Court of Queen's Bench of Alberta

Citation: Alberta Energy Regulator v Lexin Resources Ltd, 2019 ABQB 23

Date:
Docket: 1701 03460
Registry: Calgary

Between:

Alberta Energy Regulator

Plaintiff

- and -

Lexin Resources Ltd., 1051393 B.C. Ltd., 0989 Resource Partnership, LR Processing Ltd., and LR Processing Partnership

Defendants

**Decision
of the
Honourable Madam Justice B.E. Romaine**

I. Introduction

[1] Midstream Canada Ltd applied to lift the stay of proceedings in the receivership of Lexin Resources Ltd, 1051393 BC Ltd, 0989 Resource Partnership, LR Processing Ltd and LR Processing Partnership (collectively, Lexin) in order to allow Midstream to assume operatorship of certain gas facilities and gathering systems. I denied the application on the basis that, in the circumstances of this receivership, the prejudice to the Receiver of lifting the stay far outweighs the prejudice to Midstream, and it was not equitable to lift the stay for other reasons. These are my reasons.

II. Relevant Facts

[2] Originally, Midstream applied to lift the stay imposed under the receivership order with respect to three gas facilities and gathering systems (the Facilities) and 21 wells in which Midstream and Lexin have various interests. However, when the application was argued, Midstream proceeded only on the basis of the Facilities.

[3] The wells and Facilities were shut-in pursuant to an Alberta Energy Regulator order dated February 15, 2017. At that time, the wells and facilities were co-owned by Lexin and Exxon Mobil Energy Canada and operated by Lexin.

[4] Exxon did not apply to lift the stay imposed by the receivership order. On December 21, 2017, Midstream agreed to purchase Exxon's interest in the wells and Facilities. This sale closed on February 1, 2018. It included not only Exxon's interest in the 21 wells jointly owned with Lexin, but also 32 additional wells in which Lexin has no interest.

[5] Midstream has applied to the Alberta Energy Regulator for approval of the transfer of the Exxon well licenses, but had not yet obtained such approval at the time this application was heard.

[6] The three Facilities at issue are:

a) the Hooker Gas Gathering System, in which Lexin owns a 75% interest;

b) the Hooker East Compression and Gas Gathering System, in which Lexin owns a 75% interest in three of the four functional units and a 50% interest in the fourth functional unit, and therefore a 68.75% overall interest in the system; and

c) the South East Hooker Compression and Gas Gathering System, in which Lexin owns an approximately 45% interest.

[7] The receivership order imposing the stay was granted on March 20, 2017. Since July, 2017, the Receiver has been marketing Lexin's assets, including the wells and Facilities in issue. The marketing materials specify that Lexin is the operator of the wells and Facilities. The sales process has been extended a number of times, due in part to complications arising from an unrelated claim.

[8] On May 3, 2018, Midstream filed its application to lift the stay.

[9] While Midstream may be entitled by reason of its majority ownership to assert operatorship of the South East Hooker Facility, it requires the operatorship of all three Facilities in order to commerce moving product to market from the 32 wells in which Lexin has no interest.

[10] The Facilities are governed by Construction, Ownership and Operation Agreements (the CO&O Agreements) that are materially identical with respect to the provisions relevant to this application.

[11] These CO&O Agreements adopt the standard form model Petroleum Joint Venture Association 1999 Standard Operating Procedure (the 1999 PJVA).

III. The Issue

[12] The issue is whether it is appropriate to lift the stay in the circumstances of this receivership and with reference to Midstream's contractual rights.

IV. Analysis

[13] A. The Test for Lifting the Stay.

As noted in *Alignvest Private Debt Ltd v Surefire Industries Ltd*, 2015 ABQB 148 at paras 40 and 43 (appeal on other grounds dismissed, [2015] AJ No 1234), the test for lifting a stay imposed pursuant to a receivership order focuses on the totality of circumstances and the relative prejudice to the parties involved in the receivership.

[14] Guidance can be drawn from the provisions of section 69.4 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 as amended, in determining whether a stay in a receivership should be lifted. The Court should be satisfied that the party applying to lift the stay is likely to be materially prejudiced by the stay or that it would be equitable to lift the stay on other grounds. The burden is on the applicant: *Re Ma* [2001] OJ No 1189 (Ont CA).

[15] Lifting the stay is not routine: there must be sound reasons to relieve against the stay: *Re Ma,* at para 3.

[16] In order for a party applying to lift the stay to show material prejudice, it must show that it would be treated differently or some way unfairly or would suffer worse harm than other creditors if the stay is not lifted: *Golden Griddle Corp v Fort Erie Truck & Travel Place Inc* (2005), 29 CBR (5^{th}) 62 (Ont SCJ) at paras 18-19. The mere fact that a party is not entitled to exercise a contractual right for which it has bargained is not a sufficient reason to lift the stay. In that respect, the prejudice to the applicant is no different qualitatively from that suffered by other creditors, who also lose, in whole or part, the benefit of their contracts by reason of the debtor's insolvency.

[17] Since the Court's decision in *Alignvest*, there have been at lease two decisions that have caused some uncertainty about the test to be applied to such applications in the context of operatorship of oil and gas assets.

[18] The first case relied on by Midstream is *Bank of Montreal v Bumper Development Corp*, 2016 ABQB 363. In that case, the applicant Eagle Energy Inc and the debtor were parties to a joint operating agreement that incorporated the 2007 Canadian Association of Petroleum Operating Procedure (the 2007 CAPL). They were also parties to a construction ownership and operation agreement with respect to certain facilities. Those contracts included a clause that provided for the immediate replacement of the operator if the current operator became bankrupt or insolvent, was placed in receivership or sought an order under the *Companies' Creditors Arrangement Act*, RSA 1985 c C-36. These clauses are sometimes referred to as "*ipso facto*" clauses.

[19] Eagle also had the right under contract to elect to become the operator upon disposition of the debtor's interest in the joint venture properties, rather than consenting to the purchaser of the properties debtor's becoming the operator.

[20] It is important to the outcome of the case that there was evidence that the Receiver had agreed with Eagle to only sell a non-operated interest to third-party purchasers

[21] Macleod, J approved a sale of the debtor's interest to a third-party without prejudice to Eagle's right to argue the issue of operatorship at a later hearing. At that hearing, Eagle and the purchaser made opposing submissions, with no position taken either way by the Receiver. Macleod, J found that, given Eagle's negotiations with the Receiver, Eagle believed it would become operator even if it was not the successful bidder for the underlying assets. The purchaser "did not have any reasonable expectation that it was purchasing operatorship": para 22. McLeod, J found that it would be unfair to deprive Eagle of its "clear contractual right" to be operator. He lifted the stay *nunc pro tunc* and declared Eagle to be entitled to be the operator of the wells and facilities.

[22] Midstream relies on *obiter dicta* comments made by the Court at paragraphs 18 and 19 of *Bumper*, as follows:

> Had Eagle pursued its right to be Operator at the time of the granting of the Receivership Order or soon thereafter, I can think of no reason why this Court would not have acceded to Eagle's request to lift the stay and grant a declaration with respect to both the wells and the Battery.
>
> The stay was granted incidental to the appointment of the Receiver to permit for orderly realization and distribution. Eagle's right to operate, however, arises under a contract which pre-dates the receivership. Also, there is no reason to interfere with the contractual rights of Eagle which are not subject to the security of Bumper's creditors.

[23] He distinguished *Norcen Energy Resources Ltd v Oakwood Petroleums Ltd*, 92 AR 81, in which the Court reached a contrary conclusion, on the basis that *Norcen* involved the CCAA and not a receivership. I must disagree with the opinion of Justice Macleod on that issue, as, in my view, the tests for lifting a stay under the *BIA* and the *CCAA* are substantially the same.

[24] The obiter comments made by Justice Macleod on whether an application to lift the stay made prior to the sale of assets would have been successful were made without reference to the appropriate test for lifting a stay at that time, and did not reference the issue of relative prejudice. The application before Justice Macleod was an after-sale dispute between the two parties to the 2007 CAPL, and had no impact on the receivership itself. The decision appears to rely on an interpretation of a contractual provision in the 2007 CAPL that allows a party to become operator upon the sale of the operator's working interest post-sale. Thus, the decision is distinguishable from the situation in this case.

[25] The recent case of *National Bank of Canada v Scollard Energy Inc*, 2018 ABQB 126, was also relied upon by Midstream. In that case, Scollard, a debtor in receivership, and Firenze Energy Ltd were joint working interest owners in wells and facilities under an agreement that again incorporated the 2007 CAPL with Scollard as operator. An offer was before the Court that greatly exceeded other offers, including that of Firenze but this offer was conditional on the purchaser retaining the right to be operator of the facilities. Firenze applied to lift the stay and assume operatorship pursuant to clause 2.02A(a) of the 2007 CAPL, similar to the clause relied upon in *Bumper*, which provides that the operator will be replaced immediately if it becomes bankrupt or insolvent.

[26] The Court adopted the reasoning in *Alignvest*, noting that, generally speaking, the fact that a stay operates to deny a party a particular contractual remedy is not a sufficient reason to

lift the stay. The Court also noted that the existence of an *ipso facto* clause, while valid between contracting parties, is void against a trustee in bankruptcy on policy grounds and that thus the stay should not be lifted on that basis.

[27] The Court applied the *Alignvest* test, indicating that it required the Court to focus on the totality of the circumstances and the relative prejudice to the parties involved in the receivership.

[28] However, the Court then considered what it characterized as "the more central issue", which was not initially raised by counsel. Dario, J referred to clauses 2.06 and 2.09 together with clause 2.02(A)(g) of the 2007 CAPL, which she noted provide that an operator may not transfer operatorship to an assignee without the approval of the other working interest owners, requiring a vote of at least two parties with working interests of more than 50%. The Court noted that, if there are only two owners when the operator resigns or is removed, the other party may become the operator on the service of notice as long as it holds more than 40% of the working interest; *Scollard* at para 19. Section 2.02A(g) of the 2007 CAPL provides that the operator will be replaced immediately after service of notice if the operator "assigns or attempts to assign its general powers and responsibilities of supervisor and management as operator", but exempts from this provision a pending appointment of a new operator under clause 2.06.

[29] In the *Scollard* situation, Scollard and Firenze were equal working interest owners for most of the wells and facilities in question. Thus, the Court observed at para: 21.

> Firenze therefore appears to have the unconditional right to assume operatorship (in all but the four wells and associated Facilities in which it holds 40% or less of a working interest) under CAPL 2007. Thus, Firenze argues, the transfer by the Receiver of Scollard's working interest cannot include a transfer of the right of operatorship. If this were permitted, the Receiver would be placed in a better position than Scollard, who could not have transferred the operatorship outside of the procedure set out in clause 2.06, and the Receiver would be conveying more than the debtor had the right to convey before the receivership.

[30] The decision notes that the Receiver argued that the issue of the transfer of the operatorship should be left for a later day when there was an offer for the Court to consider for approval; in other words, when the triggering event set out in section 2.02A(g) had actually occurred. However, the Court disagreed with this suggestion, noting that the Receiver had made conflicting statements about whether or not it was marketing the operatorship, and finding that "the manner in which the Receiver has marketed the assets of Scollard....is not in accordance with clauses 2.06 and 2.09 of CAPL 2007." The Court was also concerned about prolonging the litigation.

[31] In summary, the Court allowed the stay to be lifted so that Firenze could serve the necessary notice to remove Scollard as operator under clause 2.02A(g).

2. Application of the Test in this Case

[32] Midstream submits that it suffers prejudice from its inability to rely on the *ipso facto* or operator insolvency contractual provisions.

[33] As noted previously, the mere existence of such contractual provisions is not in itself a sufficient basis to lift a stay. While they may be valid between contracting parties in the ordinary

course of events, these provisions are void against a receiver on policy grounds: *Re Knechtel Furniture Ltd* (1985), 56 CBR (NS) 258 (OntSC); Ex parte *Mackay* (1873), 8 Ch App 643.

[34] The reason for such a policy is clear: the prejudice to a creditor seeking to rely on such a clause is no different from that suffered by other creditors by reason of the debtor's insolvency, and giving effect to such clauses would undermine the purpose of a stay in insolvency, to permit the orderly and equitable realization and distribution of the debtor's assets.

[35] The insertion of *ipso facto* clauses in agreements relating to operation of oil and gas assets reflect the fact that operators deal with funds on behalf of the non-operating parties, and that the insolvency of an operator can give rise to a risk that the operator will comingle funds and/or put a non-operator's share of revenues at risk. However, that risk ceases to exist when a receiver is appointed.

[36] The courts have sometimes found material prejudice where an applicant was a co-owner when the stay was put in place, and the properties in question were actively producing, such that a receiver might pursue different investment and operational decisions than a party with a long-term interest in the properties in question. However, that is not the situation in this application. Midstream purchased its interest in the Facilities knowing that they were shut-in, and that there was no risk that the Receiver would make any long term investment or operational decisions that may not align with Midstream's interests. While it is possible that a third-party purchaser's interests may not align with those of Midstream, Midstream must surely have been aware of that possibility when it made the business decision to purchase the properties. While Midstream submits that it wants to restart the Facilities, and thus would suffer delay in its plans if the stay is not lifted, it was not clear at the time the application was heard that Midstream would be able to obtain the necessary license transfer and approvals to reopen the Facilities, and other interested creditors submit that, in any event, Midstream's plans would cause it to be in breach of contracts governing the Facilities.

[37] The prejudice to the Receiver is more significant. First, lifting the stay would subject the Receiver to significant capital and operating expenditures which it cannot realistically fund. The Receiver submits that it is not in a good position to assess and analyse such expenditures, and would be prejudiced by being forced to expend time and resources on this issue during a complex sales process.

[38] Second, it is clear that lifting the stay would introduce uncertainty into the sales process, particularly at this late state of the process, well after the bid deadline of October, 2017. While the Receiver has not marketed the operatorship of the Facilities as something that can be necessarily sold or assigned to the successful bidder, the Receiver has been clear about which Facilities Lexin currently operates and which CO&O Agreements govern these Facilities. As a result, bidders had a reasonable expectation that they could assume operatorship of the Facilities if their bids were successful. Bids have been submitted on the basis that Lexin is the current operator of the Wells and Facilities and also on the basis that Facilities would be shut-in when purchased. Bidders had a reasonable expectation that the *ipso facto* provisions would not be relied on to transfer operatorship prior to the sales process concluding. Midstream's counsel concedes that lifting the say would complicate the sales process and reduce the number of prospective purchasers.

[39] The third, and most persuasive reason why the stay should not be lifted is that this would prevent the Receiver from relying on certain replacement of operator provisions in the relevant

contracts, and would therefore result in Midstream taking advantage of the insolvency process to appropriate operatorship rights that would not otherwise be available to it.

[40] If the stay is not lifted, a purchaser of two of the three Facilities, the Hooker Gas Gathering System and the Hooker East Compression and Gas Gathering System, would have a contractual right to replace Lexin as operator of these Facilities.

[41] While clause 303(d) of the 1999 PJVA provides that the Operator shall cease to be operator if it ceases to be an owner, clause 304(c) states that:

> Notwithstanding subclauses 204(g), 304(a) and (b), if there are only two (2) Owners and Operator resigns or otherwise ceases to be Operator, the Owner who was not Operator previously shall automatically become Operator effective the date the previous Operator ceases to be Operator, <u>unless in the case of an assignment by Operator of its Facility Participation pursuant to Article IX, the Owners cannot agree as to whom should be Operator, the Owner with the largest Facility Participation shall become Operator.</u>
>
> (emphasis added)

[42] Article IX provides for certain notice and documentation requirements if an owner wishes to assign its interests to a third party.

[43] As the Receiver notes, one likely result of the sales process will be an assignment by Lexin of its interests in the Hooker System and the Hooker East System pursuant to Article IX of the 1999 PJVA. Provided that Lexin is the operator when its interests are assigned, the assignee will have the opportunity to become operator of these systems as it will have the largest Facility Participation in these Facilities. Midstream submits that there is no evidence that the prospect of becoming operator would be of value to a purchaser, but that is disingenuous, given the benefits that accrue contractually to operators.

[44] If the stay is lifted prior to the conclusion of the sales process and Lexin is replaced as operator, Lexin and the eventual purchaser would not be able to rely on these operatorship rights. Thus, Midstream's suggestion that the stay could be lifted without prejudice to any rights a purchaser would acquire does not address the prejudice.

[45] The denial of Midstream's application in this case is not inconsistent with *Scollard*. In *Scollard*, it appears that the Court concluded that the applicant, given its ownership interests, would ultimately be able to assume operatorship, although there was no evidence in that case that the necessary triggering events that would permit this would occur as a result of a sale.

[46] In this case, the opposite is true: the evidence establishes that it is more likely than not that Midstream would not be in a position to assume operatorship on a sale. At any rate, the contractual provisions at issue in *Scollard* are not the same as those at issue in this case.

[47] In conclusion, the prejudice to the Receiver and other creditors of Lexin if the stay is lifted outweighs the prejudice, if any, that would be suffered by Midstream if the stay is not lifted, and there are no equitable grounds that would otherwise justify the lifting of the stay. As noted by the Receiver, the insolvent operator provisions are not intended to be utilized strategically by co-owners or their assignees to obtain operatorship that would otherwise not be

contractually available. Rather, they are intended to protect non-operators from the real risks and prejudices that can arise when an operator becomes insolvent.

Dated at the City of Calgary, Alberta this 14 day of January, 2019.

B.E. Romaine
J.C.Q.B.A.

Appearances:

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