Court of Appeal of Alberta dismisses application for leave in Bellatrix CCAA proceedings

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The Court of Appeal of Alberta issued the latest decision in the *Companies' Creditors Arrangement Act* (CCAA) proceedings of Bellatrix Exploration Ltd. (Bellatrix).[1]

In the decision rendered by the Honourable Mr. Justice Watson, the Court dismissed an application by a contractual counterparty for leave to appeal a decision concerning a debtor's failure to perform an eligible financial contract (EFC). In so doing, the Court confirmed the four-factor test for leave to appeal under section 13 of the CCAA[2], and highlighted the restraint that appellate courts should apply when considering appeals of a supervising insolvency judge's decision.

As a result, the decision appealed from, *Re Bellatrix Exploration, 2020 ABQB 809*, remains good law respecting the treatment of claims against a debtor company arising from an EFC in CCAA proceedings. Namely, a party will only have an unsecured claim pursuant to an EFC, absent a security interest to the contrary. Keep reading to learn more about how parties to EFC agreements may protect their interests in insolvency proceedings.

Background

The proposed appeal arose out of a decision rendered by Madam Justice Romaine in respect of the obligation of the debtor, Bellatrix, to continue to perform an EFC during the course of its CCAA proceedings.[3]

In that decision, Justice Romaine found that subsection 34(7) of the CCAA, which excludes EFCs from the debtor's powers of disclaimer, does not however create an obligation for the debtor to continue to perform the EFC throughout the proceedings. Justice Romaine also found that the contractual counterparty to the EFC, BP Canada Energy Group ULC (BP), only had an unsecured claim for breach of contract against Bellatrix and that BP's set-off rights were not engaged, as BP had never terminated the agreement.

BP sought leave to appeal Justice Romaine's decision, alleging four manifest errors of law in the insolvency judge's decision. The decision focused on the lower court's

interpretation of the effect of disclaimers on EFCs and the related characterization of BP's claims for damages and set-off.

The court's decision

The Court of Appeal's decision sets out a principled framework for considering leave applications in the context of the CCAA. Underlying the Court's analysis is the purpose of the CCAA and the role of the supervising insolvency judge. The CCAA has an overall remedial objective to address and mitigate the potential catastrophic effects of insolvency. The supervising insolvency judge occupies a critical role in insolvency proceedings as the person with extensive knowledge of the various stakeholders' interests and the commercial realities of each proceeding.

The broad discretionary authority conferred on the supervising judge recognizes this position of knowledge and allows the Court to respond to the factual matrixes of each proceeding, as well as make decisions that further the CCAA's remedial objectives. Accordingly, the insolvency judge's decisions receive significant deference, and appellate courts should interfere only if the judge has "acted unreasonably, erred in principle or made a manifest error."

This principle of deference applied in this case, notwithstanding the fact that Justice Romaine was not the supervising insolvency judge of Bellatrix's CCAA proceedings. The Court did recognize her as an expert in this area, however. Accordingly, it reviewed her decision through a deferential lens.

On a leave to appeal application under the CCAA, the Court is to consider the following four-factor analysis:

1. Whether the point on appeal is of significance to the practice;
2. Whether the point raised is of significance to the action itself;
3. Whether the appeal is *prima facie* meritorious or, on the other hand, whether it is frivolous; and
4. Whether the appeal will unduly hinder the progress of the action.

The Court's reasons largely focused on the issue of merit. This is consistent with case law, which establishes that the lack of merit alone justifies dismissing an application for leave to appeal. Applying the principles of statutory interpretation, the Court found that BP's position (that EFCs should continue to be performed) was inconsistent with the CCAA's objective to enable the debtor to make restructuring attempts.

As to the question of set-off, the Court confirmed that the CCAA's recognition of the continued application of set-off does not in itself create an entitlement for set-off that is otherwise absent. Further, the record before Justice Romaine did not establish an "evidential" case for damages that BP would seek to set-off.

The Court went on to find that the delay of distribution of proceeds caused by BP's proposed appeal created higher stakes for Bellatrix's employees, as opposed to the claims of BP. The delay would also result in the continued erosion of the available proceeds. Critically, the Court also rejected the argument that the proposed appeal raised questions of significance to the practice, stating that "[t]he grounds proposed are

novel because they lack merit." When weighed against the lack of meritorious arguments on appeal, these considerations all favoured the dismissal of the leave application.

Implications

Although the Court's framework of analysis is not novel, this decision provides an important reminder to ground reviews of insolvency decisions on the objectives of the applicable insolvency statute.

Due to the often-complex commercial considerations and stakeholder interests involved in insolvency matters, the supervising insolvency judge is conferred significant discretionary authority. The substantial deference owed to insolvency judges must be recognized when considering leave motions. The delay occasioned by an appeal will also heighten the potential prejudice to various stakeholders given the fast-paced nature of insolvency proceedings. Further, this decision also highlights the importance of delineating the line between novel issues of law and lack of merit. This approach suggests that the appellate court's gatekeeping function generally applies to militate against granting leave applications.

Aside from providing a succinct summary of the test for leave to appeal in CCAA proceedings, the decision also affirms that the underlying decision appealed from, *Re Bellatrix Exploration, 2020 ABQB 809*, remains good law.

This prior decision determined that:

(a) Notwithstanding the fact that an EFC cannot be disclaimed in CCAA proceedings, there is no obligation on a debtor company to continue to perform its obligations pursuant to an EFC;

(b) The non-insolvent counterparty to an EFC may only exercise set-off rights pursuant to subsection 34(8) of the CCAA, where the EFC has been terminated and where the agreement itself provides for the exercise of such rights; and

(c) Any claims against the debtor company pursuant to an EFC will be simply unsecured claims, absent a security interest to the contrary.

In order for parties to EFCs to protect their positions, they should consider taking a security interest in their counterparties' assets in order to secure the obligations owing pursuant to such EFC. The difficulty, of course, is that such security interest will be subject to applicable law regarding priorities and the counterparties' assets will very likely already be encumbered.

Parties should also ensure they have a wide ability to set-off pursuant to the terms of their EFCs. Lastly, once a counterparty has entered insolvency proceedings, the non-insolvent counterparty should consider exercising its rights of termination under the EFC and insolvency legislation sooner rather than later.

[1] *Re Bellatrix Exploration Ltd*, 2021 ABCA 85.

[2] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, as amended.

[3] *Re Bellatrix Exploration Ltd*, 2020 ABQB 809.

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