Nortel Networks:
Untidy Intersection of Environmental and Insolvency Laws or Head On Collision?

Background

October 3, 2013 saw the release of the Ontario Court of Appeal's decision in the Nortel Networks Corporation case[1], which, from a factual point of view, reversed four out of five Ministry of Environment (MOE) Remedial Orders considered monetary orders in the original motion before Morawetz, J. Unfortunately, Justice Morawetz's decision and analysis was not seriously considered on its own merits, since by the time the Court of Appeal ruled on the Nortel matter, the Supreme Court of Canada had released its decision in Abitibi [2].

As a result of the Abitibi decision, the framework and analysis covered by Justice Morawetz could not be analyzed on its own merits, since the Court of Appeal was clearly bound by the Supreme Court decision, which had analyzed the applicability of environmental orders in a significantly different framework and with significantly different criteria

Justice Morawetz, an extremely seasoned insolvency jurist, recognized the "untidy intersection" [3] between the provisions of the *Companies' Creditors Arrangement Act* (CCAA)[4] and the *Bankruptcy and Insolvency Act* (BIA)[5] and provincial environmental laws. At the root of the problem is the fundamental disparity between the goals of environmental laws, which foster the preservation, protection and safekeeping of the natural environment, as opposed to insolvency laws, where creditors who are owed money by the insolvent corporation expect to receive a fair share of the debtor's assets rather than having all of those assets go toward paying environmental liabilities that they had no hand in nor any ability to control.

The Insolvency Framework in Canada

Insolvency proceedings and financial restructuring in Canada are exclusively the domain of the Federal Government and are regulated under the provisions of the CCAA and the BIA. For the purpose of this paper, readers can assume that the statutes are essentially identical but that the CCAA is more concerned with larger insolvencies and is a bit more flexible in allowing plans of compromise than is the BIA. In either case, where an entity becomes "insolvent", meaning that its

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[1] Nortel Networks Corporation, (Nortel) 2013 ONCA 599

[2] *Newfoundland and Labrador v. AbitibiBowater Inc.*, 2012 SCC 67

[3] Re Nortel Networks Corporation, 2012 ONSC 1213, para. 8

[4] *Companies' Creditors Arrangement Act* (CCAA) R.S.C. 1985 c.C-36

[5] *Bankruptcy and Insolvency Act* (BIA) R.S.C. 1985, c.B-3

liabilities exceed its assets, the insolvent entity has the ability to file an application under either statute and request that all or part of its assets be applied towards outstanding debts and that the company either be wound up thereafter or allowed to continue on under some new arrangement, usually with fresh financing but invariably without all or most of the old debts. The systems have functioned adequately for years until recently, where the concept of environmental claims, as opposed to other straight forward money claims has been the matter of a serious debate as to whether environmental liabilities ought to take precedence and if so, at whose expense? The answer to these questions is being worked out in the context of the Nortel and Abitibi decisions which will be with us for quite some time.

The Nortel Case

Most readers will be familiar with the Canadian giant technology firm Nortel Networks Corporation which carried on business in several locations in Canada and throughout the World. For a number of years, Nortel had operated sites on which it conducted manufacturing processes. Unfortunately, some of these processes and activities resulted in the lands on which the facilities were located being contaminated. In Nortel's case, it had identified five sites in Ontario that had been contaminated. It had been working with the Ministry of the Environment to attempt remediation of these sites and to that end had spent considerable amounts of money on the sites. As the Nortel climate worsened resulting in insolvency filings, Ontario's Ministry of the Environment became concerned with the ability of Nortel to continue its remediation commitments in the context of the sites that it had done remediation work on. In many cases, the sites had been sold and had not been the subject matter of manufacturing activities for many years. The Ministry of the Environment, on learning of the insolvency filing, immediately issued remediation orders on all five properties. However, by this time the filing had taken place resulting in the automatic stay provisions of the CCAA applying to any and all orders and claims outstanding as at the date of the CCAA filing. The issue to be resolved by Morawetz, J was whether the MOE orders were not subject to the stay provisions of the CCAA or whether the orders constituted compromisable claims and therefore ought to be stayed as part of proceedings under that Act.

In the Nortel case, after reviewing the various arguments and jurisprudence, Morawetz, J. set out a clearly recognized and easy to apply test for whether or not the Orders are compromisable claims. Justice Morawetz held that if the actions of the MOE are such that the debtor is required to react or respond to a step taken by the MOE and in doing so incur a financial obligation, then they are compromisable claims. Justice Morawetz recognized that any money expended by Nortel in respect of MOE obligations is money that is directed away from creditors participating in the insolvency proceedings. He felt that one court should determine who gets what and that the same insolvency considerations ought to apply regardless of who is receiving the money. In the absence of a single proceeding, Justice Morawetz held chaos would result in the handling of environmental claims and in the context of an insolvency proceeding. Interestingly, Justice Morawetz had the benefit of the trial decision in the AbitibiBowater [6] case and agreed with the approach taken.

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[6] Supra, note 2

The Abitibi Decision

A similar arrangement to the Nortel situation arose in the context of Abitibi restructuring proceedings under the CCAA. Abitibi had carried on manufacturing processes at several locations in the Province of Newfoundland and Labrador. These sites were contaminated to the knowledge of the Newfoundland and Labrador Ministry of the Environment when Abitibi filed its CCAA application in Montreal, the location of its head office. The Province of Newfoundland and Labrador immediately issued five orders to remediate the five properties in Newfoundland and Labrador subject to contamination. Simultaneously, it passed legislation expropriating all of Abitibi's property in the Province of Newfoundland and Labrador, presumably so as to provide security for the repair of the substantial environmental damage of the five sites.

When the CCAA application came forward for hearing in front of the CCAA Court in Montreal, Newfoundland and Labrador argued that the claims in question were not monetary and therefore were not covered by the Act. Given that Newfoundland and Labrador had itself expropriated all of Abitibi's assets and thus appeared to be able to valuate the claims, they were not successful in convincing the Motions Judge that the order should be excluded and accordingly the Motions Judge in Montreal ordered that the claims were in fact monetary and were caught by the CCAA. The effect of course would be that the price of remediation would be a claim which would rank along with every other normal claim and more importantly that the orders could not be enforced during the CCAA proceedings because of the stay provisions. Newfoundland and Labrador immediately appealed this order to the Quebec Court of Appeal. The Quebec Court of Appeal confirmed the Motions Judge and dismissed the appeal. Newfoundland and Labrador immediately brought leave to appeal the matter to the Supreme Court of Canada and was successful. The Supreme Court of Canada confirmed the Court of Appeal decision and developed the test set out in this paper.

Parliamentary Intervention

The Government of Canada recognized early on some of the problems that arise in the conflict between these two areas of law. Amendments to the BIA and CCAA since 1997 have helped to deal with a few of the issues, but really only superficially touch the issues that need more serious consideration.

In 1997, Receivers were protected from liability for environmental remediation costs. A super priority was created in favour of the Province for cleanup costs actually incurred by them. Cleanup costs were also allowed as a provable claim in an insolvency so as to allow Governmental Agencies to make a claim against all assets rather than just the land of any particular insolvent business. Further, the possibility of a stay of non-monetary remedial orders was also provided. This latter provision, however, raises a number of constitutional issues which themselves will need sorting out down the road as recognized by Deschamps, J. in Abitibi [7].

[7] Supra, note 2

In 2009, the power to stay was further extended but with very little guidance as to what criteria should regulate or influence the granting of a stay. Again, it is entirely foreseeable that a constitutional challenge will be required to provide some clarity to this vexing area. The Supreme Court specifically concluded in Abitibi that they were only dealing with the jurisdiction of the CCAA to stay orders that were monetary in nature. Although the Court acknowledged that Parliament gave CCAA Courts the power to stay non-monetary orders, this situation was not dealt with by the Court. The wider question of whether the CCAA provisions allowing a court to stay a non-monetary order is *ultra vires* of the Federal Government for infringing on provincial environmental rights is a matter that will remain to be determined.

The Issue

The neat issue which usually presents itself in most of these types of cases involves the following question: When and under what circumstances does the MOE have to line up with all other creditors or when can it "rise above the crowd" and claim priority for remediation costs and environmental damage in priority to claims of ordinary creditors? The present jurisprudence has two clear parameters before one runs into the third grey area. For example, events occurring after a bankruptcy proceeding and orders that are regulatory in nature are not affected by insolvency proceedings and the rights of the provincial regulators are well recognized. It is clearly accepted that CCAA and BIA protection is no licence to pollute if a business is ongoing. Obviously in a straight liquidation situation the debate becomes clear and involves who should obtain the assets of the debtor. Where a business is going to carry on and emerge from an insolvency, the situation is far less clear. The third and difficult "grey" area is in determining whether claims are monetary in nature.

In order to understand the issues presented in the Nortel Court of Appeal decision, it is necessary to review that decision as well as two other decisions which impact on it, namely the Nortel CCAA Application of the first instance before Justice Morawetz[8] and the Supreme Court of Canada decision in Abitibi[9].

The Basis of the Problem

The difficulty in analysis arises out of an examination of section 121 of the BIA which provides as follows: [10]

> 121. (1) All debts and liabilities, present or future, to which the bankrupt is subject on the

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[8] Supra, note 3

[9] Supra, note 2

[10] Supra, note 2, para 24

> day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

Section 135 of the BIA also deals with contingent or unliquidated claims and is to be read in conjunction with the interpretation of section 121. Section 135 (1.1) reads as follows:

> 135....
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> (1.1.) The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.

The provisions of the BIA are directly referable to an incorporated into the CCAA so the consideration of these items in both statutes are identical.

The Court therefore highlighted three requirements which must be met in order for an environmental obligation to be part of, and subject to insolvency proceedings. The first requirement stipulates that there must be a debt, a liability or an obligation owing to an identified creditor. The second requirement stipulates that the debt, liability or obligation must have been incurred before the debtor became bankrupt. The third requirement stipulates that it must be possible to attach a monetary value to the debt, liability or obligation.

The analysis of these three points forms the heart of the decision of the Supreme Court of Canada in Abitibi. The first and second tests are fairly straight forward in most circumstances and do no present a problem in analyzing the applicability of the statute. The difficulty arises in the third test. After much detailed analysis of this third test, the Court propounded the following test indicator which will trigger the applicability of the statute and the falling in line of other creditors of the environmental claim: there must be sufficient indications that the regulatory body that triggered the enforcement mechanism will ultimately perform remediation work and assert a monetary claim to have its costs reimbursed. If this is the case, the Order is included in the statute and will be the subject of a compromise.

While this test is extremely difficult to apply in practice, the Court did provide a bit of guidance by highlighting some issues that should be relevant. For example, the Court thought it significant as to whether the activities of the insolvent party were ongoing. It is also significant if the debtor is still in control of the property. Further, the Court considered it relevant whether the debtor had the means to comply with the Order. Lastly, the Court was prepared to look at the overall affect on the insolvency of forcing the debtor to comply with the environmental Order in the context of the insolvency process, and the effect of compliance on the success of the insolvency.

Very little guidance other than these criteria is given so as to enable us to understand when and how this state of affairs exists. Will parties alter their stance to make it appear more suitable to being in or out of the statute? In contrast, Justice Morawetz's decision in Nortel is crystal clear and works every time. Unfortunately, it is extremely hawkish on environmental matters and while it is the bane of environmental practitioners, insolvency practitioners delight in its simplicity. In place of that simplicity is a difficult analysis as to under what circumstances and with what analysis a Ministry can be said to have crossed the threshold where it is almost certain to perform remediation work. If its conduct does not go that far, then its Order is not covered by the insolvency statute and if it does, it has to line up with the other creditors. This seems to be an analysis that will ultimately confuse the issue as to whether environmental orders should or should not form part of a compromise.

Subsequent to the Supreme Court decision in Abitibi, the Nortel decision was determined by the Court of Appeal, which by this time had the clear decision of the Supreme Court of Canada. Justice Morawetz in the first instance had indicated that all five sites which were the subject matter of the MOE Orders were to be included in the compromise. Applying the rationale in the Abitibi decision, the Court of Appeal overturned Morawetz, J. on four out of five properties by concluding that there was not sufficient certainty on the evidence that the Ministry would spend money and, accordingly, only one of the Orders was to be included in the insolvency proceeding.

In analyzing Justice Morawetz's decision, the Court of Appeal attempted to divine whether Morawetz, J. had attempted to apply the test propounded by the Supreme Court of Canada which, of course, he had not since the decision did not exist. Unfortunately, a great deal of the careful and considered analysis undertaken by Morawetz, J. could not be dealt with by the Court of Appeal because by the time his decision came up for review, the Court of Appeal was bound by the Abitibi decision, which took a considerably different approach. Because the facts in the two cases were legally indistinguishable, the Court of Appeal had to proceed with the appeal of the Morawetz decision by applying the Abitibi reasoning to the facts in Nortel.

The Future

In the absence of insolvency proceedings, the concept of "polluter pay" was well known and established in Canadian Law. Under this principal, it was felt right and just that the party that caused the contamination should pay for it. This distinction becomes a definite contentious issue when put into the context of insolvency proceedings, where essentially the creditors of the insolvent company would be asked to pay for remediation under a strict application of the polluter pay principal. On the one hand, the polluter pay principal is reasonable, but on the other hand creditors feel that they should not have to pay for contamination that they potentially had nothing to do with and were powerless to prevent.

The obvious question of whether creditors ought to be paid monetary claims in advance of environmental claims leaves an inescapable conclusion that the only alternative is for the public purse to be paying for the cost of remediation. Certainly the possibility of this eventuality is well laid

bare in both the Nortel and the Abitibi decisions. What effect will this have on the future of Provincial Ministries of the Environment dealing with environmental remediation scenarios where the debtor simply doesn't have the money to effect the clean up? One solution to the problem is to have the Provinces alter their conduct so as to bring themselves either in or out of the insolvency proceeding depending upon which situation is better for them. Another and more unsatisfactory arrangement is for the issuance of orders against the parties other than the polluter in an attempt to find the deepest pockets.

While the test propounded by the Supreme Court of Canada would appear to be judicially sound, insolvency and environmental practitioners will probably find its provision and application to be uncertain and arbitrary to apply. Will the MOE attempt to alter their conduct to make themselves appear as almost certain to spend money or not almost certain to spend money depending upon whether they want to be included in the compromise or not? One thing is clear, environmental claims are becoming more numerous and more expensive to deal with it. Early reactions suggest that the results of the Abitibi Order will force Ministries of the Environment to issue more directors' orders resulting in the type of problem that arose in the Nortel case which was recently resolved by payment by the directors in the Northstar case of a sum in excess of $5.0 Million.[11] Will Ministries of the Environment wait in the bush or prematurely spring forward in order to tailor their conduct to comply or not to comply? There will be a continuous friction between polluter pay and creditor pay as long as these questions remain unanswered.

[11] Northstar Aerospace (Canada) Inc. Director's Order No. 5866-8WKV9Z