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Not Your Grandfather's Cooperative Federalism: Constitutional Themes at the Supreme Court Hearing of *Redwater*

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Case Commented On: *Orphan Well Association, et al v Grant Thornton Limited, et al*, 2017 ABCA 124 (CanLII), leave granted 2017 CanLII 75023 (SCC), webcast available here, factums on appeal available here

Background

The Orphan Well Association and Alberta Energy Regulator's action against a now-defunct oil and gas company's bankruptcy trustee and primary creditor— commonly known as *Redwater*— was heard before the Supreme Court in February, and with the facts of the case disclosing a number of significant issues pertaining to the division of powers, the constitutional themes took centre stage throughout the oral and written submissions to the court. The arguments put forward by the parties and interveners represent significant considerations of Canada's doctrinal approach to federalism as they pertain to contemporary natural resource governance. This post focuses on these substantial doctrinal issues put to the court by the parties and interveners, as it is likely that the case will be decided on narrower bases than the full suite of considerations put to the Court given its general restraint on constitutional matters that could represent a shift in the established doctrine dealing with the division of federal and provincial powers.

Redwater Energy Corporation (Redwater) was a publicly traded oil and gas company, that was licensed under the jurisdiction of the Alberta Energy Regulator (AER) with respect to several properties (for more on the *Redwater* decision, see Fenner Stewart's post and Nigel Bankes' post). The AER regulates under a complex regime dictated by the *Oil and Gas Conservation Act*, RSA 2000, c O-6, and the *Pipeline Act*, RSA 2000, c P-15 (provincial regime), enacted pursuant to sections 92(5), (13), and 92A of the *Constitution Act, 1867*. The AER had set conditions on Redwater pertaining to abandonment and environmental clean-up of some of those properties. The conditions placed restrictions on transfers of both valuable properties and those of net liability. Such conditions are imposed to ensure net funds are available to undertake environmental clean-up, avoiding the environmental liabilities accruing to taxpayers through transfer of the implicated sites to the Orphan Well Association (OWA), an arm's length non-profit that assumes this work on behalf of the provincial government.

Redwater suffered financial setbacks, and when it was unable to meet its financial obligations, its principal secured creditor, ATB Financial (ATB), commenced enforcement proceedings, and in May 2015, Grant Thornton (GT) was appointed receiver under the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (BIA), federal legislation passed under section 91(21) of the *Constitution Act, 1867*. The AER took the position that its conditions on Redwater's properties were to be discharged by the receiver prior to the distribution of funds to creditors, secured or otherwise,

owing to the AER being a regulator, not a creditor, and as such the conditions were not provable claims in bankruptcy under section 2 of the BIA. This position mirrored the ruling in *PanAmericana de Bienes y Servicios v Northern Badger Oil & Gas Limited*, 1991 ABCA 181 (CanLII).

In a majority ruling, the Alberta Court of Appeal (ABCA) held the paramountcy doctrine is engaged by the operation of the provincial regime, specifically that the pertinent provisions of the provincial regime and the AER's orders made pursuant to them: (1) are in conflict with section 14.06 of the BIA, interpreted as exempting trustees and receivers from personal liability, and allowing trustees and receivers to disclaim assets, as well as provisions respecting the priority of remediation costs; and (2) frustrate the federal purpose of managing the winding up of insolvent corporations and settling the priority of claims against them (*Orphan Well Association v Grant Thornton Limited*, 2017 ABCA 124 (CanLII) at para 89). The ABCA also held that the AER's orders are provable claims in bankruptcy per the test in *Newfoundland and Labrador v AbitibiBowater Inc*, 2012 SCC 67 (CanLII), and are therefore captured by the BIA. Professors Bankes and Stewart's posts review the specifics of the ABCA decision.

Leave to appeal to the Supreme Court was granted in November 2017 and oral submissions were heard before a seven-justice panel of the Court in February.

Paramountcy: Operational Conflict and Frustration of the *Bankruptcy and Insolvency Act*

Under the doctrine of federal paramountcy, provincial legislation will be rendered inoperative to the extent that it has operational effects that are incompatible with federal legislation. It applies equally to cases where provincial legislation includes ancillary provisions that trench on federal jurisdiction as well as those of concurrent jurisdiction (*Canadian Western Bank v Alberta*, 2007 SCC 22 (CanLII) at para 69). The doctrine is also engaged where an obligation to comply with provincial legislation would in effect frustrate the purpose of a federal law even without a direct violation of the federal law's provisions (*Canadian Western Bank* at para 73). The Supreme Court also indicated that the fact Parliament has legislated in respect of a matter does not lead to the presumption that in so doing it intended to rule out any possible provincial action in respect of that subject, and not to impute such intention in the absence of clear statutory language (*Canadian Western Bank* at para 74).

The OWA and AER's (Appellants') argument counters the engagement of paramountcy by arguing that in actuality the provincial regulations and the pertinent provisions of the BIA may be read harmoniously, as was reflected in Justice Sheilah Martin's dissent at the ABCA (Appellants' Factum at para 31). To support this position, they make two submissions. Firstly, they argue that that the principle of cooperative federalism discloses a high threshold for establishing either operational conflict or frustration of federal purpose, which is not met in either instance. And secondly, they assert that the obligations should be categorized as regulatory obligations rather than provable claims in bankruptcy, whose scope should be narrowed with respect to cooperative federalism.

The principle of cooperative federalism has developed through the complex interactions between the federal and provincial governments and accounts for the "network of relationships between

the executives of the central and regional governments [through which] mechanisms are developed, especially fiscal mechanisms, which allow a continuous redistribution of powers and resources without recourse to the courts or the amending process" (Peter W Hogg, Constitutional Law of Canada 5th Ed (Toronto: Carswell, 2007) (loose-leaf updated 2013, release 1) at 5-46). It has been invoked to provide flexibility in separation of powers doctrines such as paramountcy or interjurisdictional immunity: *Quebec (Attorney General) v Canada (Attorney General)*, 2015 SCC 14 (CanLII), and sets out an approach of shared governing interests between the federal and provincial governments.

The Appellants maintain that while courts should make efforts to find consistency between provincial and federal legislation: *Alberta (Attorney General) v Moloney*, 2015 SCC 51 (CanLII), cooperative federalism obliges them to go further. Indeed, they argue that as per *Saskatchewan (Attorney General) v Lemare Lake Logging Ltd*, 2015 SCC 53 (CanLII), courts must prefer a reading of the provincial and federal laws as compatible as a necessary incident to cooperative federalism (Appellants Factum at para 101). During an exchange with Justice Russell Brown in oral argument, it was advanced that cooperative federalism actually represents a principle of statutory interpretation, which counsel for the Appellant argued urges courts to favour operationally consistent interpretations of provincial and federal statutes. In this vein, they submit that legislation be presumed to exist harmoniously and conflict only be found in cases where the federal legislation uses clear and unambiguous language that would rebut such a presumption. In this case, this presumption would provide that section 14.06 of the BIA does not provide receivers with the power to renounce anything apart from their personal liability, and that such a broad power should not be read into it. Similarly, the BIA contains no express exemptions of receivers from regulatory requirements generally, or respecting end-of-life obligations. In this sense, the Appellants assert the obligations pursuant to the provincial regime are not held against receivers or trustees, but against the value of estate.

In *AbitibiBowater*, the Court set out a test to determine when a particular regulatory order may become a "provable claim in bankruptcy" within the meaning of section 2 of the BIA: (1) there must be a debt, liability, or obligation to a creditor; (2) the debt, liability, or obligation must have been incurred before the debtor became bankrupt; and (3) it must be possible to attach a monetary value to the debt, liability, or obligation (*AbitibiBowater* at para 26). The distinction between a regulatory order and a provable claim is critical because where such orders become transmuted through application of the test, the Appellants argue it undermines the jurisdiction of the province to regulate through performance of the orders (Appellants' factum at para 82). It is in this way, they submit, that through cooperative federalism the court should construe such "provable claims" narrowly, allowing regulatory orders, like the conditions imposed by the AER, to continue as such. An application of the narrowed test would effectively pre-empt the engagement of paramountcy by implicitly supporting a harmonious interpretation of the provincial regime with the BIA per *Lemare Lake*, the principle invoked in Justice Martin's dissent at the ABCA.

The Appellants did not deal with the issue of frustration directly, but were supported in this consideration by an intervenor, Greenpeace. Greenpeace similarly advanced that a high threshold applies in determining a frustration of federal purpose, specifically that provincial laws do not frustrate federal legislation merely because they have an incidental impact per *Canadian Western*

Bank (Greenpeace Factum at para 28). In *Moloney*, Justice Clément Gascon defined the two purposes of the BIA: (1) an equitable distribution of assets; and (2) the financial rehabilitation of the debtor (*Moloney* at para 32). Greenpeace suggests only the former purpose is engaged, and submits that the effects of the provincial regime on a particular insolvency will be incidental, and that they don't subvert the BIA merely because they have the effect of incidentally reducing the size of a debtor's estate as a result of simply complying with the regulatory process. Greenpeace suggests this approach promotes cooperative federalism, allowing provinces to continue to protect the environment during insolvency cases as governed by the BIA.

GT and ATB's (the Respondents') paramountcy position largely reflects the decisions of the lower courts: provincial regulations governing the conditions the AER imposed are both in conflict with, and frustrate the purpose of, the BIA. The operational conflict, as they allege, is two-fold: restrictions on a trustee's or receiver's renunciation [of liability for sites with onerous environmental obligations] contradict their positive "right" to do so as recognized in section 14.06(4) of the BIA; and compliance with the provincial regime would have them pay what would otherwise be considered "costs of administration" out of priority, contravening section 14.06(6) of the BIA. Their assertion of frustration is also two-pronged: by defining trustees and receivers under the provincial regime as "licensees" and making them liable for the AER's obligations, and by requiring payment of these obligations ahead of all other priority claims. The Respondents adopt the conventional test for operational conflict described by Justice Gascon in *Moloney*, "where one enactment says 'yes' and the other enactment says 'no'". They assert that section 14.06(4) of the BIA recognizes a power of the trustee or receiver to renounce and that such recognition creates or implies a positive right. By including trustees and receivers within the definition of licensee, the Respondents submit the provincial regime would effectively deny the exercise of this positive right. In the words of the *Moloney* maxim, the federal law says liability does not exist against trustees and receivers, and the provincial law says liability does exist (GT Factum at para 82). This may constitute a real risk, as contravention of the provincial legislation is an offence that attracts fines to the trustee or receiver itself, not to the estate under receivership. Additionally, as these obligations are generally categorized for bankruptcy purposes as "costs of administration", the requirement to distribute such funds out of the order of priority established in the BIA would contravene that enactment. In this way, the Respondents allege impossibility of compliance with both regimes (GT Factum at paras 85-87).

The Respondents would define the purpose of section 14.06 of the BIA as to encourage insolvency professionals to accept mandates where a debtor has interests in property affected by environmental conditions or damage. As above, defining trustees and receivers to be licensees under the provincial legislation frustrates this objective by denying the right of renunciation, thereby removing incentives for insolvency professionals to accept mandates (GT Factum at para 92). This would certainly be true in cases where the entire benefit of realizations would accrue to the AER. The BIA at large also has the purpose, as described by the Appellants, of the orderly liquidation of insolvent debtors through a single proceeding, which strives to ensure maximum recovery for all creditors in accordance with legislated priority. This purpose is frustrated when the AER attempts to collect on its obligations outside the single proceeding prescribed by the BIA, where those claims would rank much lower (GT Factum at paras 125-127). The Respondents suggest that subsections 14.06(2), (4), (6), and (7) deal directly with questions of priority and therein balance policy considerations in protecting the environment on one hand, and

on the other ensuring creditors do not unduly bear the burden of a debtor's environmental liability. Further to that interpretation, they advance that if Parliament had intended a debtor always satisfy these obligations, it would have granted the requisite priority (GT Factum at para 96). With no such priority in existence, the AER's obligations would be categorized per the test in *AbitibiBowater* as provable claims under the BIA regime.

Interjurisdictional Immunity: the "Core" of Section 92A

In spite of the notice of the constitutional question, the Appellants did not directly argue that via the Interjurisdictional Immunity doctrine (IJI) the relevant provisions of the BIA are inapplicable. In written submissions, they make several oblique references to the BIA intruding on a "core of provincial power". The question was taken up primarily by the intervenor Attorney General of British Columbia (AGBC), arguing that IJI is engaged in the case, shielding the provincial regime from the application of the BIA. In particular, the AGBC argues that managing end-of-life liabilities of non-renewable resource extraction is a core competency protected by section 92A(1)(b) of the *Constitution Act, 1867*; and that section 14.06 of the BIA has a significant impact on the ability of the province to conserve and manage its non-renewable resources. This argument is buttressed by the concurrent claim that section 14.06 is far from the core of federal power under section 91(21) of the *Constitution Act, 1867*.

Previous pro-provincial IJI arguments failed for certainty with respect to anchoring action within exclusive provincial jurisdiction, notably *Canada (Attorney General) v PHS Community Services Society*, 2011 SCC 44 (CanLII). However the AGBC argues that a textual and historical reading of the section overcomes the uncertainty that dogged prior cases. Unlike other sections like 92A(2) or (4), 92A(1) uses the word "exclusively" in relation to management, conservation and development [of non-renewable natural resources]. This is supported by word choice in section 92A(3), which states 92A(2) does not "derogate" from federal power, implying by interpretive canon that 92A(1) does derogate (AGBC Factum at para 18). These word uses are also significant when considering that section 92A was drafted well after the development of the double aspect doctrine, providing for concurrency of federal and provincial powers. The historical context of section 92A therefore cannot be ignored according to the AGBC. From their admission as provinces to Canada, the four western provinces did not enjoy full ownership of "lands, mines, minerals and royalties" as did the founding four. They sought such ownership in the early twentieth century, with the resulting Natural Resources Transfer Agreements (NRTA) developed by 1930. However, provinces continued to be limited even under the NRTA through operation of federal paramountcy. Section 92A was ultimately added in the run-up to patriation in 1982. The AGBC also asserts that to not consider the textual and historical context would run contrary to the court's reasoning in *Reference re Supreme Court Act*, 2014 SCC 21 (CanLII) which rejected the "empty vessels" theory with respect to sections 41(d) and 42(1)(d) of the *Constitution Act, 1982*, noting the language of those provisions also sprung from negotiations leading up to patriation (AGBC Factum at para 25).

The AGBC advances specifically that managing end-of-life liabilities of non-renewable resource extraction is a core of provincial power under section 92A(1)(b). The non-renewable nature of the resource is significant as costs may persist well beyond revenue-generating activities as a necessary facet to management and conservation, because by definition, their valuable life comes

to an end. Crucial to regulating in this area is addressing this issue, and the incentives it creates. The provincial regime is a response to this issue, in particular the powers of the AER with respect to end-of-life considerations and their environmental impact, and should be seen to be within the core of the section.

Using the interpretation of the majority of the ABCA, the AGBC argues section 14.06 of the BIA has an extremely serious and significant impact on the ability of the province to conserve and manage its natural resources and disturbs settled expectations and competences, thus impairing the defined core within section 92A(1)(b) of the *Constitution Act, 1867*. In this vein, the incentives are engaged with the operation of the BIA. Through restrictions on transferability of collateral properties, the provincial regime allows end-of-life costs to be internalized throughout the business cycle, and for those costs to become an anticipated and uncontroversial aspect of insolvency in the non-renewable sector (AGBC Factum at para 51). By contrast, Section 14.06 allows secured creditors to take as their collateral the value of a subset of properties, notably those with a positive asset to liability ratio, rather than all properties taken as a whole. In addition to side-stepping the otherwise internalized end-of-life costs, it creates a potential windfall for creditors who priced their interest rate on the basis of those costs as per *Northern Badger*. In allowing such a departure from the ambit of the provincial power, the AGBC contends this makes out impairment.

To solidify its contentions, the AGBC argues that there is nothing about section 14.06 of the BIA that would mean it should defeat the core objectives of section 92A(1)(b) (AGBC Factum at para 55). Here, the AGBC defines the core of a head of power as that which is "absolutely necessary" for Parliament or legislature to be able to pursue the objectives underlying the power. The principle of equitable distribution is important with respect to federal powers of bankruptcy under section 91(21) of the *Constitution Act, 1867*, though its ambit is the distribution of assets, not their enhancement, especially since values of assets of the estate and security is typically a provincial matter. Further, protecting insolvency professionals from personal liability may be an ancillary consideration of the BIA, but it is far from the core of section 91(21) power.

The Respondents for their part are skeptical of the applicability of the pro-provincial IJI argument based on the concurrency of federal and provincial power over the environment, and argued that if any core competency is engaged, it is the federal power under section 91(21) (GT Factum at paras 142-146). In this way, they assert the province's exclusive jurisdiction is not engaged, and that to the extent the provincial regime and section 14.06 of the BIA interact, they interact within the context of concurrent jurisdiction with respect to the environment. They suggest that the provincial regime has the effect of permitting the AER to obtain payment of environmental obligations in priority to all other creditors, imposing liabilities on and nullifying rights given to insolvency appointed pursuant to the BIA. Such a power would fall more closely within section 91(21), thus engaging Paramountcy more readily than IJI.

Final Thoughts

The parties laid bare that the constitution is fully implicated in the *Redwater* litigation, with both Paramountcy and IJI taking centre stage at the hearing and in written submissions. The policy

and legal ramifications of the case, regardless of outcome, will be significant, especially here in Alberta. But the case will also result in a substantial statement of division of powers doctrine. Cooperative federalism has historically served to limit harsh or overly stringent applications of division of powers doctrines including paramountcy and IJI. As both were raised, it will be interesting to see how the Court treats this principle in light of the arguments of the parties, and its interpretation by Justice Martin in dissent at ABCA, now a member of the Court herself. In particular, the exchange with Justice Brown on the meaning of cooperative federalism may be instructive. By positioning cooperative federalism as a principle of statutory interpretation, the Court may imbue it with substantive implications mediating the application of paramountcy when reading potentially conflicting statutes.

IJI has never been successfully argued to apply to provincial powers, despite its availability as in *PHS*, albeit limited per *Canadian Western Bank*. However, where *PHS* failed for certainty of provincial exclusivity, the AGBC presents a compelling case for the specificity of section 92A of the *Constitution Act, 1867* being a potential guarantor of sole provincial jurisdiction. Where the court will land on the question of the core of any power will certainly be significant, particularly with regards to the Appellants' assertions on the stance and meaning of cooperative federalism. Regardless, the real challenge will not be the legal one argued before the court, but in dealing with the operation and regulation of the industry in spite of the environmental and technical difficulties laid bare in *Redwater*.

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