Alberta Court of Appeal vindicates trustee in the latest Perpetual Energy decision

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In the recent decision in *PricewaterhouseCoopers Inc. v Perpetual Energy Inc.*, 2021 ABCA 16 (Perpetual Energy), the Alberta Court of Appeal has reversed the Honourable Justice D.B. Nixon's decision, striking out or summarily dismissing claims by PricewaterhouseCoopers Inc. in its capacity as trustee in bankruptcy (the Trustee) of Sequoia Resources Corp. (Perpetual/Sequoia). As a result, the Trustee's claim that Perpetual had undertaken pre-bankruptcy transactions at less than fair market value must proceed to trial. In doing so, the Court of Appeal commented upon the scope and nature of the Supreme Court of Canada's decision in *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 (Redwater) regarding abandonment and reclamation obligations (AROs) associated with energy projects. The Court of Appeal also reversed a punitive costs decision which Justice Nixon had issued against the Trustee personally.

Perpetual Energy is a pivotal decision for creditors, stakeholders and regulators involved in the Sequoia Resources Corp. bankruptcy. It is also significant for Alberta insolvency and corporate law generally as well as for the Alberta oil and gas sector with respect to AROs.

Background: the Perpetual/Sequoia litigation

The Perpetual group of companies (Perpetual Energy Inc., Perpetual Operating Trust, and Perpetual Energy Operating Corp.) owned various oil and gas interests in Alberta. In particular, the group was structured such that:

- The Operating Trust held beneficial title to assets and associated AROs;
- The Operating Corp. held legal title to the assets and related licenses, and
- Perpetual Energy Inc. was the ultimate parent of the group, such that the Operating Corp. was a wholly owned subsidiary.

In 2016, Perpetual undertook multi-step transactions (the Transactions) aimed at transferring Perpetual's uneconomic assets to a third party, while retaining economic assets. Specifically, the Transactions were undertaken such that:

- All beneficial interest and burden to the uneconomic assets was transferred from the Operating Trust to the Operating Corp. for nominal consideration and all

valuable assets were transferred out of the Operating Corp. to a newly formed entity;
- Perpetual Energy Inc. sold its shares in the Operating Corp. to a third party for $1.00;
- Susan Riddell Rose, the sole director of the Operating Corp., resigned as director; and
- The Operating Corp. changed its name to Sequoia Resources Corp. (Perpetual/Sequoia).

Approximately 18 months after the Transactions closed, Perpetual/Sequoia assigned itself into bankruptcy and PricewaterhouseCoopers Inc. was appointed as Trustee. Following its appointment, the Trustee commenced litigation against various defendants, including Perpetual Energy Inc., the Operating Trust and Ms. Rose, on the basis that the Transactions were such that Perpetual/Sequoia obtained only $5.67 million in assets but assumed over $223 million in AROs. The specific claims advanced by the Trustee included:

- A claim under Section 96(1)(b) of the *Bankruptcy and Insolvency Act* (Canada) (BIA) that the Transactions (or parts thereof) were transfers at undervalue;
- The business of Perpetual/Sequoia had been operated in an oppressive manner, contrary to the provisions of the Alberta *Business Corporations Act* (BCA); and
- Ms. Rose had breached her duties as director of Operating Corp prior to the Transactions occurring.

In January 2020, on application by Perpetual and Ms. Rose, Justice Nixon struck out or summarily dismissed all but one of the Trustee's claims. The claim not struck out was the claim under Section 96(1)(b) of the *BIA*, which Justice Nixon then subsequently struck out upon a further application for summary dismissal by the defendants, which subsequent decision is still under appeal. Additionally, Justice Nixon ordered the Trustee to pay 85 per cent of Ms. Rose's legal costs personally. The Trustee appealed the dismissal of its claims, while the defendants both appealed against the refusal to also dismiss the Section 96 claim. The Court of Appeal allowed the Trustee's appeal and reversed Justice Nixon's decision, including his costs award, and dismissed the defendants' appeal.

Legal issues in *Perpetual Energy*

The legal nature of the AROs and the *Redwater* decision

To commence its analysis, the Court of Appeal undertook a detailed review and explanation of the Supreme Court of Canada's landmark decision in *Redwater*. This was necessary since the majority of Justice Nixon's analysis and findings was premised on an interpretation of *Redwater* determining that ARO liabilities were not "real" liabilities, but contingent liabilities or something less. The Court of Appeal rejected this interpretation of *Redwater*.

Instead, the Court of Appeal held that *Redwater* stands for the proposition that while AROs may not be current liabilities or obligations, they are nonetheless real liabilities and obligations of a company (para 87). Although AROs may not be seen as conventional "debt" as there is no "creditor" (neither the Alberta Energy Regulator nor

the Orphan Well Association is owed anything), they are obligations of companies "owed to the public" that the Trustee cannot ignore (para 93). The Court of Appeal went one step further in this determination and found that not only did *Redwater* confirm that the AROs are continuing obligations of a bankrupt corporation, but also that AROs have to be discharged even in priority to secured creditors (para 95).

As Drew Yewchuk notes in the article, *The Sequoia Bankruptcy Part 1: The Motion to Strike and the Interveners*, Justice Nixon's determinations would have "open[ed] the door to interpretations [of the *BIA* and the *BCA*] where general laws become meaningless and only debts owed to creditors count." The Court of Appeal's decision unequivocally closes this door and brings the literal meaning of the words of the statutes more in line with the common sense understanding of business and environmental obligations within the oil and gas industry. In so doing, the Court of Appeal's explanation of *Redwater* should be a welcome clarification to the industry.

Oppression claim & creditor remedies

With respect to the Trustee's oppression claim, the Court of Appeal found that Justice Nixon erred by failing to appreciate the collective nature of the role of the Trustee as representing all the creditors (para 127). As such, the Court found that the Trustee has standing to bring an oppression action as a "proper person."

Additionally, the Court of Appeal noted that it is not oppressive for a company to have become insolvent or bankrupt. Yet, the Trustee may be able to challenge pre-bankruptcy conduct on the basis that creditors have a "reasonable expectation that the corporation's business and assets will not be unfairly re-structured in such a way that payment of … debts becomes impossible" (para 129).

Director duties

Similarly, the Court of Appeal found that Justice Nixon erred in dismissing the Trustee's claim against Ms. Rose, seeking damages for the alleged breach of her duties as director. Although Ms. Rose had signed a Resignation & Mutual Release as part of the Transactions, it is unclear whether a generalized release would release the director from duties owed to the public. The extent of a director's duty to ensure that the corporation discharges environmental obligations would need to be determined at trial (para 97). Further, the Court of Appeal rejected the notion that directors of a special purpose corporation owe any lesser or different duty from directors generally.

Role of a trustee and scope of duties

Finally, in the context of the costs award, the Court of Appeal found that although a trustee in bankruptcy is an officer of the court, the Trustee's "primary duty … is to the creditors of the estate through the inspectors." Similar to a lawyer, who is also an officer of the court, the Trustee does not owe duties to potential defendants and in fact would be placed in a conflict of interest if it was also under a legal duty to third parties (para 202).

Furthermore, relying on an Ontario Superior Court of Justice case, *Golden Oaks Enterprises Inc (Trustee of) v Scott*, 2019 ONSC 5108, the Court distinguished

impartiality from a proper adversarial role in litigation. Once the Trustee has reasonably concluded that there are assets belonging to the estate in third party hands and that there are grounds to recover them, and it obtains instructions to begin legal proceedings from inspectors, according to the Court of Appeal its role will necessarily involve some advocacy (para 203, citing *Golden Oaks* para 48).

The Court of Appeal also dismissed Justice Nixon's finding that as an officer of the Court, the Trustee should be held to a higher standard and be required to comply with principles of procedural fairness. There is no free standing right to procedural fairness in civil law; it is a principle of administrative law. Principles of administrative law are not transferable to civil commercial matters (para 204). As such, there is no requirement for the Trustee to conduct any investigation before suing. The Trustee might seek information from the former directors of the corporation, but that is not always necessary as there may be ample information available in the corporate records, or from other sources (para 213).

Conclusion and implications

To summarize, the Alberta Court of Appeal has determined that none of the Trustee's claims in *Perpetual Energy* fail to disclose a cause of action and therefore, none can be struck out or summarily dismissed. These complex issues all need to be tried on their merits. The Court of Appeal has also set aside the unusual costs award granted by Justice Nixon against the Trustee personally. *Perpetual Energy* is a significant and decisive victory for PricewaterhouseCoopers Inc. as Trustee.

More generally, *Perpetual Energy* has important ramifications for insolvency law, corporate and commercial law, as well as the Alberta oil and gas sector. In particular, the Court of Appeal has explained that:

- The obligation of a trustee in bankruptcy to act "impartially" does not mean that a trustee cannot take a proper adversarial role in litigation, nor does a trustee in bankruptcy owe a duty to investigate to third parties. It will remain prudent for trustees and other insolvency professionals to conduct an investigation prior to commencing litigation on behalf of the insolvent estate, to determine whether such action is warranted.
- The duty of directors to the company are "universal" to all corporations, and there are no special or lesser rules for special-purpose vehicles. Directors should be mindful that when a company approaches or enters the "zone of insolvency", the scope of their duties broaden and they also owe duties to the company's creditors more generally, as well as corporate and shareholder interests.
- Creditors may be entitled to assert oppression claims against past directors or a bankrupt corporation where the corporation has structured its affairs in such a way that the payment of debts "becomes impossible".
- Finally, AROs are continuing obligations of a bankrupt corporation and those obligations will have to be discharged, even in priority to paying secured creditors. AROs are a future, but very real liability and transactions intended to shift AROs into a "BadCo.", which only holds assets of little value with significant liabilities, may be impeachable under the *Bankruptcy and Insolvency Act*.

The authors would like to thank Sinem Ersoy for her contribution to this article.

By

Miles F. Pittman, Josef Krüger, Jessica Cameron, Jack Maslen, Sinem Ersoy

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Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

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