, the decision should give purchasers in insolvency proceedings comfort that their legitimate expectations will be protected.

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