No. S120712
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

BETWEEN

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,*
R.S.C. 1985, c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *CANADA BUSINESS CORPORATIONS ACT,* R.S.C. 1985, c. C-44

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT,* S.B.C. 2002, c. 57

AND

IN THE MATTER OF CATALYST PAPER CORPORATION AND THE PETITIONERS LISTED IN SCHEDULE "A"

PETITIONERS

RESPONSE TO NOTICE OF CONSTITUTIONAL QUESTION

(Pursuant to section 8 of the *Constitutional Question Act*, R.S.B.C. 1996, c. 68)

NAME OF RESPONDENT Attorney General of British Columbia

TO: the Service List

IN RESPONSE TO THE REVISED NOTICE OF CONSTITUTIONAL QUESTION the Attorney General of British Columbia will submit as follows:

1. It is premature to rule on the constitutional questions in relation to the Elk Falls Mill. The Plan Sanction Order should be amended to defer the hearing of all questions concerning the continued operation of the *Environmental Management Act* S.B.C. 2003, c. 53 ("EMA") and regulations promulgated thereunder in relation to the petitioners or any of them (collectively, "Catalyst") and the Elk Falls Mill until (a) the Supreme Court of Canada has rendered judgment in *HMQ Newfoundland and Labrador v AbitibiBowater Inc.* and (b) there are orders and notices of non-compliance outstanding in relation to any environmental responsibility of Catalyst creating a pending issue for the courts to resolve. There are no such orders at the moment.

2. It is also premature, for the same reason, to rule on any constitutional questions as may exist in relation to any other properties of Catalyst and in particular those which will continue to be owned by Catalyst after its restructuring in completed.

3. The definition of "Pre-Commencement Claim" in the Claims Procedure Order overreaches constitutional boundaries. That definition lays the

groundwork to compromise and extinguish all statutory duties, responsibilities, directions or orders under EMA or the regulations. Any declaration or order of this court in these proceedings whose purpose or effect, alone or in combination, may be to release or discharge anyone who has been, is or may become subject to a statutory duty or responsibility, direction or order under EMA or the regulations in relation to any property or operations, past or present, is of no force or effect in that regard unless and until the person seeking the declaration or order has given notice of constitutional question under or in relation to the *Constitutional Question Act* and the question has been finally determined. No such notice was given in relation to the Claims Procedure Order.

4. The doctrine of federal paramountcy does not provide a basis to render any provision of EMA or the regulations constitutionally inoperative in relation to Catalyst and the Elk Falls Mill, as contemplated under the Plan and proposed to be sanctioned by this court, or in relation to any of the other Catalyst properties, either. The current facts and circumstances relevant to the paramountcy question and the Elk Falls Mill are set out in the Affidavit of Hubert Bunce # 1. The current facts and circumstances relevant to the paramountcy question and the other properties are set out in that and in other affidavits, to be filed.

PARTICULARS OF THE POINTS TO BE ARGUED in relation to paramountcy are as follows.

Introduction to paramountcy doctrine

1. Parliament is empowered under section 91(21) of the *Constitution Act 1867* to make laws in relation to the matter of bankruptcy and insolvency. Provincial legislatures are empowered under section 92(13) and (16) of that Act to make laws in relation to matters of property and civil rights and local matters, including laws to protect the environment.

2. The scheme of federalism in Canada implies that a government does not encroach on the powers of the other level of government. To that end, the courts have developed constitutional doctrines which permit an appropriate balance to be struck in the recognition and management of the inevitable overlaps in rules made at the two levels of legislative power.

3. The only way provisions of provincial law can be rendered inoperative as against a company in or following from CCAA proceedings is through the doctrine of federal paramountcy. That doctrine directs that where there is an inconsistency between validly enacted but overlapping provincial and federal legislation, the provincial legislation is inoperative to the extent of the inconsistency.

4. The paramountcy doctrine requires either an actual conflict in operation between the relevant provisions of the federal law and those of the provincial law (i.e. an impossibility of dual compliance) or that the operation of the provisions of provincial law is incompatible with the purpose of the federal law (i.e. would frustrate Parliament's purpose in enacting it).

5. The Supreme Court of Canada has directed that a paramountcy analysis must not proceed based on an " 'impressionistic" interpretation of the conflict, but depends on the existence of "a right positively provided for in a rule.

Testing validity

6. Before considering conflict, the threshold step in any paramountcy analysis is to test the validity of the federal and provincial legislative provisions in question.

7. The CCAA courts in *AbitibiBowater Inc.* and *Nortel* failed to engage that threshold step. They each referred to the well-established constitutional validity of the CCAA as a whole. However, neither court referred to the specific provisions of the CCAA with which provincial laws were said to be in conflict, nor tested the constitutional validity of those CCAA provisions.

8. The federalism analysis does not end merely because it has been determined that a law, viewed as a whole, is within a national or provincial head of power under the *Constitution Act 1867*. Even if a statute is in pith and substance valid in relation to the matter of bankruptcy and insolvency, it may nevertheless contain provisions which are neither within nor ancillary to that head of legislative authority. An invalid legislative provision is not rendered valid merely because it is included in a legislative scheme that, viewed globally, is valid.

9. The decisions in *AbitibiBowater Inc.* and *Nortel* are for that reason, among others, not determinative of the constitutional question in the case at bar.

10. The mandated approach in cases where, as here, the validity of specific provisions of an enactment is engaged is to consider the challenged provisions, read in context of the statutory scheme, and answer the following questions:

    (a) Do the impugned provisions intrude into a provincial head of power and to what extent?

    (b) If so, are they nevertheless part of a valid national legislative scheme?

    (c) If so, are they sufficiently integrated with that scheme?

11. Courts are directed to consider both the purpose and effect of the challenged provisions.

12. In the present case, it is necessary for that analysis to infer from the notice of constitutional question which specific provisions of national may be engaged.

There is substantial constitutional intrusion

13. The impugned provisions of the CCAA, as purportedly interpreted by Catalyst, substantially intrude into provincial power to regulate the environment, with the effect of nullifying that power. The intended effect of the proposed Plan Sanction Order is to relieve Catalyst of its statutory duties and responsibilities in relation to the Elk Falls Mill, and the regulatory authorities' ability to enforce performance by direction or order under EMA or the regulations. To make such an order requires an authorizing provision in the CCAA to that effect. The result of such an order and such a provision is to eviscerate British Columbia's ability, through those regulatory authorities, to carry out its core regulatory functions in relation to the environment.

Not constitutionally part of the valid legislative scheme

14. CCAA provisions to that effect would not be part of the Act's valid national legislative scheme in relation to bankruptcy and insolvency. They would lie beyond the nature and scope of Parliament's authority under section 91(21) of the *Constitution Act 1867*, properly construed.

15. The nature and scope of Parliament's authority under section 91(21) is properly determined by a precise interpretation of "bankruptcy and

insolvency" under that subsection. Such interpretation is informed by co-operative federalism, the principle of subsidiarity and how sections 91 and 92 are designed to work harmoniously together.

16. On that analysis, "bankruptcy and insolvency" under section 91(21) should not be interpreted to encompass insolvency generally, but only to allow Parliament to create legislative schemes and procedures to which recourse may be had in the event of an insolvency. The Supreme Court's jurisprudence supports that view of "insolvency" in that technical, procedural sense.

17. Parliament's "bankruptcy and insolvency" jurisdiction therefore does not include making changes to the substantive provincial law upon which national insolvency schemes and procedures are properly based. Any broad application of "claim" and/or other CCAA provisions which purportedly transforms Catalyst's statutory duties into a deemed liability to the regulatory authorities, or permanently enjoined regulatory enforcement of those statutory duties in order to secure restructured Catalyst's financial bottom line not only lies beyond Parliament's jurisdiction but is antithetical to the fundamental premise of that jurisdiction.

Not constitutionally integrated into the CCAA scheme

18. Provisions which do not lie within the strict bounds of a legislature's constitutional powers may nevertheless be habilitated through the ancillary powers doctrine. Where, however, as here, there would be a very serious intrusion on the power of provinces (in their ability to regulate the environment), provisions enacted under Parliament's ancillary powers must not only have a rational and functional connection to the constitutionally-valid purpose of the CCAA as a whole, but be highly integrated in the Act and necessary to its national purpose.

19. Here, the intended effect of the proposed Plan Sanction Order, and the CCAA provisions on which it is presumptively based, are not necessary to, but depart fundamentally from and substantively overreach the constitutionally-valid purpose of the CCAA. It is not integral or necessary to the CCAA's technical, procedural legislative mandate that the statutory definition of "claim" be expanded, including for the purposes of CCAA section 11.8(8) and (9), to substantively improve a company's restructuring prospects or post-restructuring financial position from what it would otherwise be under the normal operation of provincial laws.

Conclusion on validity for paramountcy purposes

20. It is beyond Parliament's jurisdiction to depart so fundamentally from the general law on which the operation of national bankruptcy and insolvency statutes is founded. If Parliament could do so, the scope of provincial constitutional authority over property and civil rights in the event of insolvency would come to be measured by the potential reach of a national policy favouring beneficial financial outcomes above all. That would upset the intended balance in the distribution of constitutional powers.

21. It is therefore beyond the constitutional authority of a CCAA court to make any declaration or order whose effect may be

    (a) to release or discharge anyone who has been, is or may become subject to a statutory duty or responsibility, direction or order under EMA or the regulations promulgated thereunder in relation to any property or operations, past or present, of Catalyst, or

(b) to cause, confirm or sanction the compromise, waiver or extinguishment of any such statutory duty or responsibility or requirement to perform any such duty or responsibility or to comply with any such direction or order which has been, is or may be made under EMA or the regulations, or

(c) to permanently prohibit, enjoin, bar, estop, stay or otherwise limit the making of any such direction or order,

except in relation to

(d) any claim in the CCAA proceedings for a debt or liability to government under section 59(2), section 80(6)(a) or section 88(3) of EMA to which Catalyst was subject on the Commencement Date or to which it may become subject before sanction any plan of compromise or arrangement, or

(e) any order or proceeding under EMA to enforce payment of a claim described in subparagraph (d).

22. It follows, for paramountcy purposes, that the CCAA provisions, under Catalyst's proposed interpretation, could for the same reason not be a proper basis for this court to rule that provisions of provincial environmental legislation otherwise applicable to Catalyst and the Elk Falls Mill are constitutionally inoperative.

No operational conflict in any event

Introduction

23. The constitutional question stated in paragraph 8 of Catalyst's notice of constitutional question is fundamentally misconceived. The paramountcy

question is properly not whether EMA is an impediment to the CCAA court's authority to issue any form of Sanction Order it may consider just and equitable. Rather, the paramountcy question is whether the particular form of Sanction Order proposed in the case, and the specific provisions of the CCAA on which presumptively the order is based, can override the ongoing operation of specific, valid and otherwise applicable provisions of provincial law. It is not a question of the scope of the court's discretion, but of constitutional law.

24. The point made in paragraph 9 of the notice, combined with the statement of law in paragraph 2, reflects a more conventional approach to a challenge to the operation of provincial laws based on the doctrine of paramountcy. Even so, Catalyst's challenge on that approach must also fail.

No actual conflict in operation

25. Paramountcy is a means for courts to resolve actual conflicts in operation between specific national and provincial legislative provisions. As noted, the test is impossibility of dual compliance.

26. Here, the only CCAA provision specifically referred to in Catalyst's notice is section 11.8 (and perhaps by implication the other CCAA provisions from which the meaning of "claim" as used in that section is derived). The notice omits to mention other provisions, such as section 11.01, on which clauses of the Sanction Order may rely. It is impossible to respond to an argument of actual conflict in operation without knowing the other statutory provisions involved.

27. As for provincial law, the notice omits to mention any specific provisions of EMA which may require Catalyst to incur costs of the sort referred to in CCAA section 11.8.

28. Those deficiencies in the notice limit the authority of this court to apply paramountcy.

29. Turning to subsections 11.8(8) and (9), they do not, on their face, relate to the cost of complying with any and every environmental order. Rather, those subsections refer to the "costs of remedying any environmental condition or environmental damage." Even if the costs referred to in those subsections were automatically "claims" (which is denied), there is no impossibility of dual compliance in requiring Catalyst to meet the requirements of ongoing environmental orders short of actual remediation.

30. It would be inconsistent with the presumption of constitutionality and directives of the Supreme Court of Canada for this court to adopt, for paramountcy purposes, an interpretation of subsections 11.8(8) and (9), either to expand the definition of "claim" to mean costs, simpliciter, whenever they may be incurred, or to read into those subsections not only the cost of remedying but also the cost of complying with any and every existing or potential regulatory order.

31. Further, even if the claims referred to in subsections 11.8(8) and (9) could be interpreted to include the cost of complying with any and every environmental order (which is denied), there is on the facts of this case no necessary impact on the scheme of priority by the investigative, monitoring and reporting requirements of Catalyst's permits. The provisions of EMA do not operate in tandem such that permit requirements or even investigative orders necessarily result in the making of any

remedial order. The bare existence of permit responsibilities in relation to the Elk Falls Mill therefore cannot be said to secure the costs of remediation of that Mill ahead of the priority provided in section 11.8(8).

No frustrated national purpose

32. In the absence of an actual conflict in operation, paramountcy will only render provincial laws constitutionally inoperative if there is evidence that their operation would frustrate a constitutionally-valid purpose of Parliament.

33. The onus of evidentiary proof of frustrated purpose is on the party seeking to invoke the paramountcy doctrine, and the standard of proof is high. Catalyst has not met that onus in the case at bar.

34. There are two kinds of evidence relevant in constitutional cases: evidence of legislative facts and evidence of adjudicative facts.

(a) Legislative facts

35. The courts have found considerable interpretive flexibility in the provisions of the CCAA, enabling them to facilitate achievement of the purposes of that Act. Interpretive flexibility has allowed CCAA courts to fill in legislative gaps or extend the legislative scheme for dealing with insolvencies in various ways. Even so, interpretive flexibility is not open-ended.

36. In particular, in the context of a potential constitutional conflict, the Supreme Court of Canada has noted that explicit language is required before sweeping powers could be attached to *Bankruptcy and Insolvency Act* provisions in the face of preservation of provincially created civil rights.

37. Consistent with that premise, and despite the skeletal design of the CCAA, the lack of explicit language to the effect sought by Catalyst is evidence that it was not Parliament's purpose to empower CCAA courts to override the continued operation of provincial environmental law, especially in the factual circumstances of this case.

(b) Adjudicative facts

38. As noted, it is not a constitutionally-valid purpose of Parliament, by relieving a company in CCAA proceedings from environmental costs, to substantively improve a company's restructuring prospects – whether by increasing the amount of money available to unsecured creditors under its plan, or by enabling its new stakeholders to avoid significant post-restructuring expenses.

39. However, even if it were, in the present case there is no evidence of frustration of purpose in either of those respects.

40. There is no evidence that the cost to Catalyst of complying with the permit responsibilities could materially affect the amount of money available to unsecured creditors, causing them to vote against the Plan.

41. Nor is there evidence of actual or potential post-restructuring expenses sufficient to deter Plan support by future stakeholders. There is merely the costs of ongoing monitoring, investigation and reporting, plus an indeterminate risk that an environmental condition or environmental damage may be found, or may develop, such as to warrant future regulatory orders. There is no evidence whatsoever of the likelihood of that happening, or what order or orders may be made, or when, or against whom, or with what compliance costs.

42. Nor, it follows, is there any evidence that the risk of any such future order would deter stakeholders from supporting Catalyst's Plan and thereby frustrate Parliament's putative purpose.

Conclusion

43. In the result, even if *arguendo*

(a) the scope of Parliament's constitutional authority under the bankruptcy and insolvency power were to be found by the Supreme Court of Canada in *AbitibiBowater Inc.* no longer limited to the enactment of provisions which, in a technical, procedural sense, facilitate corporate restructuring, and

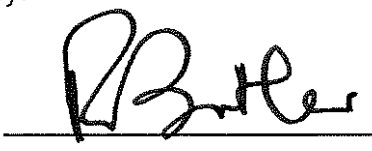
(b) on that basis the CCAA could be interpreted to contain constitutionally-valid provisions to the effect proposed by Catalyst in relation to the Plan Sanction Order,

there is on the evidence here no conflict between those putative provisions and the continued operation of EMA and the regulations in relation to Catalyst and the Elk Falls Mill, such as to trigger paramountcy and make those provincial laws constitutionally inoperative.

AND TAKE NOTICE THAT, in support of this response, the Attorney General of British Columbia will rely on the Affidavit # 1 of Hubert Bunce, the pleadings and proceedings filed and to be filed herein, and such other documents or materials as counsel may advise and the court allow.

The Attorney General estimates that the hearing of arguments in relation to paramountcy will require one full day.

Dated: May 22, 2012



Counsel for Attorney General
of British Columbia

SCHEDULE "A"

LIST OF ADDITIONAL PETITIONERS

Catalyst Pulp Operations Limited

Catalyst Pulp Sales Inc.

Pacifica Poplars Ltd.

Catalyst Pulp and Paper Sales Inc.

Elk Falls Pulp and Paper Limited

Catalyst Paper Energy Holdings Inc.

0606890 B.C. Ltd.

Catalyst Paper Recycling Inc.

Catalyst Paper (Snowflake) Inc.

Catalyst Paper Holdings Inc.

Pacifica Papers U.S. Inc.

Pacifica Poplars Inc.

Pacifica Paper Sales Inc.

Catalyst Paper (USA) Inc.

The Apache Railway Company