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# The Sequoia Bankruptcy Part 3: The Second Application for Summary Dismissal Should Never Have Been Heard

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**Case Commented On**: *PricewaterhouseCoopers Inc v Perpetual Energy Inc,* 2022 ABCA 111

This is part 3 of a series on the litigation resulting from the Bankruptcy of Sequoia Resources Corp. (Sequoia). Part 1 covered the first application to strike and the first application to intervene. Part 2 covered a costs decision against the Trustee and the first appeal decision.

This third part covers some of the interlocutory decisions, the Court of Appeal's decision on the second summary dismissal decision, and explains how the initial asset transfer seems to have passed regulatory review.

The facts are set out in my first post on the Sequoia bankruptcy, or in a short summary written by the Court of Appeal (*PricewaterhouseCoopers Inc v Perpetual Energy Inc,* 2021 ABCA 16 (CanLII) at paras 3-13).

I will continue to use the short forms established in the earlier posts: 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 Minor Decisions

First, a brief summary of the earlier decisions related to procedural steps taken in this litigation, which explain some of the delay (the initial statement of claim was filed in August 2018).

*PricewaterhouseCoopers Inc v Perpetual Energy Inc,* 2020 ABCA 36 (CanLII) is a decision from November 2019 on an application for security for costs of the first appeal by the Perpetual Group. Justice Barbara Veldhuis ordered the Trustee to post security for costs for its appeal (which the Trustee was later successful in). Justice Veldhuis found the individual representative of the Trustee provided deliberately unhelpful answers during examination for discovery (at para 24-32); answers that Justice Veldhuis found were inconsistent with the Trustee's role as an officer of the court (at para 51-56).

*PricewaterhouseCoopers Inc v Perpetual Energy Inc*, 2020 ABCA 254 (CanLII) is a decision on a bundle of applications. Justice Veldhuis referred the applications to a panel at the Court of Appeal under rule 14.37(2)(f) of the Alberta Rules of Court, Alta Reg 124/2010, and the applications were heard by Justices Thomas Wakeling, Michelle Crighton, and Ritu Khullar. The applications

centred around attempts by the individual representative for the Trustee to obtain intervener status to dispute the Justice's findings that he had acted inconsistently with his role as an officer of the court and to protect his personal reputation (at paras 8-11). The applications were dismissed because the individual's reputation was not an issue in the substantive appeal, and because an appeal is of the order given by the court, not of the reasons (at paras 18-22).

*PricewaterhouseCoopers Inc v Perpetual Energy Inc*, 2020 ABCA 273 (CanLII) was the costs decision following those dismissed applications.

Finally, in *Susan Riddle Rose*, *et al v PricewaterhouseCoopers Inc*, *et al*, 2021 CanLII 58908 (SCC), the Supreme Court dismissed the Perpetual Group's application for permission to appeal the Court of Appeal's decision on the first summary dismissal.

**The Appeal of the Second Summary Dismissal**

*PricewaterhouseCoopers Inc v Perpetual Energy Inc,* 2022 ABCA 111, released March 25, 2022, is the decision on the appeal of Justice DB Nixon's second decision that summarily dismissed the section 96 *Bankruptcy and Insolvency Act,* RSC 1985, c B-3 (BIA) claim brought by the Trustee. The appeal was heard by Justices Patricia Rowbotham, Ritu Khullar, and Jolaine Antonio.

The decision starts by reviewing the history of the litigation (at para 1-12, and the timeline in the appendix to the decision). The Court of Appeal noted that Justice Nixon released his second decision granting summary dismissal before the Court of Appeal's decision on the appeal of his first decision granting summary dismissal was released, and so he did not have the benefit of their directions (at para 23). The Court of Appeal concluded Justice Nixon erred on three points: (1) failing to consider how ARO impacts asset value; (2) misunderstanding the evidence about the amount of ARO; and (3) finding the application was not an abuse of process (at para 3).

The Court of Appeal found that Justice Nixon erred by considering only whether ARO counted as "obligations, due or accruing due" for the purposes of the Balance Sheet Solvency Test, contrary to *Redwater* (*Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 (CanLII)) (at para 31). The Court of Appeal pointed out that applying "the Balance Sheet Solvency Test post-*Redwater* to pre-*Redwater* affidavits, proved to be something of a linguistic and legal minefield" (at para 35). I observed the hearing, and the question of whether ARO belongs as a positive number on the liabilities side of a balance sheet or a negative number on the assets side of the balance sheet took a significant amount of time at the hearing. The Court of Appeal determined the "correct legal approach is not defined by the industry's accounting practices" (at para 40) and concluded:

> As *Redwater* and the *First Appellate Decision* have made clear, end-of-life obligations are an inherent part of asset value. When they do not constitute a conventional debt payable to an identifiable creditor, it will be appropriate to account for them as depressing values on the left-hand side of the balance sheet. (at para 39)

Justice Nixon misunderstood some of the evidence and in some parts of his decision considered only the ARO of a select set of the most valuable assets (at para 59-63), and he incorrectly adopted an unduly strict interpretive approach to the *BIA* based on his view the *BIA* was equivalent to a

penal statute (at paras 71-74). The Court of Appeal dismissed this approach entirely, as "[n]o party or intervenor seriously defended the chambers judge's approach" (at para 71).

The Court of Appeal also concluded the second application for summary dismissal was an abuse of process that should never have been heard (at paras 75, 103). Justice Nixon misdirected himself by focusing on whether the same arguments would be made at the second application: "[a]rguments that could have been made, but were not, are captured by the rationales underlying abuse of process, res judicata, issue estoppel, merger, and the jurisprudence prohibiting relitigation and litigation by instalment" (at paras 85-86). A new application for the same relief cannot be brought solely to switch to a different tactic that could have been attempted the first time (at paras 93-95). This "blatant attempt to relitigate" also created inconsistencies of position, as the Perpetual Group reversed their position on at least two issues in the second application to strike (at paras 98-102).

The Perpetual Group also argued that because of certain trusts involved in the movement of the assets, there was no 'transfer' for the purposes of the *BIA*. In relation to this argument, the Court of Appeal noted that "that on the record available to us, it is not persuasive" (at para 27).

**Commentary**

There are not many surprises in 2022 ABCA 111. Because the decision results from re-litigation in an abuse of process, the decision largely repeats the earlier Court of Appeal decision in 2021 ABCA 16. However, in rejecting misleading analogies between mortgage debts and ARO, the Court of Appeal did write a helpful analogy:

> [54] Building on the repair analogy, end-of-life obligations could be loosely thought of as asbestos in the walls of a house. It will need to be rectified sooner or later, and someone will have to pay for it. If work is underway or complete, any outstanding payment for the work may be an obligation due or accruing due. Until then, however, the house is worth less than a similar asbestos free house. The asbestos depresses the value of the house.

Thinking of Alberta as a house with asbestos in most of the walls is, unfortunately, a useful exercise for understanding the orphan and inactive oil and gas infrastructure problem.

What is next for the Sequoia litigation? Now that the procedural tangle of the double summary dismissals has been sorted out, the litigation is back at Queen's Bench. The claim may proceed to trial, or the Trustee may proceed with the application for summary judgment they filed back in August 2018.

**A Note on the Initial Asset Transfer**

One positive to the lengthy litigation is that quite a few documents from the litigation have been made public, clarifying how the initial transfer was structured to get past the AER's review. At the time of the transfers in 2016, the AER had a system for assessing the asset-to-liability ratio of corporations being transferred licenses for oil and gas assets in Alberta. The purpose of the system was to block transfers that would result in corporations holding ARO they could not reasonably

pay to clean up. Since that is what happened with Perpetual and Sequoia, an important question is how the license transfers got past the AER.

It appears it was done like this:

During the initial transfers, Sequoia (at that time still called Perpetual Energy Operating Corp) was given an undivided 1% legal interest in certain highly productive oil and gas assets *and the right to be the licensee of record with respect to the wells associated with those assets,* but Sequoia would hold those assets as a bare trustee for Perpetual Operating Trust, and transfer them fully to Perpetual Operating Trust if Sequoia had an asset-to-liability ratio of 1.1 or higher a year after the deal closed (see paragraph 10 of the Statement of Claim or 2020 ABQB 6 at para 261, described as "the scheme"). This somehow allowed the transfer to avoid regulatory scrutiny (2021 ABCA 16 at paras 9 and 147).

I did not grasp how that approach helped avoid regulatory scrutiny until I read one of the transcripts of questioning involved in the litigation: the AER's approach to liability management used *deemed* assets and *deemed* liabilities, which were calculated based on the cash flow for the assets the corporation was the licensee of record for, whether the corporation holds 1% or 100% of the asset (see Questioning of CNRL's Affiant, pages 27-34). So Sequoia, as the licensee of record, would have appeared on the AER's asset-to-liability paperwork with the full benefit of "certain highly productive oil and gas assets", despite owning only 1% of them subject to conditions that meant Sequoia owned something closer to 0% of them.

This approach to reviewing transfers, of course, did not reflect commercial reality or anything else recognizable as "reality". The AER has since changed their liability system somewhat, and hopefully one of the changes was to stop considering only who the licensee of record is rather than considering asset ownership, in order to pay more attention to reality. This sort of regulation is how Alberta ended up with metaphorical asbestos in the walls, and justifies Albertan's low confidence in their regulators.

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