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The Sequoia Bankruptcy Part 2: The Appeal of the Motions to Strike and Dismiss

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Cases Commented On: *PricewaterhouseCoopers Inc v Perpetual Energy Inc*, 2020 ABQB 513 (CanLII); *PricewaterhouseCoopers Inc v Perpetual Energy Inc*, 2021 ABCA 16 (CanLII)

This is part two of a series on the litigation resulting from the bankruptcy of Sequoia. The first part covered the first application to strike, and the applications to intervene in the appeal of that decision at the Court of Appeal.

This part covers two decisions in the Sequoia bankruptcy saga: 2020 ABQB 513 (CanLII), a costs decisions at the Queen's Bench level, and 2021 ABCA 16 (CanLII), the Court of Appeal decision overturning that costs decision and the decision to strike the majority of the Trustee's claims.

The basic facts are set out in my first post on the Sequoia bankruptcy, and in a short summary written by the Court of Appeal (2021 ABCA 16 (CanLII) at paras 3-13). I will continue to use the short forms established in the first post: The Alberta Energy Regulator (AER), Perpetual Energy Inc, Perpetual Operating Trust, and Perpetual Operating Corp (The Perpetual Group), Abandonment and Reclamation Obligations (ARO), and PricewaterhouseCoopers (the Trustee).

The Queen's Bench Decision on Costs Against the Trustee

PricewaterhouseCoopers Inc v Perpetual Energy Inc, 2020 ABQB 513 (CanLII) is a costs decision decided in August 2020 in relation to the initial application to strike. Based upon the premise that the Trustee had carelessly sued Susan Riddell Rose for her decisions as a Director of Sequoia in relation to the asset transfer, Justice Nixon ordered the Trustee to pay 85% of Rose's legal costs (at para 217). Justice Nixon found there was no evidence that the inspectors appointed to supervise the Trustee's work had approved the litigation (at para 64). That is a particularly odd finding, because without the permission of inspectors to bring the action, the Trustee would have no power to bring the action at all (see section 30(1)(d) of the *Bankruptcy and Insolvency Act,* RSC 1985, c B-3). The Trustee was found to be personally liable for costs– ordinarily a Trustee is entitled to be indemnified for litigation costs from the bankrupt estate (at paras 42-44). Justice Nixon also found the Trustee had incorrectly sworn an affidavit saying that Rose had benefitted from the Sequoia transaction (at paras 76-82), and that the Trustee failed to provide Rose the level of procedural fairness she was owed prior to filing the action. (at paras 83-114)

The Court of Appeal Overturns the Decision to Strike

The Court of Appeal heard *PricewaterhouseCoopers Inc v Perpetual Energy Inc*, 2021 ABCA 16 (CanLII) on December 10, 2020 and released a 229 paragraph decision on January 25 – a remarkably quick turnaround in light of the complexity and number of issues on appeal. The decision is an appeal of Justice Nixon's decision to strike most of the Trustee's statement of claim (2020 ABQB 6 (CanLII)) and the associated costs decision discussed above. The Perpetual Group also cross-appealed seeking to strike out the portions of the claim that were not struck out or dismissed by Justice Nixon (at para 56). In short, the Court of Appeal overturned Justice Nixon's decision striking most of the claims and the costs order was set aside. The Court of Appeal also rejected the Perpetual Group's cross-appeal (at paras 227-229). The Court of Appeal found a number of errors in Justice Nixon's approach and interpretation of the law. As further set out below, the Court of Appeal found Justice Nixon improperly changed his reasons for decision between the oral reasons for decision and the written reasons, incorrectly combined the analysis for applications to strike and summary dismissal, misinterpreted the impact of the Supreme Court decision in *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 (CanLII) (*Redwater*), made errors in deciding whether the Trustee should have complainant status for an oppression claim, failed to understand the public policy claim and improperly struck it for being novel, incorrectly accepted contradictory evidence that Rose had acted in the best interest of Sequoia, misunderstood the costs protections for Trustees in the *Bankruptcy and Insolvency Act*, and made unwarranted criticisms of the Trustee.

The Court of Appeal criticized Justice Nixon for first issuing his decision orally but then later issuing significantly different written reasons for the decision some five months later (at paras 60-67). The Court of Appeal found that Justice Nixon had blurred the considerations for an application to strike with the considerations for an application for summary dismissal, which led to him striking claims because the pleadings lacked particulars that the pleadings were not required to have (at paras 68-81).

The Court of Appeal also rejected Justice Nixon's troubling interpretation of *Redwater*:

> The case management judge focused on the fact that *Redwater* confirmed that the Alberta Energy Regulator is not a "creditor" with respect to the Abandonment and Reclamation Obligations, and accordingly the Abandonment and Reclamation Obligations cannot be a "claim provable in bankruptcy". That much is an accurate reading of *Redwater*, but it does not mean that Abandonment and Reclamation Obligations are "assumptions and speculations" that do not exist, that they are not an obligation or liability of Perpetual/Sequoia, or that they should be valued at "nil". The Abandonment and Reclamation Obligations are an obligation of Perpetual/Sequoia, owed "to the public" and the surface landowners, but which are nevertheless obligations which the trustee of a bankrupt corporation cannot ignore. Not only did *Redwater* confirm that Abandonment and Reclamation Obligations are a continuing obligation of a bankrupt corporation, that decision confirms that those obligations had to be discharged even in priority to paying secured creditors. (at para 95)

The Court of Appeal proceeded to find that much of the ARO was no longer contingent in any regard, as the assets in question "included 910 shut in wells and 727 abandoned wells, meaning that some portion of the obligation to reclaim was due to be performed or was imminent. The exact cost of reclamation may have been unknown and unquantified, but the obligation was no longer 'contingent'; the obligation was merely unperformed" (at para 88).

The Court of Appeal was also critical of the Perpetual Group's cross-appeal asking to strike the claim of a transfer at undervalue under the *Bankruptcy and Insolvency Act*. Perpetual argued that the challenged transaction was at arm's length and could not be challenged. There were two sets of transactions: (1) the transaction that moved the Perpetual Group's high ARO assets to Sequoia, which was not shown to be at arm's length, and (2) the transaction that sold Sequoia from the Perpetual Group to Kailas Corp, which was at arm's length (at paras 105-106). The Perpetual Group's cross-appeal focused on the second transaction, even though it was the first transaction that was being challenged. The Court of Appeal determined the claim of a transfer at undervalue not at arm's length must be resolved at trial (at para 111).

The Court of Appeal restored the oppression claim, finding that Justice Nixon erred in conflating the question of "complainant status" for an oppression claim with the merits of that claim (at para 144).

On the claim that the transaction violated public policy, the Court of Appeal noted that there was an important public policy issue relating to the careful structuring of the transaction to avoid regulatory scrutiny:

> A central issue underlying this litigation is whether an oil and gas company can arrange its affairs so as to avoid regulatory scrutiny, in a manner that is analogous to income tax law. For example, does the Alberta Energy Regulator's policy enable a technique such as leaving the Retained 1% Interests in Perpetual/Sequoia for a few minutes in the middle of this transaction in order to bypass regulatory scrutiny? The public policy pleading alleges that this type of strategy is not permissible, and that avoiding regulatory scrutiny is not necessarily equivalent to regulatory compliance… (at para 147)
>
> The case management judge concluded that the Trustee in Bankruptcy was attempting to impose liability for environmental claims on directors, contrary to the intentions of the Legislature. That, however, is not the thrust of this litigation. The Trustee does not seek to make directors liable for environmental damage, but rather to hold them to account for allegedly having structured the affairs of the corporation (Perpetual/Sequoia) in such a way that made it impossible for that corporation to discharge its public obligations. This may be a novel position, but it is not one that should be resolved summarily (at para 149).

Ultimately, the Court of Appeal concluded that while the public policy claims may require amendment or particulars, they should not have been struck out (at para 152).

The Court of Appeal found that Justice Nixon erred in striking the claim against Rose for a breach of director's duties, partly because his decision to strike relied on his misreading of *Redwater*, and partly because he had reached inconsistent conclusions on whether the former

Sequoia director had acted in Sequoia's best interests (at paras 153-159). The Court of Appeal raised the possibility that an agreement releasing a director from liability may not release the director from duties owed to the public (at paras 165-166) and that a decision on the exact scope of the release in question required further evidence and could not be resolved without a trial (at paras 167-171).

It necessarily followed from the above that Justice Nixon's costs award should be vacated, but the Court of Appeal went on to note that there were a number of important reviewable errors in the costs decision itself. The first was the distinction that Justice Nixon drew between the Court of Queen's Bench and "bankruptcy court," an institution that does not exist in Alberta (at paras 184-187). This false distinction led Justice Nixon to determine protections for a Trustee in "bankruptcy court" did not apply. The second error was to draw a distinction between the Trustee, the estate in bankruptcy, and the bankrupt corporation for the purposes of liability for costs. This unhelpful distinction led Justice Nixon to reach conclusions that were moot or incomprehensible relating to the Trustee's personal liability and the Trustee's right to be indemnified by the bankrupt estate (at paras 188-193). The Court of Appeal also rejected as unreasonable Justice Nixon's finding that the Trustee's litigation may not have been properly authorized by the inspectors (at paras 194-198).

The Court of Appeal also criticized Justice Nixon's conclusion that the Trustee owed administrative law duties of procedural fairness to Rose. The Court of Appeal found that these principles of administrative law are not transferable to civil commercial matters, and that such a duty of fairness would conflict with the Trustee's duties to the bankrupt estate. In short, "a trustee in bankruptcy is not an administrative tribunal" (at paras 199-205). Some of the recommendations Justice Nixon made for the conduct of the Trustee were "absurd" (at para 215) or would have had no point (at para 217). Justice Nixon's criticisms of the Trustee were unwarranted (at para 219) and none of the Trustee's claims were egregious or unjustified (at paras 220-225).

Further Sequoia Litigation

Justice Nixon released another Sequoia-related decision, *PricewaterhouseCoopers Inc v Perpetual Energy Inc*, 2021 ABQB 2 (CanLII) on January 14, 2021. The decision summarily dismisses the section 96 *Bankruptcy and Insolvency Act* claim brought by the Trustee. The decision turns on whether the ARO were "obligations, due and accruing due" for the purposes of the *Bankruptcy and Insolvency Act*. The Queen's Bench Justice found (as he did in his prior decision) that it was not, and should be valued at "nil". (at paras 194, 255-256, 278) Strangely, the *Redwater* decision (*Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5) which was centrally important to his first decision, is not cited even once in this new decision.

Although the Court of Appeal decision has now rejected the conclusion about ARO underlying this decision (see 2021 ABCA 16 (CanLII) at para 95), this decision will still need to be overturned in a separate appeal. This is an unfortunate situation. An application on substantially the same issues that had already been decided and that was under appeal should not have been heard. This bizarre situation is the result of Justice Nixon's conclusion that hearing another application for summary dismissal of the same claim was not an abuse of process (at paras 43-

46). These procedural tangles are meant to be prevented by the doctrine of abuse of process (see *Toronto (City) v CUPE, Local 79*, 2003 SCC 63 (CanLII) at paras 51-52)

So what is the current state of the Sequoia litigation? Once the procedural tangle noted above is sorted out, the litigation will effectively be back at square one.

Commentary

The Court of Appeal was highly critical of Justice Nixon's decisions on a wide variety of issues. It is unusual to see an appellate court explicitly and trenchantly reject so many different aspects of a lower court decision. Most notable is the Court of Appeal's thorough rejection of the idea that *Redwater* nullified ARO, or determined ARO were not liabilities. The Orphan Well Association, the industry interveners, and Alberta landowners should be happy with this outcome.

And there is other news for Albertans haunted by thoughts of ARO liabilities. Roughly two years after the Supreme Court issued its judgment in *Redwater,* the AER has started to outline a new plan for ARO. Another blog post assessing those proposed changes will follow. I leave you with some words from the Court of Appeal decision that should be carved into the iron rings of Alberta's engineers:

> "while the Abandonment and Reclamation Obligations may not crystallize for some time, they are inevitable; no well produces forever." (2021 ABCA 16, at para 86)

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