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| COURT | COURT OF QUEEN'S BENCH OF ALBERTA | |
| JUDICIAL CENTRE | Calgary | |
| PLAINTIFF | **ALBERTA ENERGY REGULATOR** | |
| DEFENDANTS | **LEXIN RESOURCES LTD., 1051393 B.C. LTD., 0989 RESOURCE PARTNERSHIP, LR PROCESSING LTD. and LR PROCESSING PARTNERSHIP** | |
| DOCUMENT | **BRIEF OF THE RECEIVER** | |

ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT

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## I. INTRODUCTION

1. This Brief is submitted on behalf of Grant Thornton Limited, in its capacity as the court-appointed receiver (the "**Receiver**") of Lexin Resources Ltd. ("**Lexin**"), in response to the application of the Applicant, Midstream Canada Ltd. ("**Midstream**") seeking an order lifting the stay of proceedings in the Receivership Order granted in these proceedings (the "**Receivership Order**") and the Bankruptcy Order issued on October 25, 2017 (the "**Stay**"). Midstream asks the Court to lift the Stay so that it can assert Operatorship over certain wells and facilities which are jointly owned by Lexin and Midstream, and further asks the court to declare that Midstream should be named Operator of such wells and facilities.

2. For the reasons set in this Brief, Midstream is not entitled to the orders sought in its application. Midstream has not been prejudiced by the Stay and there is no equitable ground for lifting it. In contrast, the Receiver, and by extension the receivership estate, will be significantly prejudiced if the Stay is lifted. Midstream should not be permitted to take advantage of Lexin's receivership to obtain rights of operatorship that would otherwise be unavailable to it. The Stay should remain in place until the Sales Process, through which the Receiver is selling the wells and facilities at issue, is complete at which point the issue of operatorship should be resolved as between Midstream and the eventual purchaser in accordance with their respective contractual rights.

## II. FACTS

### *The Wells and Facilities*

3. This application relates to operatorship of 21 wells (the "**Wells**") and three gas gathering systems (the "**Facilities**") in the High River Area of Alberta.

4. The Wells are listed in Exhibit "B" to the Affidavit of Neeky Noor-Ali, sworn on April 30 2018 (the "**Noor-Ali Affidavit**"). Operatorship of the Wells is governed by standard form, model operating agreements in the 1990 Canadian Association of Petroleum Landmen ("**1990 CAPL**") form. Pursuant to the 1990 CAPL operating agreements in place, Lexin is the currently the operator of the Wells. As described in Exhibit "B" to the Noor-Ali Affidavit, Lexin holds a 50% interest in most of the Wells, but Lexin holds a greater than 66% interest in six of the Wells (the "**Six Wells**").[1]

[1] The six wells are identified by the following Unique Well Identifiers: 100/04-09-017-29W4/0; 100/15-09-017-29W4/0; 100/08-28-018-29W4/0; 100/01-34-018-29W4/0; 100/12-34-018-29W4/2; 100/01-25-018-30W4/3.

5. The Facilities include pipelines, gathering systems and related facilities known as the Hooker Gas Gathering System (the "**Hooker System**"), the Hooker East Compression and Gas Gathering System (the "**East System**"), and the South East Hooker Compression and Gas Gathering System (the "**South East System**"). Operatorship of the Hooker System, East System, and South East System is governed by a Construction, Ownership and Operation Agreement (a "**CO&O Agreement**), attached as Exhibits "E", "F" and "G" to the Noor-Ali Affidavit respectively. Although there are slight differences between the CO&O Agreements governing each of the Facilities, each CO&O Agreement adopts the standard form, model Petroleum Joint Venture Association 1999 Standard Operating Procedure (the "**1999 PJVA**").

6. Lexin holds a 75% interest in the Hooker System. The East System is divided into four functional units. Lexin holds a 75% interest in three of these functional units, and a 50% interest in the fourth functional unit, and therefore holds a majority overall interest (68.75%) in the East System. Lexin holds a 45.1178% interest in South East System.

7. The Wells and Facilities were shut-in as a result of AER Closure Order C2017-01, dated February 15, 2017. At the time they were shut-in, the Wells were all co-owned by Lexin and ExxonMobil Energy Canada ("**Exxon**") and operated by Lexin.

***The Receivership Order, Stay and Sales Process***

8. The Receivership Order which imposed the Stay was granted on March 20, 2017. On July 14, 2017, this Court approved a sales process to facilitate the marketing and sale of Lexin's assets, including the Facilities and Wells (the "**Sale Process**"). Since this Court's approval of the Sales Process, the Receiver has marketed the Wells and Facilities in the High River area, among other Lexin assets, as further described in the Receiver's Seventh and Eighth Reports. The marketing materials prepared in support of the Sales Process clearly specified that Lexin was the operator of the Wells and Facilities.[2]

9. Exxon, as co-owner of the Wells and Facilities, did not apply to lift the Stay at any time after it was imposed. Rather, for almost nine months, the Stay remained in place and the Wells and Facilities remained shut-in. Then, on December 21, 2017, with the Stay in place, the Applicant, Midstream Canada Ltd. agreed to purchase the Wells and Facilities from Exxon, in a transaction which closed on February 1, 2018 (the "**Midstream Sale**").

[2] Receiver's Eighth Report, filed May 29, 2018 [**Eighth Report**] at para 26(d).

10. Shortly after the Midstream Sale closed, Midstream informed counsel for the Receiver of Midstream's desire to assume operatorship of the Wells and Facilities. The Receiver indicated that the Stay prevented Midstream from asserting operatorship of the Wells and Facilities.

11. On May 3, 2018, Midstream filed the within Application, seeking to lift the Stay to allow it to assume operatorship of the Wells and Facilities on the basis of contractual rights in the 1990 CAPL and the 1999 PJVA which permit a non-operating co-owner of jointly held property to assume operatorship if the operator becomes bankrupt or insolvent or is placed in receivership.

## III. ISSUES

12. The issue before this Honorable Court is whether it is appropriate to lift the Stay in the circumstances.

## IV. ARGUMENT

***Contractual Rights Triggered by Lexin's Insolvency are an Insufficient Basis to Lift the Stay***

13. Midstream seeks to lift the stay in order to enforce Clause 303 of the 1999 PJVA and Section 202 of 1990 CAPL (collectively, the "**Insolvent Operator Provisions**"). The Insolvent Operator Provisions both provide that an operator shall be replaced as operator in a number of situations, including if the operator becomes bankrupt or insolvent or is placed in receivership. Section 202 of 1990 CAPL requires that a non-operator who is party to the agreement issue a notice to the operator to effect their replacement as operator, while Clause 303 of 1999 PJVA does not require notice. Rather, Clause 303 of the 1999 PJVA provides that the operator "shall immediately cease" to be operator if a condition such as insolvency or receivership arises during the joint venture relationship.[3]

14. Insolvent Operator Provisions reflect "the understanding that Operators conduct operations on behalf of all parties and in so doing, frequently deal with money belonging to the non-operating parties."[4] As such the "reason for removal of an Operator in the case of insolvency is the risk to the co-owners if an insolvent Operator co-mingles funds thereby putting at risk the co-owner's share of revenues."[5] Where an operator has committed an act of insolvency, but no stay of proceedings

[3] Appendix "A" to this Brief includes Clause 303 of 1999 PJVA and Section 202 of 1990 CAPL in their entirety.
[4] *Bank of Montreal v. Bumper Development Corp.*, 2016 ABQB 363 [***Bumper***], at para 17 **[TAB 1]**
[5] *Eon Energy Ltd v Ferrybank Resources Ltd*, 2016 ABQB 585 at para 311 **[TAB 2]**

has been put in place, courts have not hesitated to enforce Insolvent Operator Provisions to effect the replacement of an insolvent operator.[6]

15. However, where a stay has been put in place and a receiver appointed, generally, "a contractual provision cannot defeat the operation of the statutorily embodied and court enforced stay of proceedings."[7] As conceded by Midstream, contractual rights to assume operatorship upon the operator's insolvency are not by themselves a sufficient basis to lift the Stay.[8] The reason for this is that an Insolvent Operator Provision "while valid between contracting parties – is void against the bankruptcy or insolvency trustee on policy grounds."[9] For example, it has been noted that:

> "an agreement that provides that upon a person becoming bankrupt his property should pass to a third party is void against a bankruptcy trustee as being in violation of the bankruptcy laws. *That policy principle applies equally to an agreement that purports to forfeit a person's rights in the event of insolvency.*"[10] [Emphasis added]

16. The existence of the Insolvent Operator Provisions therefore provide no special justification that warrant the lifting of the Stay. Depriving a contracting party "of rights that it had specifically bargained for" under an agreement is often necessary in a receivership, and in fact, is generally the purpose of the Stay, and as such, does not constitute material prejudice.[11] The contracting party entered into the contract "knowing the risks."[12] The Receiver submits that this policy rationale is especially strong in this case, as Midstream was assigned or novated into the relevant contracts knowing not only was there a risk of a stay, but in fact: (i) knowing the receiver was appointed and the Stay already in place; (ii) aware that the Wells and Facilities were previously shut-in; and (iii) intimately aware that the Sales Process had been run.

***The Relative Prejudice to the Parties does Not Support Lifting the Stay***

17. Given that the Insolvent Operator Provisions are void as against the Receiver and provide no special justification for lifting the Stay, Midstream must meet the general test for lifting a stay imposed pursuant to a receivership. This test "focuses on the totality of circumstances and the relative prejudice to the parties involved in the receivership."[13] The court "should be satisfied that the party

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[6] *Firenze Energy Ltd v Scollard Energy Ltd*, 2018 ABQB 126 [***Scollard***] at para 10 **[TAB 3]**
[7] *Ibid*, at para 11 **[TAB 3]**
[8] *Ibid*, at para 12 **[TAB 3]**
[9] *Ibid* **[TAB 3]**
[10] *Knechtel Furniture Ltd., Re*, 1985 CarswellOnt 190, at para 10 **[TAB 4]**
[11] *Alberta Treasury Branches v. COGI Limited Partnership*, 2018 ABQB 356 [***COGI***], at para 52 **[TAB 5]**
[12] *Ibid* **[TAB 5]**
[13] *Alignvest Private Debt Ltd. v. Surefire Industries Ltd.*, 2015 ABQB 148 [***Alignvest***], at para 40 **[TAB 6]**

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."[14] Lifting the stay is "far from a routine matter."[15]

18. To meet their burden of showing material prejudice, an applicant must show "special harm,"[16] or that it has been "treated differently or some way unfairly"[17] as a result of the stay. Generally, the fact that a stay limits opportunities to take steps that are economically motivated is not sufficient material prejudice to justify lifting a stay.[18]

***Midstream has not been Prejudiced by the Stay***

19. In the context of applications to lift a stay to effect a transfer of operatorship from an insolvent operator, courts have suggested that a stay may materially prejudice an applicant where:

i. the applicant was a co-owner when the stay was put in place; and

ii. the properties in question were actively producing when the stay was put in place, such that the insolvent operator, or more accurately its receiver, might intermingle joint funds or "pursue different investment and operational decisions than a party with a long-term interest in the vitality" of the properties in question. [19]

20. These circumstances are not present in Midstream's case. It cannot say that is has been prejudiced by the Stay when it purchased the Wells and Facilities knowing they were shut in and knowing the Stay was in place. Midstream's position has never been affected by the Stay, but only by its own business decision to purchase shut-in assets, operated by the Receiver of an insolvent entity protected by the Stay. The fact that the Wells and Facilities are currently shut-in limits any potential prejudice to Midstream, as there is no risk of intermingling joint funds or putting Midstream revenues at risk. There is also no risk that the Receiver will make any long term investment or operational decisions respecting the Wells and Facilities which may not align with Midstream's interest in the long-term vitality of the properties.[20]

21. While Midstream argues that it has an economic interest in urgently restarting operations at the Wells and Facilities, this interest has always been subject to the Stay, and has thus never been

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[14] *Alignvest,* at para 41 **[TAB 6]**
[15] *Ma, Re*, [2001] O.J. No. 1189, at para 3 **[TAB 7]**
[16] *COGI,* at para 53 **[TAB 5]**
[17] *Alignvest,* at para 43 **[TAB 6]**
[18] *COGI,* at para 53-54 **[TAB 5]**; *Baytex Energy Ltd. v. MNP Ltd.*, 2012 ABQB 539, at para 18 **[TAB 8]**
[19] *Scollard,* at para 37 **[TAB 3]**
[20] *Ibid* **[TAB 3]**

prejudiced or otherwise impacted by the Stay, which pre-existed Midstream's interest. Further, even if the Stay were lifted, it is unclear that Midstream is in fact in any position to obtain an economic benefit. As discussed in the Receiver's Eighth Report, it is unclear whether Midstream will be able to obtain the license transfers and other necessary approvals required to recommence production. Thus, any economic benefit is contingent on certain unknown factors.[21]

22. Finally, if the Sales Process is allowed to conclude without the Stay being lifted, Midstream will have an opportunity to participate in recommenced operations at the Wells and Facilities along with the successful purchaser. While Midstream no doubt has an interest in recommencing operations, it has provided no evidence that recommencing operations is especially urgent in the circumstances. Put another way, Midstream has not met its burden of showing that it will suffer "special harm" if operations are not recommenced now, as opposed to at the conclusion of the Sales Process.

23. Lifting the Stay only provides Midstream with the opportunity to potentially obtain a short term, and as yet uncertain economic benefit. Loss of such an opportunity does not constitute material prejudice sufficient to justify lifting the Stay.

***The Receiver Would Face Significant Prejudice if the Stay were to be Lifted***

24. If the Stay were to be lifted, the Receiver would face significant prejudice. This prejudice falls into three categories:

i. Lifting the Stay would subject the Receiver and the receivership estate to unnecessary capital and operating expenditures and increased costs of administration;

ii. Lifting the Stay would introduce uncertainty and otherwise prejudice the Sales Process;

iii. Lifting the Stay would prevent the Receiver from relying on replacement of operator provisions in the governing agreements, and would therefore result in Midstream taking advantage of the insolvency process to appropriate operatorship rights that would not otherwise be available to it.

25. As discussed in the Receiver's Eighth Report, lifting the Stay would subject the Receiver to significant capital and operating expenditures which it cannot realistically fund.[22] Further, the Receiver is not in a good position to assess and analyse such expenditures, and would be prejudiced

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[21] Eighth Report at para 26(e)
[22] *Ibid* at para 26(f)

by being forced to expend time and resources on this issue while it is in the midst of running the Sales Process.

26. Lifting the Stay would also introduce uncertainty into the Sales Process. Midstream's position is distinguishable from that of its predecessor, Exxon. Exxon was clearly impacted by the Stay and the suspension orders which shut-in the Wells and Facilities. Shortly after the Stay was imposed, Exxon could have pursued its rights to assume operatorship pursuant to the Insolvent Operator Provisions, and it is possible that a court would have granted such relief.[23] Instead, Midstream purchased the assets almost 10 months later. The Sales Process had already reached an advanced stage (well after the bid deadline in October, 2017) by the time Midstream first mentioned its desire to assert operatorship. Bids have been submitted on the basis that Lexin is the current operator of the Wells and Facilities and also on the basis that the Wells and Facilities would be shut-in when purchased.[24] Bidders had a reasonable expectation that the Insolvent Operator Provisions would not be relied on to transfer operatorship prior to the Sales Process concluding. Forcing bidders to re-examine their bids based on Midstream's late stage assertion of operatorship would prejudice the Sales Process. Such uncertainty and prejudice would arise even at the prospective re-bid stage, as current bidders have based their participation in the Sales Process on marketing materials which do not account for Midstream's assertion of operatorship.

27. Finally, lifting the Stay would prevent the Receiver and the receivership estate from relying on replacement of operator provisions in the governing agreements, and would therefore result in Midstream taking advantage of the insolvency process to appropriate operatorship rights that would not otherwise be available to it.

28. Contrary to Midstream's assertions, if the Stay is not lifted, the Sales Process is likely to result in the eventual purchaser of two of the three Facilities assuming operatorship from Lexin. Specifically, because Lexin is the majority interest holder and current operator of both the Hooker System and East System, the eventual purchaser would have a right to replace Lexin as operator of these Facilities upon purchasing them.

29. Clause 303(d) of the 1999 PJVA states as follows:

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[23] *Bumper*, at para 18 **[TAB 1]**; *COGI* **[TAB 5]**
[24] Eighth Report, at para 26(f).

> Operator shall immediately cease to be Operator [...] and a replacement Operator be appointed pursuant to Clause 304, if [...] Operator ceases to be an owner .[25]

30. Clause 304(c) states:

> 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, 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.[26]

31. Article IX generally provides for certain notice and documentation requirements, if an owner wishes to assign its interests to a third party.[27]

32. The Receiver submits that one likely result of the Sales Process will be an assignment by Lexin of its interests in the Hooker System and the East System pursuant to Article IX of the 1999 PJVA. Pursuant to Clause 304, provided that Lexin is the operator when its interests are so assigned, the assignee shall have the opportunity to become operator of the Hooker System and the East System, as it will have the largest Facility Participation in these Facilities.

33. As a result of Clause 304(c), Lexin need not attempt to assign operatorship to the eventual purchaser. Rather, provided that Lexin is the operator when its interests in the Hooker System and the East System are sold, the eventual purchaser shall have the option to assume operatorship of these Facilities. If the Stay is lifted prior to the Sales Process concluding, such that Lexin is replaced as operator, Lexin and the eventual purchaser shall not be able to rely on these operatorship rights. Midstream will have gained operatorship of these two Facilities as a result of Lexin's receivership, even though, pursuant to the 1999 PJVA, the eventual purchaser would otherwise have had the right to assume operatorship.

34. The effect of Clause 304(c) is analogous to the effect of the replacement of operatorship clauses discussed in *Scollard.* There, the non-operator had a right to assume operatorship upon assignment by the operator of its interest. However, this right was only available if the non-operator held more than 40% of the working interest. In *Scollard*, the court refused to lift the stay on the basis of the

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[25] Appendix "A" to this Brief includes Clause 303 in its entirety.
[26] Appendix "A" to this Brief includes Clause 304 in its entirety.
[27] Appendix "A" to this Brief includes Article IX in its entirety.

operator's insolvency and instead looked to the operatorship upon assignment provisions (similar to Clause 304(c)) to lift the stay in relation only to those wells in which the non-operator held more than a 40% interest. In other words, the court was willing to lift the stay if the non-operator was ultimately able to assume operatorship upon a sale by the operator, but was not willing to lift the stay if doing so impacted on the contractual rights of a party to assume operatorship upon a sale by the operator.

35. 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 operatorship of the Facilities could be assumed by them if their bids were successful.[28] Some bidders outlined their own plans for operating the Facilities in a manner that does not accord with the plans proposed by Midstream.[29] If the Stay is lifted, such that the successful bidder will have no opportunity to assume operatorship of any facilities, it will likely negatively impact the bids for the Facilities, and therefore prejudice the Receiver's ability to carry out its mandate to maximize the realization of Lexin's assets.

36. The Receiver concedes that pursuant to Clause 206(a) of 1990 CAPL, Midstream will have a right to assume operatorship of the Wells upon the assignment of these Wells by Lexin to a third party.[30] However, pursuant to Clause 202(b)(i) of CAPL 1990, a joint owner who holds more than 66% of the working interest in a well has a general right to replace the incumbent operator at any time by providing notice.[31] As such, for the Six Wells, the successful bidder would have an immediate right to replace Midstream as operator simply by providing notice upon closing a sale transaction. As such, for the Six Wells, even if operatorship is transferred temporarily to Midstream, the successful bidder will have the right to assume operatorship as soon as the Sales Process is complete and a sale closes. For the Six Wells at least, a short term, temporary transfer of operatorship to Midstream would require the Receiver to expend time, effort and costs, without providing any material benefit to Midstream.

[28] Eighth Report at para 26(d)
[29] *Ibid* at para 26(f)
[30] Appendix "A" to this Brief includes Clause 206 of 1990 CAPL in its entirety.
[31] Appendix "A" to this Brief includes Clause 202 of 1990 CAPL in its entirety.

*Equity Weighs Against Lifting the Stay*

37. When considering whether equitable grounds exist to lift the Stay, the Receiver submits that it is relevant that Midstream has already benefited from Lexin being in receivership. If Lexin had not been insolvent when Midstream acquired its interests in the Wells and Facilities from Exxon, Lexin would have been able to rely on the same contractual provisions now asserted by Midstream to assert operatorship over many of the jointly owned wells and assets formerly operated by Exxon. Because it was insolvent, Lexin was ineligible to assert operatorship, and thus operatorship was assumed by Midstream by default. Having already taken advantage of Lexin's insolvency once to obtain operatorship that would otherwise be unavailable to it, Midstream now attempts to take further advantage by asserting operatorship that it would not otherwise be entitled to, simply because of Lexin's pre-existing insolvency.

## V. CONCLUSION

38. The purpose of the Stay, is to "permit for orderly realization and distribution" of the debtor's assets.[32] In the present case, the Stay is functioning exactly as intended by permitting the Receiver to conduct the Sales Process in an orderly fashion, and in a way that maximizes the realization of Lexin's assets. Further, and in accordance with longstanding bankruptcy law and policy, the Stay is preventing the Insolvent Operator Provisions from causing Lexin to forfeit contractual rights simply by reason of its insolvency.

39. It is clear that lifting the Stay would throw the Receiver's Sale Process for the Wells and Facilities into disorder, and would likely prejudice the Receiver's ability to maximize the realization of these assets. To the extent the CO&O Agreements permit the successful bidder under the Sale Process to assume operatorship, there is no reason to interfere with these contractual rights, which pre-dated the receivership. 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.

40. Midstream is not faced with any real risks or prejudices as a result of Lexin's receivership. Rather, Midstream has simply faced a delay or limitation in pursuing a potential opportunity to achieve short-term economic benefits. To the extent that the loss of this potential opportunity might be characterized as material prejudice, Midstream assumed this prejudice with its eyes open when it

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[32] *Bumper,* at para 19 **[TAB 1]**

acquired assets that were shut-in and subject to the Stay. Indeed, the only reason that Midstream became the operator of many of the former Exxon assets, and is thus in a position to pursue this opportunity in the first place, is because Lexin was insolvent at the time of the Midstream Sale. Having materially benefited from Lexin's insolvency, Midstream cannot now claim to be prejudiced by it.

## VI. RELIEF SOUGHT

41. In the result, the Receiver requests that this Honourable Court:

i. Dismiss the within Application;

ii. Grant costs to the Receiver;

iii. Order such further and other relief as the Court may consider appropriate.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 1st DAY OF JUNE 2018.**

**BORDEN LADNER GERVAIS LLP**

Per: ______________________

**Robyn Gurofsky**
Solicitor for the Receiver/Applicant

## LIST OF AUTHORITIES

1. *Bank of Montreal v. Bumper Development Corp.*, 2016 ABQB 363
2. *Eon Energy Ltd v Ferrybank Resources Ltd*, 2016 ABQB 585
3. *Firenze Energy Ltd v Scollard Energy Ltd*, 2018 ABQB 126
4. *Knechtel Furniture Ltd., Re*, 1985 CarswellOnt 190
5. *Alberta Treasury Branches v. COGI Limited Partnership*, 2018 ABQB 356
6. *Alignvest Private Debt Ltd. v. Surefire Industries Ltd.*, 2015 ABQB 148
7. *Ma, Re*, [2001] O.J. No. 1189
8. *Baytex Energy Ltd. v. MNP Ltd.*, 2012 ABQB 539

# APPENDIX "A"

# OPERATING PROCEDURE

CAPL

CANADIAN ASSOCIATION of PETROLEUM LANDMEN

CANADIAN ASSOCIATION OF PETROLEUM LANDMEN

1990

## ARTICLE II

## APPOINTMENT AND REPLACEMENT OF OPERATOR

201 ASSUMPTION OF DUTIES OF OPERATOR – The Operator named in the Agreement, or any succeeding Operator appointed hereunder, shall assume the duties and obligations of the Operator hereunder and shall have all the rights of the Operator hereunder.

202 REPLACEMENT OF OPERATOR –

(a) The Operator shall be replaced immediately and another Operator appointed forthwith pursuant to Clause 206 upon notice to such effect being served by any party to the other parties if:

(i) the Operator becomes bankrupt or insolvent, commits or suffers any act of bankruptcy or insolvency, is placed in receivership, seeks debtor relief protection under applicable legislation (including, without restricting the generality of the foregoing, the Bankruptcy Act of Canada and the Companies' Creditors Arrangement Act of Canada) or permits any judgement to be registered against its working interest, and without restricting the generality of the foregoing, an Operator shall be deemed insolvent for the purposes of this Clause if it is unable to pay its debts as they fall due in the usual course of business or if it does not have sufficient assets to satisfy its cumulative liabilities in full; or

(ii) the Operator assigns or purports or attempts to assign its general powers and responsibilities of supervision and management as Operator hereunder.

(b) The Operator shall be replaced and another Operator appointed pursuant to Clause 206 if:

(i) the Joint-Operators agree, by the affirmative vote, by notice to the other parties, of two (2) or more Joint-Operators representing a majority of the working interests, to replace the Operator, provided that a single Joint-Operator holding more than a sixty-six percent (66%) working interest in the joint lands shall have the right, by notice to the other parties, to replace the Operator and to become Operator at the time prescribed by Subclause 206(d), unless it would then be subject to replacement pursuant to paragraph 202(a)(i); or

(ii) the Operator defaults in its duties or obligations or any of them hereunder and, within thirty (30) days after written notice from a majority in working interest of the Joint-Operators, excluding the Operator, specifying the default and requiring the Operator to remedy the same, it does not commence to rectify the default and thereafter diligently continue to remedy the default.

203 CHALLENGE OF OPERATOR – At any time after an Operator has been Operator for at least two (2) years, any Joint-Operator, other than the Operator, may give notice ("the challenge notice") to the other parties that it is ready, able and willing to conduct operations for the joint account on more favourable terms and conditions. The challenge notice shall contain sufficient detail to enable the receiving parties to evaluate the nature of the challenge notice and to measure the effect the revised terms and conditions would have on joint operations. The Operator shall, within sixty (60) days after receipt of the challenge notice, advise the Joint-Operators either that:

(a) it is prepared to operate on the terms and conditions set out in the challenge notice, whereupon it shall forthwith proceed to do so; or

(b) it is not prepared to operate on the terms and conditions set out in the challenge notice and that it will resign as Operator effective not later than ninety (90) days following the sixty (60) day period provided above.

Failure by the Operator to advise the Joint-Operators of its election within such sixty (60) day period shall be deemed to be an election by the Operator to resign. If the Operator resigns, a new Operator shall be appointed pursuant to Clause 206, whereupon such new Operator shall operate on the terms and conditions set out in the challenge notice. If no other Joint-Operator is prepared to act as Operator on the terms and conditions set out in the challenge notice, the Joint-Operator giving the challenge notice shall become the new Operator and shall thereafter conduct operations pursuant to the undertakings made by it in the challenge notice. Any costs in excess of those set out in the challenge notice shall be for the new Operator's sole account. Notwithstanding Clause 204, the new Operator shall not resign from the position of Operator until it has acted as Operator for a period of at least two (2) years. A Joint-Operator may not issue a challenge notice or become Operator pursuant thereto if, at the time of issuing the challenge notice or the time it would become Operator pursuant thereto, it would be subject to replacement as Operator pursuant to Subclause 202(a) if it were Operator at that time.

204 RESIGNATION OF OPERATOR -- Subject to Subclause 202(a) and Clauses 203 and 205, the Operator may resign as Operator on giving each of the Joint-Operators ninety (90) days' notice of its intention to do so.

205 MODIFICATION OF TERMS AND CONDITIONS BY OPERATOR – At any time after an Operator has been the Operator for a continuous period of two (2) years, it may give notice ("the Operator's notice") to the other parties of the revised terms and conditions on which it is prepared to continue to conduct joint operations. Within sixty (60) days of receipt of the Operator's notice, each Joint-Operator shall advise the Operator whether it agrees to the Operator continuing as Operator and conducting joint operations on the terms and conditions contained in the Operator's notice, provided that failure by a Joint-Operator to respond within such period shall be deemed to be agreement by that party to the terms and conditions in the Operator's notice. If any Joint-Operator does not so agree, it shall give notice ("counter proposal") to the other parties of the terms and conditions upon which it would conduct joint operations. Any such counter proposal shall be deemed to be a challenge of Operator and shall be subject to all of the terms and conditions of Clause 203, as though such counter proposal was "the challenge notice" provided therein, except that in determining the merits of the counter proposal, it shall be compared to the terms and conditions contained in the Operator's notice, rather than to the existing operating terms and conditions.

206 APPOINTMENT OF NEW OPERATOR –

(a) If an Operator resigns or is to be replaced, a successor Operator shall be appointed by the affirmative vote (by notice to the other parties) of two (2) or more parties representing a majority of the working interests in the joint lands, provided that a single Joint-Operator holding more than a sixty-six percent (66%) working interest in the joint lands shall have the right, by notice to the other parties, to become the Operator hereunder, unless it would then be subject to replacement pursuant to paragraph 202(a)(i). If there are only two (2) Joint-Operators and the Operator that resigned or is to be replaced is one of the Joint-Operators, the other Joint-Operator shall have the right to become the Operator.

(b) No party shall be appointed as Operator hereunder unless it has given its written consent to the appointment. However, if the parties fail to appoint a successor Operator or if any appointed Operator fails to carry out its duties hereunder, the party having the greatest working interest shall act as Operator pro tem, with the right, should a similar situation re-occur after a new Operator has been appointed, to require the party having the next greatest working interest to act as Operator pro tem and so on as the occasion demands.

(c) No provision of this Article shall be construed to re-appoint as next-succeeding Operator an Operator who had been replaced under Clause 202, except with the unanimous consent of the parties.

(d) Except as provided in Subclause 202(a), every replacement of Operator shall take effect at eight o'clock in the morning (0800 hours) on the first (1st) day of the calendar month following the determination to replace the Operator pursuant to Subclause 202(b) or such other date as may be prescribed pursuant to Clause 203 or 204, as the case may be, notwithstanding anything contained herein.

207 TRANSFER OF PROPERTY ON CHANGE OF OPERATOR – At the effective date of the resignation or replacement of an Operator as provided in this Article II, the Operator being replaced shall deliver to the successor Operator possession of:

(a) the wells being drilled or operated by the Operator hereunder, except any wells in respect of which the succeeding Operator is not entitled to information, which shall be operated by a party determined pursuant to Clause 1004 until the successor Operator becomes entitled to such information;

(b) all production facilities, other facilities and funds held for the joint account, together with all production, if any, which has not been delivered in kind;

(c) copies of books of account and records kept for the joint account or pertaining to wells delivered hereunder; and

(d) all documents, agreements and other papers relating to property transferred hereunder.

Upon compliance with such obligation, the outgoing Operator shall be released and discharged from, and the successor Operator shall assume, all duties and obligations of the Operator, except those unsatisfied duties and obligations of the outgoing Operator which had accrued prior to the effective date of the change of Operator, for which the outgoing Operator shall continue to remain liable.

208 AUDIT OF ACCOUNTS ON CHANGE OF OPERATOR – Within ninety (90) days after the successor Operator commences to act as Operator, the parties shall cause an audit to be made of the books of account and records kept for the joint account and may cause an inventory of controllable material to be taken. The cost of the audit and inventory shall be a charge for the joint account.

209 ASSIGNMENT OF OPERATORSHIP – In the event the Operator wishes its assignee to replace it as Operator after having disposed of all or a portion of its working interest in the joint lands and any production facilities to such assignee pursuant to Article XXIV, such assignee shall have the right to become Operator if it is an Affiliate of the Operator or, if it is not an Affiliate of the Operator, if the parties agree that it shall become Operator pursuant to Clause 206. Should an assignee which is an Affiliate of the Operator become the Operator pursuant to this Clause, the two (2) year time periods described in Clauses 203 and 205 shall be calculated as if the assignment had not occurred and the audit prescribed pursuant to Clause 208 shall not be required.

## ARTICLE III

## FUNCTION AND DUTIES OF OPERATOR

301 CONTROL AND MANAGEMENT OF OPERATIONS –

(a) The Operator shall consult with the Joint-Operators from time to time with respect to decisions to be made for the exploration, development and operation of the joint lands and the construction, installation and operation of any production facilities, and the Operator shall keep the Joint-Operators informed with respect to operations planned or conducted for the joint account. Subject to the provisions hereof, the Operator is hereby delegated the management of the exploration, development and operation of the joint lands and the construction, installation and operation of any production facilities for the joint account on behalf of the Joint-Operators.

(b) The Operator shall be entitled to make or commit to such expenditures for the joint account as it considers necessary and prudent in order to conduct a good and workmanlike operation on the joint lands for the joint account. However, the Operator shall not make or commit to an expenditure for the joint account for any single operation, the total estimated cost of which is in excess of twenty-five thousand ($25 000) dollars, without an approved Authority for Expenditure from the Joint-Operators, unless the expenditure is reasonably considered by the Operator to be necessary by reason of an event endangering life or property or is required by the Regulations and failure to make such expenditure could result in the prosecution of the Operator thereunder. If the Operator is required to make such an expenditure, it shall promptly advise the Joint-Operators of the nature of such event or requirement and the expenditure anticipated to be associated therewith.

(c) Approval of an Authority for Expenditure by a party shall constitute that party's approval of all expenditures necessary to conduct the operation described therein, subject to the provisions of Article IX. However, if the Operator incurs or expects to incur expenditures with respect to a joint operation which would exceed by more than ten percent (10%) the total amount estimated in the AFE therefor, the Operator thereupon shall, for informational purposes only, forthwith advise the Joint-Operators of such overexpenditure, the Operator's explanation therefor and the Operator's revised estimate of the cost of such operation. The Operator thereafter shall provide estimates of current and cumulative costs incurred for the joint account with respect to such operation. Such estimates shall be provided on a daily basis where practical, but in any event at intervals of not greater than ten (10) days until the operation is completed.

302 OPERATOR AS JOINT-OPERATOR – The Operator shall have all of the rights and obligations of a Joint-Operator with respect to its working interest.

303 INDEPENDENT STATUS OF OPERATOR – The Operator is an independent contractor in its operations hereunder. The Operator shall supply or cause to be supplied all material, labor and services necessary for the exploration, development and operation of the joint lands and the operation of any production facilities for the joint account. The Operator shall determine the number of employees respecting its operations, their selection, their hours of labour and their compensation. All employees and contractors used in its operations hereunder shall be the employees and contractors of the Operator.

304 PROPER PRACTICES IN OPERATIONS – The Operator shall conduct all joint operations diligently, in a good and workmanlike manner, in accordance with good oilfield practice and the Regulations.

305 BOOKS, RECORDS AND ACCOUNTS – The Operator shall, with respect to all joint operations, keep and maintain true and correct books, records and accounts with respect to the development and progress made, drilling done, the conduct of other operations, the production of petroleum substances and the disposition thereof in the manner prescribed herein and in the Accounting Procedure. The Operator shall, upon request of a Joint-Operator, make available in Alberta and there permit each Joint-Operator during normal business hours to inspect such books, records and accounts and to make extracts or copies therefrom and thereof, and to audit the Operator's books, records and accounts as provided in the Accounting Procedure. However, a Joint-Operator shall not have the rights granted under this Clause with respect to a well while not entitled to information with respect to that well.

EXHIBIT "A" to

# AGREEMENT FOR THE CONSTRUCTION, OWNERSHIP AND OPERATION OF THE HOOKER GAS GATHERING SYSTEM

## OPERATING PROCEDURE

Petroleum Joint Venture Association
1999

109. Preparation and Distribution of Revised Appendices

Each time that an Appendix is to be revised or corrected pursuant to this Agreement, Operator shall effect the required revisions or corrections in a timely and diligent manner and shall provide each Owner with one (1) copy of the revised or corrected version of the Appendix.

# ARTICLE II

## SUPERVISION AND CONTROL OF JOINT OPERATIONS

201. Operating Committee

The Owners shall form an Operating Committee composed of their duly appointed representatives to supervise and control all Joint Operations. As soon as possible after the Effective Date, each Owner shall notify Operator in writing of the names and addresses of its primary representative and one (1) or more alternate representatives. The representative of an Owner shall be deemed to have full power and authority to represent and bind such Owner with respect to all matters within the power of the Operating Committee, and all acts done by such representative in such capacity shall be deemed to be the acts of the Owner appointing such representative. An alternate representative shall have full power to act for an Owner in the absence of the primary representative. An Owner may change any of its representatives from time to time by written notice to Operator. Two (2) or more Owners may appoint the same Person as their representative, who shall in such cases, cast a separate vote for each Owner being represented.

202. Chairman

The representative of the Operator shall be the chairman of the Operating Committee.

203. Powers

The Operating Committee shall, in accordance with the terms of this Agreement, exercise overall supervision and control of and shall determine all matters of importance relating to Joint Operations, except for those matters:

(a) specifically designated in this Agreement to be within the exclusive jurisdiction and control of Operator; or

(b) specifically excluded in this Agreement from the jurisdiction and control of the Operating Committee.

204. Voting Procedure

Subject to Clause 208, the Operating Committee shall determine all matters properly coming before it by vote, in accordance with the following voting procedure:

(a) Voting Interest

For the purpose of determining the number of Owners having voted or deemed to have voted on any matter pursuant to this Article II, Owners who are Affiliates of each other and who vote the same in respect of a matter hereunder shall be deemed to be one (1) Owner only.

Except as may otherwise be provided in this Agreement, each Owner shall have a voting interest equal to:

(i) its Facility Participation, if the matter materially affects or involves the entire Facility;

(ii) its Functional Unit Participation in a specific Functional Unit, if the matter relates to such Functional Unit and does not materially affect or involve any other Functional Unit; and

(iii) its aggregate weighted interest in the applicable Functional Units, if the matter affects or involves more than one (but less than all) of the Functional Units, with this interest calculated by adding the percentages obtained after multiplying the applicable Functional Unit Participations by the relative weightings of Functional Unit Participations set forth in the Appendix titled "FACILITY AND FUNCTIONAL UNIT PARTICIPATION".

Any dispute as to whether a matter materially affects or involves more than one (1) Functional Unit shall be decided by a vote in accordance with Paragraph 204 (e) (i) hereof.

Notwithstanding Subclause 204 (c), if an Owner is precluded from voting pursuant to Paragraph 602 (b) (ii), the voting interest of each non-defaulting Owner shall be revised so as to bear the same ratio to the other as do their Functional Unit Participations or Facility Participations, so that the voting interests of all non-defaulting Owners equals one hundred percent (100%).

(b) Negative Vote

Notwithstanding Subclause 204 (e) and (h), but subject to Subclauses 204 (f), (g) and (i), no single Owner shall be able to defeat a vote on a matter, unless such Owner's voting interest with respect to such matter is greater than fifty five percent (55%), and if a single Owner with a voting interest of fifty five percent (55%) or less is the only Owner voting negatively on a matter, such Owner shall be shown to have voted negatively in recording the results of the vote, but such matter shall be conclusively deemed carried in the affirmative.

(c) Deemed Vote

Subject to Subclauses 204 (f), (g) and (i), an Owner who does not vote or abstains from voting on any matter shall be conclusively deemed to have voted in the affirmative on the matter. In recording the result of a vote, such Owner shall be shown as having abstained from voting, been absent from the meeting in which such vote was taken, if applicable, or otherwise having failed to vote on such matter, as the case may be.

(d) Effect of Vote

A determination of a matter by the vote of the Owners in accordance with the provisions of this Agreement shall be binding upon all of the Owners, except as otherwise provided in this Agreement.

(e) General Vote

Except as otherwise provided herein, a matter being voted on by the Operating Committee shall be decided by the affirmative vote of:

(i) two (2) or more Owners having a combined Facility Participation of seventy five percent (75%) or more, if such matter materially affects or involves the entire Facility;

(ii) two (2) or more Owners having a combined Functional Unit Participation in the applicable Functional Unit of seventy five percent (75%) or more, if such matter relates to one (1) Functional Unit and does not materially affect or involve any other Functional Unit; and

(iii) two (2) or more Owners having a combined aggregate weighted interest of seventy five percent (75%) or more in the applicable Functional Units, if the matter affects or involves more than one (but less than all) of the Functional Units, with this interest calculated by adding the percentages obtained after multiplying the applicable Functional Unit Participations by the relative weightings of Functional Unit Participations set forth in the Appendix titled "FACILITY AND FUNCTIONAL UNIT PARTICIPATION".

(f) Vote for Removal of Operator

Operator may be removed by the affirmative vote of two (2) or more Owners having a combined Facility Participation of ninety percent (90%) or more of the remaining Facility Participation, after excluding the Facility Participations of Operator and its Affiliates, provided that:

(i) subject to Clause 303 and Subclause 602 (e), Operator may not be removed by a vote of the Operating Committee if Operator and its Affiliates collectively hold Facility Participations totalling ninety percent (90%) or more, and

(ii) the provisions of Subclauses 204 (b) and (c) shall not apply to a vote taken under this Subclause 204 (f).

(g) Vote for Replacement Operator

A successor Operator that consents to assume all the duties and obligations of Operator shall be appointed by an affirmative vote of two (2) or more Owners having a combined Facility Participation of ninety percent (90%) or more. In voting on the appointment of a successor Operator, the departing Operator and its Affiliates shall not be entitled to vote to have the departing Operator or any of its Affiliates succeed the departing Operator. In addition:

(i) should more than one (1) potential successor Operator be voted on, the potential successor Operator that receives the greatest combined Facility Participation vote shall be the successor Operator, and the requirement for the specified number of Owners voting in the affirmative and the provisions of Subclauses 204 (b) and (c) shall not apply; and

(ii) should two (2) or more potential successor Operators receive an equal Facility Participation voting percentage, the potential successor Operator holding the largest Facility Participation shall be the successor Operator.

(h) Amendment of Appendices

The Appendices may be revised, amended or replaced from time to time in the following manner:

(i) Appendices VI, XII, XIII and XIV at the direction of the Operating Committee by an affirmative vote of:

(1) two (2) or more Owners having a combined Facility Participation of seventy five percent (75%) or more, if such matter materially affects or involves the entire Facility;

(2) two (2) or more Owners having a combined Functional Unit Participation in the applicable Functional Unit of seventy five percent (75%) or more, if such matter relates to one (1) Functional Unit and does not materially affect or involve any other Functional Unit; and

(3) two (2) or more Owners having a combined aggregate weighted interest of seventy five percent (75%) or more in the applicable Functional Units, if the matter affects or involves more than one (but less than all) of the Functional Units, with this interest calculated by adding the percentages obtained after multiplying the applicable Functional Unit

Participations by the relative weightings of Functional Unit Participations set forth in the Appendix titled "FACILITY AND FUNCTIONAL UNIT PARTICIPATION".

(i) Vote for Termination of Agreement

Subject to the provisions of Article X, this Agreement may be terminated by the affirmative vote of two (2) or more Owners having a combined Facility Participation of ninety percent (90%) or more; provided that the provisions of Subclauses 204 (b) and (c) shall not apply to a vote taken under this Subclause.

(j) Vote by Proxy

An Owner may appoint a proxy to attend any meeting on its behalf. Such proxy appointment shall be by written instrument signed by the Owner, setting forth the extent of the authority granted to the proxy holder. A proxy appointment shall not be effective unless such instrument is deposited with the chairman of the Operating Committee prior to or during the first meeting in respect of which such proxy has been appointed to attend. An Owner who has submitted an instrument appointing a proxy may revoke such instrument at any time prior to the commencement of or during any meeting to which the proxy appointed thereby is to attend, provided that the revocation of an appointment of proxy during a meeting shall not apply to any vote conducted during that meeting prior to the revocation of that appointment. In addition to revocation in any other manner permitted by law, an instrument appointing a proxy shall be deemed to be automatically revoked for a meeting to which the proxy appointment relates, insofar as the Operating Committee representative of the Owner who appointed the proxy attends that meeting.

(k) Vote by Notice

(i) An Owner not represented at a meeting may vote on any matter on the agenda by prior written notice to Operator, indicating the position of such Owner regarding such matter.

(ii) Operator may, without calling a meeting, call for a vote on any matter by submitting such matter, together with reasonable details regarding the same, to each Owner by mail ballot notice. Each Owner shall, by notice to Operator, cast its vote within fifteen (15) Days from the date of deemed receipt of such mail ballot notice by the Owners. Such vote shall be binding, unless, within seven (7) Days after sending such mail ballot notice, Operator calls a meeting or is requested to call a meeting to consider the matter in accordance with Clause 205. Operator shall promptly notify the Owners of the result of such vote after the expiry of such fifteen (15) Day period.

(iii) All mail ballots shall be numbered consecutively. Such numbering shall include the Year in which the mail ballot is issued.

(l) Matters relating to Environment, Health and Safety

Notwithstanding Subclause 204(b), (e) and (h), any health, safety or environmental matters to be voted on by the Operating Committee and in respect of which the Operator (acting reasonably) believes will negatively impact the Facility operations as it pertains to environment, health and safety issues, shall be decided by the affirmative vote of fifty percent (50%) or more of the Owners, with each Owner entitled to one (1) vote; for clarity the vote will be decided upon by the number of Owners and not on their Facility or Functional Unit Participation.

205. Meetings

The following procedures shall apply to meetings of the Operating Committee:

(a) The Operating Committee shall hold meetings whenever called by Operator. Operator may call a meeting at any time and from time to time on its own motion. One (1) or more Owners having Facility

Participations totalling five percent (5%) or more shall have the right to request the Operator to call a meeting to deal with specific stated items. Operator shall issue the notice of such meeting within ten (10) Days of receipt of a written request by an Owner, and the meeting shall be held within thirty (30) Days of receipt by Operator of such request.

(b) At least ten (10) Days' notice of each meeting shall be given to each Owner, unless all of the Owners agree in writing or by vote at a meeting, to waive or shorten such notice period. Notice of any meeting shall be accompanied by an agenda together with reasonable details of the matters on the agenda and any motions to be voted on at the meeting. Any Owner shall have the right to require Operator to place an item on the agenda for such meeting, provided such item and reasonable details sufficient to enable the Owners to consider beforehand the nature of such item shall be furnished to the other Owners by such Owner within five (5) Days of the date of deemed receipt of the notice of such meeting. A motion not contained in the agenda or an amendment to be made to a motion which is contained in the agenda shall not be voted on at a meeting unless all of the Owners, whether or not present at such meeting, agree to add or amend such motion; provided that if any motion principally relates to one (1) Functional Unit and does not materially affect or involve any other Functional Unit, such motion may be added to the agenda or amended if all of the Owners, including any Owner not present at the meeting, having Functional Unit Participations in the affected Functional Unit, agree to such addition or amendment.

(c) Motions voted on at a meeting shall be numbered in accordance with Paragraph 204 (k) (iii).

(d) A representative of any Owner attending a meeting of the Operating Committee may be accompanied by a reasonable number of advisors, and the chairman may be accompanied by such additional attendees as are required to record the minutes of the meeting or otherwise assist in the conduct thereof.

(e) All meetings of the Operating Committee shall be held at the office of the Operator or at such other place as the Operating Committee may decide.

206. Minutes

Operator shall keep minutes of the proceedings of each meeting of the Operating Committee and a copy thereof shall be forwarded to each Owner within thirty (30) Days of the date of such meeting. The minutes shall contain the names of all Owners' representatives present at the meeting, indicating their capacity and the Owners that they represent, a description of the matters reviewed, the result of any vote and any dissenting Owner opinion. The minutes for any Operating Committee meeting shall be deemed to be correct as written and distributed, unless an Owner receiving the minutes gives Operator notice of an error or omission regarding such minutes within thirty (30) Days of the date upon which such minutes were sent to the Owners. Upon receiving such a notice:

(a) Operator shall promptly correct and re-issue the minutes if Operator agrees with the claim of an error or omission; or

(b) Operator shall promptly submit the matter to the Operating Committee for resolution by a vote in accordance with Subclause 204 (e) if Operator does not agree with the claim of an error or omission.

Any revised version of the minutes shall be deemed to replace all prior versions of the same and shall be deemed correct as written and distributed, subject to the terms of this Clause, which shall apply to such revised version of the minutes as if they were the original version of the same.

207. Reduction in Owners

Subject to Clause 208, if the number of Owners having a Facility Participation or Functional Unit Participation decreases after the Effective Date to a level equal to or less than the minimum number of Owners required to determine a matter under Subclause 204 (e), (f), (g), (h) or (i), the minimum number of Owners required to determine a matter shall always be one less than the number of Owners entitled to vote.

208. Unanimous Approval

If and for so long as there are only two Owners for voting purposes, Subclauses 204(b), (e), (f), (g), (h) and (i) shall not have any effect, and all matters coming before the Operating Committee shall be determined by the unanimous approval of the representatives of the Owners. At any time where unanimous approval cannot be reached in respect of any matter, either Owner may invoke the provisions of the Appendix titled "DISPUTE RESOLUTION", to resolve such matter.

209. Subcommittees

The Operating Committee may from time to time establish subcommittees to deal with defined mandates as provided by the Operating Committee. Any such subcommittee shall not have any powers of supervision or control, but shall only be entitled to report and make recommendations to the Operating Committee.

210 Enlargement

Any Enlargement shall be approved and conducted in accordance with the Appendix titled "ENLARGEMENT".

211. Environmental Matters

The Appendix titled "ENVIRONMENTAL MATTERS" shall only be effective from the first Day of the Month next following execution of this Agreement by one hundred percent (100%) of the Owners, and shall not apply prior to such date.

## ARTICLE III

## APPOINTMENT AND REPLACEMENT OF OPERATOR

301. Assumption of Duties of Operator

Operator named in the Head Document, and any succeeding Operator appointed hereunder, shall assume the duties and obligations of Operator hereunder and shall have all the rights of Operator hereunder.

302. Resignation of Operator

Operator may resign as Operator on giving each of the Owners a minimum of ninety (90) Days' notice of its intention to do so, provided that such resignation shall be effective at the end of a Month.

303. Replacement of Operator

Operator shall immediately cease to be Operator in the circumstances described in Subclauses (a) and (b)below and in all circumstances described in this Clause a replacement Operator be appointed pursuant to Clause 304, if:

(a) Operator becomes bankrupt or insolvent, commits or suffers any act of bankruptcy or insolvency, is placed in receivership or a receiver/manager or Person filling that role is appointed with respect to its property, seeks debtor relief protection under applicable legislation (including, without restricting the generality of the foregoing, the Bankruptcy and Insolvency Act of Canada and the Companies' Creditors Arrangement Act of Canada) or permits any judgement to be registered against its interest in the Facility or any portion thereof, and without restricting the generality of the foregoing, an Operator shall be deemed insolvent for the purposes of this Clause if it is unable to pay its debts as they fall due in the usual course of business;

(b) subject to Clauses 307 and 402, Operator assigns or attempts to assign its general powers and responsibilities of supervision and management as Operator hereunder, unless such assignment is to an Affiliate of Operator who is also an Owner;

(c) the Operating Committee votes pursuant to Subclause 204 (f) to remove Operator and such motion is carried;

(d) Operator ceases to be an Owner; or

(e) Operator resigns pursuant to this Article.

304. Appointment of Successor Operator

(a) Interim Operator

Upon Operator resigning or otherwise ceasing to be Operator and until a replacement Operator is appointed, the Owner with the largest Facility Participation, excluding the Facility Participation of the departing Operator and any Affiliate of the departing Operator, shall automatically become the interim Operator. The interim Operator shall immediately cease to be interim Operator upon the appointment of a replacement Operator.

(b) Appointment

If an Operator resigns or otherwise ceases to be Operator, a successor Operator shall be appointed by the Operating Committee. An interim Operator is not disqualified from being elected as the successor Operator.

(c) Two Party Agreement

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 that the previous Operator ceases to be Operator, 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.

(d) Consent

Subject to Subclauses 304 (a) and (c), no Owner shall be appointed as Operator unless it has given its written consent to the appointment.

(e) Re-appointment

No provision of this Article shall be construed to re-appoint as next-succeeding Operator an Operator who has ceased to be Operator or any Affiliate of that former Operator, except with the unanimous consent of the Owners.

(f) Effective Time

Except as otherwise determined by the Operating Committee, the appointment of a successor Operator (including an automatic appointment as Operator pursuant to the terms of this Article), shall be effective immediately upon the previous Operator ceasing to be Operator.

305. Transfer of Property on Change of Operator

At the effective date of the resignation or replacement of an Operator as provided in this Article, Operator being replaced shall immediately deliver to the successor Operator possession and control of:

(a) the Facility;

(b) any and all funds held for the Joint Account;

(c) any and all Inlet Substances and Facility Products, if any, which have not been delivered in kind;

(d) all Material held for the Joint Account;

(e) copies of books of account and records kept for the Joint Account; and

(f) all documents, agreements and other papers relating to property transferred hereunder.

Upon compliance with such obligation, the departing Operator shall be released and discharged from, and the successor Operator shall assume, all duties and obligations of Operator, except those unsatisfied duties and obligations of the departing Operator which had accrued prior to the effective date of the change of Operator, for which the departing Operator shall continue to remain liable. If the departing Operator holds any real or personal property on behalf of the Owners, such property shall continue to be held by the departing Operator in trust for the Owners until title and possession of such property has been transferred to the successor Operator in trust for the Owners.

306. Inventory and Audit of Accounts on Change of Operator

Subject to Clause 307, within ninety (90) Days after the successor Operator commences to act as Operator, the Operating Committee may cause an audit to be made of the books of account and records kept for the Joint Account and may cause an inventory of Controllable Material to be taken. The cost of the audit and inventory shall be for the Joint Account.

307. Assignment of Operatorship

If Operator wishes its assignee to replace it as Operator after having disposed of all or a portion of its Facility Participation to such assignee pursuant to Article IX, such assignee shall have the right to become Operator if it is an Affiliate of Operator or, if it is not an Affiliate of Operator, if the Operating Committee approves that it shall become Operator.

# ARTICLE IV

## FUNCTIONS AND DUTIES OF OPERATOR

401. Control and Management of Joint Operations

Operator shall consult with the Operating Committee from time to time with respect to decisions to be made for the conduct of Joint Operations, and Operator shall keep the Owners informed in a timely manner with respect to changes in operating conditions or significant Joint Operations. Operator is required to obtain approval of all Owners before changing operating conditions in a Functional Unit that would adversely affect existing well flow rates of Owner Substances or Customer Substances already connected to the Facility, by more than ten (10) percent. If approval to change operating conditions is not obtained from the Owners, the Operator shall take corrective action to ensure that existing wells connected to a Functional Unit are not affected by greater than the said percentage, after one (1) calendar

Operator shall include with such payment a statement showing the manner in which the amount was calculated. If Operator does not pay such amount within thirty (30) Days following its receipt, the interest provisions of Subclause 602 (b) shall apply with respect to such outstanding amounts.

806. Audit by Non-Taking Owner

To the extent only that Operator sells all or a portion of the share of Facility Products of a non-taking Owner, the audit provisions of the Accounting Procedure shall, with the necessary changes, apply with respect to such sale between Operator and the non-taking Owner on whose behalf such Facility Products were sold, provided that Operator shall not be required to provide the auditors with access to any of Operator's proprietary marketing information and that the non-taking Owner shall bear all costs of such audit.

807. Operator to be Indemnified

If an Owner does not take in kind and separately dispose of its share of Facility Products and Operator disposes of such Facility Products on behalf of the non-taking Owner pursuant to this Article, the non-taking Owner shall indemnify Operator with respect to any injury, loss or damage which Operator may suffer with respect to such sale by virtue of defects in the non-taking Owner's title to such Facility Products.

808. Indemnification for Royalties and Other Payments

Each Owner shall pay or be responsible for the payment of and shall indemnify the other Owners against liability for any and all royalties, overriding royalties, production payments, taxes and any and all other payments chargeable against its share of Facility Products.

809. Warranty by Owners

Each Owner warrants that it has the right to produce its portion of the Inlet Substances and dispose of its portion of the Facility Products and agrees to indemnify and save harmless the other Owners from all actions, causes of actions, claims and demands that may be made by any Person who has or claims to have an interest in such Inlet Substances or Facility Products.

# ARTICLE IX

## DISPOSAL OF FACILITY INTEREST

901. Disposal of an Interest in the Facility

Except as provided in this Article IX, no Owner shall sell, transfer, assign, mortgage or otherwise dispose of all or part of its interest in the Facility or any Functional Unit. An Owner who intends to dispose of all or a part of its interest in the Facility or any Functional Unit (in this Article called "the Disposing Owner") shall comply with the provisions of ALTERNATE __B__ immediately below:

ALTERNATE A. The Disposing Owner shall be under no obligation to obtain the consent of the other Owners or to provide the other Owners with a right to acquire that Disposing Owner's interest in the Facility.

ALTERNATE B. The Disposing Owner shall obtain the consent of the other Owners, and shall provide them with information regarding the disposition, including the description of the Functional Unit Participation proposed to be disposed and the identity of the proposed assignee. Such consent shall not be unreasonably withheld, and it shall be reasonable for an Owner to withhold its consent to the disposition if it reasonably believes that the disposition would be likely to have a material adverse effect on its Functional Unit Participation or Joint Operations, including, without limiting the generality of all or any part of the foregoing, a reasonable belief that the proposed assignee does not have the financial capability to meet prospective obligations arising out of this Agreement, provided that an Owner which withholds its consent shall include in its notice its reasons for withholding consent. However, an Owner shall be deemed to have consented to the disposition to the proposed assignee, unless, within twenty (20) Days, the Owner advises the other Owners, by notice, that it is not prepared to consent to such disposition.

ALTERNATE C.

(a) The Disposing Owner shall, by notice, advise each other Owner (in this Article called an "Offeree") of its intention to make the disposition, including in such notice a description of the Functional Unit Participation proposed to be disposed, the identity of the proposed assignee, the price or other consideration for which the Disposing Owner is prepared to make such disposition, the proposed effective date and closing date of the transaction and any other information respecting the transaction which the Disposing Owner reasonably believes would be material to the exercise of the Offerees' rights hereunder (such notice in this Article called "the Disposition Notice").

(b) If the consideration described in the Disposition Notice cannot be matched in kind and the Disposition Notice does not include the Disposing Owner's bona fide estimate of the value, in cash, of such consideration, an Offeree may, within seven (7) Days of the receipt by the Offerees of the Disposition Notice, request the Disposing Owner to provide such estimate to the Offerees, whereupon the Disposing Owner shall provide such estimate in a timely manner and the election period provided herein to the Offerees shall be suspended until such estimate is received by the Offerees.

(c) If there is a dispute as to the reasonableness of an estimate of the cash value of the consideration described in the Disposition Notice or provided pursuant to Subclause (b), as the case may be, the matter shall be referred directly to arbitration under the Appendix titled "DISPUTE RESOLUTION" within seven (7) Days of the receipt of such estimate. The Disposing Owner and the applicable Offeree shall thereupon diligently attempt to complete such arbitration in a timely manner. The equivalent cash consideration determined in such arbitration shall thereupon be deemed to be the sale price for the Functional Unit Participation described in the Disposition Notice.

(d) Within the later of i) thirty (30) Days from the receipt of the Disposition Notice, as modified by any suspension pursuant to Subclause (b) of this Alternate C; or ii), if Subclause (c) of this Alternate C is applicable, fifteen (15) Days from receipt of notice of the arbitrated value determined pursuant to the preceding Subclause, an Offeree may give notice to the Disposing Owner that it elects to purchase the Functional Unit Participation described in the Disposition Notice for the applicable price (in this Article called a "Notice of Acceptance"). A Notice of Acceptance shall create a binding contractual obligation upon the Disposing Owner to sell, and upon an Offeree giving a Notice of Acceptance to purchase, for the applicable price, all of the Functional Unit Participation included in such Disposition Notice on the terms and conditions set forth in the Disposition Notice. However, if more than one Offeree gives a Notice of Acceptance, each such Offeree shall purchase the Functional Unit Participation to which such Notice of Acceptance pertains in the proportion its Functional Unit Participation bears to the total Functional Unit Participation of all such Offerees.

(e) If the Functional Unit Participation described in the Disposition Notice is not disposed of to one or more of the Offerees pursuant to the preceding Subclause, the disposition to the proposed assignee shall be subject to the consent of the Offerees. Such consent shall not be unreasonably withheld, and it shall be reasonable for an Offeree to withhold its consent to the disposition if it reasonably believes that the disposition would be likely to have a material adverse effect on its Functional Unit Participation or Joint Operations, including, without limiting the generality of all or any part of the foregoing, a reasonable belief that the proposed assignee does not have the financial capability to meet prospective obligations arising out of this Agreement, provided that an Owner which withholds its consent shall include its reasons for withholding consent in its notice. However, an Offeree shall be deemed to have consented to the disposition to the proposed assignee, unless, within the time period prescribed in Subclause (d), the Offeree advises the other Owners, by notice, that it is not prepared to consent to such disposition.

(f) If the Functional Unit Participation described in the Disposition Notice is not disposed of to one or more of the Offerees pursuant to Subclause (d) of this Alternate C, the Disposing Owner may, subject to obtaining the consents prescribed by the preceding Subclause, dispose of such Functional Unit Participation at any time within one hundred and fifty (150) Days from the issuance of such Disposition Notice, provided that such disposition is not on terms that are more favourable to such proposed assignee than those offered in the Disposition Notice.

(g) Following a disposition herein or one hundred and fifty (150) Days following the issuance of a Disposition Notice from which a disposition did not result, as the case may be, the provisions of this Clause 901 shall once again apply to the Functional Unit Participation described in the Disposition Notice.

902, <u>Unrestricted Disposals</u>

Notwithstanding anything contained in this Article IX, an Owner may transfer all or a portion of its interest in the Facility without providing prior notice or the option to acquire such interest to the other Owners in the following instances, namely:

(a) a disposition to an Affiliate of the Owner, or in consequence of a merger or amalgamation of the Owner with another corporation or pursuant to an assignment, sale or disposition made by an Owner of its entire Facility Participation to a corporation in return for shares in that corporation or to a registered partnership in return for an interest in that partnership;

(b) if a portion of an Owner's interest in the Facility is disposed of as a result of the conversion of a gross overriding royalty interest or other interest to a working interest in a well pursuant to an agreement in existence as of the Effective Date, and the production from such well is required to be delivered to the Facility;

(c) a disposition made by an Owner of all, or substantially all, or of an undivided interest in all or substantially all, of its petroleum and natural gas rights in the province or territory where the Facility is situated, and for the purposes of this Subclause, "substantially all" means a percentage of ninety percent (90%) or more of the net hectares held by such Owner in that province or territory;

(d) Subclause (d) shall _X_ /shall not ___ apply:

a disposition made by an Owner of all, or substantially all, or of an undivided interest in all or substantially all, of its petroleum and natural gas rights in wells producing to the Facility, and for the purposes of this Subclause, "substantially all" means a percentage of ninety percent (90%) or more of the working interest held by such Owner in such wells; and

(e) Subclause (e) shall _X_ /shall not ___ apply:

a disposition made by an Owner of a portion of its petroleum and natural gas rights in wells producing to the Facility, where such disposition is accompanied by the disposition of a proportionate part or share of the Facility.

(f) A disposition made by a Midstream Company of it's Functional Unit Participation as part of a disposition of all or substantially all, of its interest in the Mazeppa Gas processing plant.

However, an Owner making such a disposition pursuant to Subclause (a), (b), (c), (d) (e) or (f) of this Clause shall advise the Operator of such disposition in a timely manner, and shall comply with the provisions of Clause 905.

If the transfer is to an Affiliate, the Owner shall execute and deliver to Operator a continuing guarantee of all obligations to be assumed by the Affiliate under this Agreement. Such guarantee shall also provide that the guarantor waives notice of any extensions, modifications or amendments to this Agreement and agrees to be bound thereby; that no such extensions, modifications or amendments will release the guarantor; and that the guarantor will not be released by any waiver of any obligation of the Affiliate by the indulgence or concession granted to it.

903. Financing

Notwithstanding anything contained in this Article IX:

(a) An Owner may mortgage its interest in the Facility; provided that any such mortgage shall expressly provide that the mortgagee shall hold the interest subject to all the terms and provisions of this Agreement, and shall also provide that upon any realisation of the security, the party acquiring the interest in the Facility shall be required to assume all obligations of the mortgagor under this Agreement, including the obligations imposed under Clause 905; and

(b) An Owner may assign its interest in the Facility in connection with an arrangement for the financing of its interest in the Facility provided that:

(i) any such assignment shall expressly provide that the assignee shall hold the interest subject to all the terms and provisions of this Agreement;

(ii) until the assignee gives notice to Operator of a default by the assignor under the arrangement for financing and complies with the provisions of Clause 905, the assignor shall not be released from its obligations under this Agreement, shall remain an Owner for the purposes of Exhibit "A", under the Appendix titled "FACILITY AND FUNCTIONAL UNIT PARTICIPATION", and the Owners shall be entitled to deal exclusively with the assignor in all matters under this Agreement;

(iii) until the assignee gives notice to Operator of a default by the assignor under the arrangement for financing and complies with the provisions of Clause 905, the assignor shall have full power and authority to act on behalf of and bind the assignee for all matters respecting this Agreement, and any information , notices or billings served on or by, or any payment to the assignor shall be deemed to have been served on or by or payment made to the assignee and the other Owners shall neither honour notices from nor give notices to the assignee; and

(iv) any such assignment shall expressly provide that immediately upon receipt by the Operator of notice from the assignee that the assignor is in default under the arrangement for financing, realisation of the security or otherwise, the assignee shall be required to assume all obligations of the assignor under this Agreement.

904. Admission of New Owners Through Enlargement

No Person shall become an Owner through an Enlargement except with the approval of the Operating Committee and upon such terms and conditions as may be imposed by the Operating Committee, which shall include the condition that any Person becoming an Owner shall execute and deliver to Operator one (1) counterpart of this Agreement.

905. Disposal of Interest Documentation

(a) Every disposition of an interest in a Functional Unit shall be made subject to this Agreement and shall not be binding on the other Owners until the first Day of the Month next following the date:

(i) the Person acquiring the interest, if not already an Owner, has executed and delivered to Operator one (1) counterpart of this Agreement; and

(ii) a copy of the instrument, executed by both the disposing Owner and its assignee, evidencing such change in ownership has been delivered to Operator.

Once such disposition becomes effective, the assignor shall thereupon be relieved from all obligations that thereafter accrue hereunder with respect to the assigned interest, subject to Clauses 504, 505, 902 and 1001.

(b) Subject to Clause 307, the assignment of any interest in the Facility by an Owner while acting in the capacity of Operator shall not confer upon the Person acquiring such interest the position of Operator.

(c) In the event of a Conversion, a Midstream Company shall provide the following information to the existing Owners:

(i) existing parties under firm (take or pay) commitments;
(ii) the volume of firm Capacity granted under existing firm (take or pay) commitments;
(iii) expiry date of the existing firm (take or pay) commitments; and
(iv) which well(s) or designated area(s) are participating in the firm (take or pay) commitments.

906. Change of Name

An Owner whose name is changed by due legal process shall notify and supply evidence of the change to Operator as soon as possible.

# ARTICLE X

## TERM AND TERMINATION

1001. Term

This Agreement shall remain in full force and effect from the Effective Date so long as all or any portion of the Facility is held pursuant to this Agreement and so long thereafter as may be necessary to decommission, abandon, dispose of and reclaim the Facility, in accordance with the Regulations, and final settlement of accounts has been made

# TAB 1

2016 ABQB 363
Alberta Court of Queen's Bench

Bank of Montreal v. Bumper Development Corp.

2016 CarswellAlta 1278, 2016 ABQB 363, [2016] A.W.L.D. 3135, 268 A.C.W.S. (3d) 277, 38 C.B.R. (6th) 118

# Bank of Montreal, Plaintiff and Bumper Development Corporation Ltd. Bumper Development Corporation, Defendants

A.D. Macleod J.

Heard: May 24, 2016
Judgment: June 29, 2016
Docket: Calgary 1601-02201

Counsel: C.J. Popowich, J.R. Devlin, for Eagle Energy Inc.
Peter Linder, Q.C., for Forent Energy Ltd.

Subject: Civil Practice and Procedure; Insolvency

APPLICATION by corporation to enforce joint operating agreement.

***A.D. Macleod J.*:**

1 At issue here is whether Eagle Energy Inc. ("Eagle") can enforce an operating agreement in the context of a court approved sale of the underlying oil and gas properties in a receivership under s 243 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3. Eagle seeks to enforce the operating agreement through this application. Forent Energy Ltd. ("Forent"), the company that successfully bid on and purchased the oil and gas properties from the Receiver, opposes this application.

2 On February 16, 2016, Bank of Montreal applied for a Receivership Order with respect to Bumper Development Corporation Ltd. ("Bumper").The Order was granted and Alvarez & Marsal Canada Inc. was appointed Receiver/ Manager over all of the assets of Bumper pursuant to s 243 of the *Bankruptcy and Insolvency Act*. The objective of the receivership was to protect and realize upon Bumper's assets and distribute the proceeds to the stakeholders under the supervision of the Court.

3 At the time the receivership order was granted, Eagle and Bumper were parties to a Joint Operating Agreement ("JOA"). The JOA related to approximately twenty eight wells near Twining, Alberta. While the JOA is dated April 9, 2013, the original signing parties were Bumper and Coda Petroleum Inc. ("CODA"). Eagle became party to the JOA by purchasing CODA. Bumper and Eagle also entered into an agreement for the construction, ownership and operation of the Twining 16-20-31-24 W4M Battery ("Battery") which, while dated as of January 1, 2015, was actually signed by Bumper on February 3, 2016.

4 Incidental to this Court's power to appoint a Receiver, the Order of February 16, 2016 also contains the following clause at paragraph 9:

> **No Exercise of Rights or Remedies**
>
> All rights and remedies (including, without limitation, set-off rights) against the Debtors, the Receiver, or affecting the Property, are hereby stayed and suspended except with the written consent of the Receiver or leave of this Court...

 

5 As is the case with most JOAs in this province, the operatorship was governed by the CAPL operating procedure (2007) issued by the Canadian Association of Petroleum Landmen. Clause 2.02 of that operating procedure reads in part as follows:

> **2.02 Replacement of Operator**
>
> A *Immediate Replacement*-The Parties acknowledge that the Operator's ability to fulfill its duties and obligations for the Parties' benefit is largely dependent on its ongoing financial viability and that the Operator may not seek relief at law, in equity or under the Regulations to prevent its replacement in accordance with this Subclause. The Operator will be replaced immediately after service of notice from Non-Operator to the other Parties to such effect if:
>
>> a) the Operator becomes bankrupt or insolvent, commits or suffers any act of bankruptcy or insolvency, is placed in receivership or seeks debtor relief protection under applicable legislation (including the *Bankruptcy and Insolvency Act* (Canada) and the *Companies' Creditors Arrangement Act* (Canada)), and it will be deemed to be insolvent for this purpose if it is unable to pay its debts as they fall due in the usual course of business or if it does not have sufficient assets to satisfy its cumulative liabilities in full;
>>
>> . . .
>
> Any such notice from a Non-Operator must be a *bona fide* notice that specifies the basis for replacement under this Subclause and includes verifiable evidence substantiating that basis in reasonable detail. Subject to the restrictions in Subclause 2.06B on the appointment of a successor Operator, the Party with the largest Working Interest will then act as Interim Operator on the same basis as in Subclause 2.06D, unless the Parties have otherwise appointed a successor Operator under Clause 2.06.

6 Similarly, clauses 3.03 and 3.04 of the Operating Agreement governing the Battery state:

> **3.03** Operator shall immediately cease to be Operator in the circumstance described in Subclauses (a) and (b) below and in all circumstances described on this Clause a replacement. Operator appointed pursuant to Clause 304 if:
>
>> (a) Operator becomes bankrupt or insolvent, commits or suffers any act of bankruptcy or insolvency, is placed in receivership or a receiver/manager or person filling that role is appointed with respect to its property...
>
> **3.04**
>
>> (a) Upon Operator resigning or otherwise ceasing to be Operator and until a replacement Operator being appointed, the Owner with the largest Facility Participation... shall automatically become the Interim Operator

7 Eagle also asserts a right to operatorship to both the wells and the Battery under other provisions dealing with the disposition of Bumper's interest. In those circumstances, Eagle has the right to elect to become Operator rather than consenting to the assignee or the purchaser becoming Operator.

8 Pursuant to those provisions Eagle, upon learning of the Receivership Order, notified the Receiver of its intention to assume operatorship of both the wells and the Battery. Those letters are dated February 26, 2016 and are Exhibits C and D to the Affidavit of Richard W. Clark, President and CEO of Eagle.

9 On February 29, 2016, the Receiver responded that under paragraph 9 of the Order, the notices were stayed and Bumper remained the Operator of both the wells and the Battery.

10 Meanwhile, Bumper's interest in the properties was put up for sale and bids were received from both Eagle and Forent. On March 22, 2016, Eagle sent a letter to the Receiver. The letter provided notice of two things: one, that pursuant to clause 24.01 of the CAPL Operating Procedure, no disposition could be made of Bumper's working interest in the

JOA assets without notice to Eagle of its intention to do so; and two, that Eagle was entitled to 20 days within which to determine whether the disposition of Bumper's interest in the JOA assets would be likely to have a material adverse effect on Eagle. A copy of that letter is attached as Exhibit "F" of the Affidavit of Richard W. Clark. The Receiver did not respond.

11 Mr. Clark, in his Affidavit, goes on to state that he and Mr. Cortese of Eagle attended a meeting with the Receiver's representative on April 14, 2016. He deposes at paragraph 14 of the Affidavit that he informed the Receiver that the JOA provided that Eagle becomes Operator upon the disposition of Bumper's interest. Apparently, the Receiver's representative agreed that the Receiver would not entertain any offer purporting to convey operatorship of Bumper's assets to any persons except for Eagle. He states at paragraph 16 that:

> The Receiver's Representative also agreed that, should Eagle not be the successful bidder, the purchase and sale agreement with the successful bidder would provide, as a condition of closing, that the operating licence pertaining to the Bumper Assets would be electronically transferred, at closing, directly from Bumper to Eagle; that the Receiver would arrange for this in advance with the Alberta Energy Regulator; and that the Receiver would notify Eagle of any changes of these provisions.

12 Following the meeting, Mr. Clark wrote an email to the Receiver which is Exhibit "G" to his Affidavit. It was sent on April 14, 2016 and reads as follows:

> Orest, thank you for taking the time to visit with Frank and I this morning. You have advised us that all offers are due at close of business tomorrow and that a final decision will be made the lender Monday. In addition, I confirm our conversation regarding the following terms:
>
>> 1. You have confirmed that you will be presenting the bank with ONLY a non-operated offer from Forent. Furthermore, you have confirmed that you will not present the bank with an offer from Forent or any other potential bidder (other than Eagle) which purports to convey operatorship or is based on any party other than Eagle operating the conveyed assets. In consideration of these undertakings, Eagle will amend its offer (which has expired) and resubmit it to you tomorrow, with as many of the conditions removed as possible. Eagle's offer will also contemplate an extremely short closing period, subject to the transaction paperwork being in the state of readiness as represented by you today.
>>
>> 2. In the event that Eagle is not the successful buyer, Eagle requires that the following terms be handled as set out below, In order for Eagle to not challenge the sale process in court:
>>
>>> a) The PSA with the Buyer must contain a condition of closing provision that the electronic filing of transfer of the operating license pertaining to the properties and the facilities will be made at closing, directly from Bumper to Eagle and not via the purchaser and then to Eagle. This will be a condition of closing and will be a process established by you with the AER in advance of closing. You will agree to promptly advise us if this provision changes in any way. Eagle has advised that the AER has approved this approach and can modify its license transfer process to accommodate this structure.
>>>
>>> b) You and Eagle will prepare a plan which provides that at or prior to closing, all land and other customary records (both physical and electronic) needed for Eagle to operate the assets, be delivered into Eagle's possession. Frank Cortese will be Eagle's lead on this matter.
>>>
>>> c) Although it was not discussed on either of our calls today, we understand, that there are some joint partner wells which Eagle would end up operating in which Eagle will have no working interest. Further provisions may need to be made in this regard, depending on with whom the license reside for the purpose of LMR calculations. Kindly advise if I have missed anything material to our discussion or if any of the above is contrary to your understanding. Many thanks. RC

  

13 The Receiver indicated in his second report that he did not agree to refrain from transferring the licenses but did agree that operatorship was not part of the sale. But in any event, the Receiver did not respond to Mr. Clark's email.

14 Forent was the successful bidder and the Receiver applied for approval of the sale of Bumper's interest to Forent and for a Vesting Order. The matter came before me on May 11, 2016 at which time Eagle filed an application for this Court to recognize Eagle's right to become Operator of the assets after the sale. Eagle had not been shown a copy of the proposed sale agreement and did not know whether its rights were being undermined by the proposed sale. It did not want a Vesting Order to go if its rights to be Operator were affected.

15 My decision was to approve the sale upon the recommendation of the Receiver and the secured creditor, The Bank of Montreal. The sale was to be without prejudice to Eagle's right to argue the issue of operatorship at a later date. Accordingly, the Vesting Order contained the following paragraphs:

> **Operating Interest and Associated Licenses**
>
> 16. This Order shall be without prejudice to the rights of Eagle Energy Inc. ("Eagle") to assert its position related to the Eagle Application as at the time of the granting of this Order.
>
> 17. To that extent that Eagle may claim an entitlement to become the operator of any of the Assets in relation to which it presently holds a working interest (the "Eagle Related Assets"), and/or to hold the associated licenses related thereto, such claim shall be adjudicated before Justice Macleod on or before May 24, 2016 or such other date as counsel to Forent and Eagle may argue (the "Eagle Application"). AER will be provided with notice if the application date changes. The Receiver takes and will take no position with respect to the Eagle Application. Neither the Purchaser nor Eagle shall seek any damages against the Debtor or the Receiver in relation to the Eagle Application.

16 As per my Order, the matter came back in front of me on May 24, 2016, and the issue of operatorship was argued by Eagle and Forent. The Receiver took no position. The Alberta Energy Regulator also did not take a position, as it was common ground that this Court would not be interfering with the discretionary authority of the Alberta Energy Regulator.

17 It is quite clear from the contractual documents at issue that as between Eagle and Bumper, Eagle was entitled to be Operator of the wells and the Battery upon Bumper becoming insolvent or being placed in receivership (see *Tri-Star Resources Ltd. v. J.C. Int. Petroleum Ltd.*, [1987] 2 W.W.R. 141, 48 Alta. L.R. (2d) 355 (Alta. Q.B.)). The existence of such an arrangement reflects the understanding that Operators conduct operations on behalf of all parties and in so doing, frequently deal with money belonging to the non-operating parties.

18 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.

19 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.

20 This is not a situation such as the one facing this Court in *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 92 A.R. 81, 63 Alta. L.R. (2d) 361 (Alta. Q.B.). In that case s 11 of the *Companies Creditor's Arrangement Act*, RSC 1970, c C-25 (*CCAA*) was at issue. Section 11gives very broad powers to the Court in situations where arrangements involving compromise can be utilized to rescue insolvent companies. The *CCAA* has proved to be an extraordinarily flexible Act. The Act has been used effectively to give debtors respite from creditors in order to allow the stakeholders

  

to negotiate a proposal for continuing the business, rather than allowing the business to fall into bankruptcy. Here, the issue is not Bumper's survival but the realization on its assets.

21 Forent argues that Eagle sat upon its right and did not bring an application in a timely manner to lift the stay. Having sat on its rights until the eve of an application for approval and a Vesting Order, this Court should not allow the stay to be lifted.

22 In my view, however, Eagle acted reasonably. When faced with the Receiver's position with respect to the stay, Eagle met with the Receiver's representatives and negotiated a deal. Based on this deal, Eagle believed it would be the Operator even if it were not the successful bidder for the underlying assets. Clearly, Forent did not have any reasonable expectation that it was purchasing operatorship.

23 In my view it would be unfair to deprive Eagle of its clear contractual right to be Operator of both the wells and battery. To do so would be tantamount to appropriating Eagle's right for the benefit of Bumper's creditors.

24 Forent also argued that Eagle was invoking the equitable jurisdiction of this Court in seeking either specific performance or a declaration. Forent argues that Eagle does not come to this Court with clean hands. Forent alleges that Eagle obtained its original interest in the Twining area by misappropriating Forent's confidential information. Eagle then used Forent's confidential information for the improper purpose of acquiring CODA.

25 While the argument was interesting and skillfully made, I cannot give effect to it. First of all, while I allowed the sale I did so without prejudice to Eagle's right to make the argument as the situation was on May 11, 2016. Moreover, the issue was between Bumper and Eagle rather than Forent and Eagle.

26 Furthermore, Forent has issued a Statement of Claim against Eagle for breach of confidence, breach of fiduciary duty and alleging that Eagle holds its entire interest in the area in trust for Forent. Eagle has denied the allegations and filed a Statement of Defence. The timing of the Statement of Claim is also interesting in that it was issued on May 10, 2016. Forent argues that there is sufficient evidence contained in the affidavits filed supporting its allegations for me to find in favor of Forent and that I should do so because it is the right thing to do. With respect, that is turning due process on its head. Eagle is entitled to full answer and defence. I think it would be inappropriate for me to pre-judge the outcome of this litigation by denying Eagle its claim to operatorship, the effect of which would be to grant operatorship to Forent. Moreover, there is no prejudice to Forent. Should Forent be successful in its litigation it will be entitled to the relief it seeks i.e. to all of Eagle's interest in both the wells and battery.

27 Accordingly, the stay is lifted "*nunc pro tunc*" and Eagle's application is granted. There will be a declaration that Eagle is entitled to operate both the wells and Battery in question. It is also directed that the Receiver and others, including Forent, transmit to Eagle all accounts, licences etc. which are reasonably necessary for Eagle to succeed Bumper as Operator under both of the agreements.

28 Eagle is entitled to costs of the application.

*Application granted.*

**End of Document**



  

# TAB 2

2016 ABQB 585
Alberta Court of Queen's Bench

Eon Energy Ltd. v. Ferrybank Resources Ltd.

2016 CarswellAlta 2028, 2016 ABQB 585, [2016] A.W.L.D. 5063, 272 A.C.W.S. (3d) 179

# Eon Energy Ltd. (Plaintiff) and Ferrybank Resources Ltd. (Defendant)

K.D. Nixon J.

Heard: September 8, 2014; September 9, 2014; September 10, 2014; September 11, 2014; September 12, 2014; September 15, 2014; September 16, 2014; September 17, 2014; September 18, 2014; September 19, 2014; September 22, 2014; September 23, 2014; September 30, 2014; October 1, 2014; October 2, 2014; October 3, 2014
Judgment: October 19, 2016
Docket: Calgary 1001-18533

Counsel: Mr. Rinus de Waal, Mr. Luke Rasmussen, for Plaintiff
Mr. Bradley Y. Minuk, Mr. Richard Harrison, for Defendant

Subject: Civil Practice and Procedure; Contracts; Natural Resources

ACTION by corporate plaintiff to determine issues of ownership interests in oil, whether revenues were owed, whether pliantiff owed defendant expenses, which entity was entitled to operate well, which entity was responsible for preparation of joint account and whether they were permitted share of production in-kind.

***K.D. Nixon J.*:**

**Introduction**

1 Ferrybank Resources Ltd. ("Ferrybank") and Eon Energy Ltd. ("Eon") are the joint owners of five wells in Alberta. Four are conventional stripper wells producing a modest number of barrels of crude oil a day. Two of the oil wells also produce a small amount of solution gas. The fifth well is a shut in gas well.

2 Mr. Bodard and his wife are the principals of Ferrybank. Mr. Laviolette is a director of Eon, a company owned by his wife. The parties acquired their joint interests in the wells from Crossroads Energy Ltd. ("Crossroads"). Laviolette was a principal of Crossroads. Bodard and Laviolette were the only individuals associated with Ferrybank and Eon who were called as witnesses. Bodard spoke for Ferrybank and Laviolette spoke for Eon.

3 In October 2000, Ferrybank acquired a 100% interest in six wells from Crossroads pursuant to a Purchase and Sale Agreement dated October 1, 2000 (the "October 2000 Agreement"). That agreement provided that, in the event Ferrybank could not come up with the purchase price, its 100% interest would revert to a 10% interest with the remaining 90% interest owned by Eon and the wells would be governed by a joint operating agreement.

4 When Ferrybank was unable to pay the purchase price, the default clause was invoked and on February 1, 2001 the parties entered into a Confirmation of Interests and Joint Operating Agreement (the "JOA") resulting in Ferrybank's interest reverting to 10%. The parties acquired a joint interest in four additional wells in October 2001 in the same percentages, 10% for Ferrybank and 90% for Eon. There is no executed written agreement with respect to these four additional wells (the "October 2001 Agreement").

5 Five of the ten wells have since been sold. Of the five remaining, three are from the initial group of six wells and two are from the second group of four wells.

 

310 As Eon is already the *de facto* operator, it is not necessary to establish any of these circumstances for Eon to manage the wells, collect the revenues and pay all expenses. Eon's entitlement to do so comes from the JOA. These issues, therefore, are relevant to whether Ferrybank should be permitted to assume these operator roles from Eon or continue to perform the operator roles of collecting revenues with respect to the 4-07, 6-07 and 6-25 wells.

*a) Insolvency*

311 The reason for removal of an operator in the case of insolvency is the risk to the co-owners if an insolvent operator co-mingles funds thereby putting at risk the co-owner's share of revenues: *Tri-Star Resources Ltd. v. J.C. Int. Petroleum Ltd.* (1986), 48 Alta. L.R. (2d) 355 (Alta. Q.B.).

312 Eon has established that Ferrybank suffered an act of insolvency, disentitling it from managing the wells, and collecting revenues.

313 Eon submits that Ferrybank meets the legal definition of insolvency because it cannot meet its obligations as they become due. Ferrybank counters that Eon owes it significant amounts for unpaid expenses and fees under the JOA. It submits, therefore, that Eon committed an act of insolvency itself because it failed to pay Ferrybank operator fees and 10% of oil revenues. Ferrybank asserts that, should Eon become operator, it would be immediately replaced because of its own acts of insolvency.

314 Insolvency, within the meaning the Operating Agreement, has its normal meaning: the inability to pay one's debts: *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 92 A.R. 81 (Alta. Q.B.) at paras 36 - 41.

315 There is no merit to Ferrybank's position that Eon committed an act of insolvency. The evidence does not establish that Eon owes Ferrybank anything for unpaid expenses. Ferrybank was not entitled to oil revenues until it served notice asserting its working interest and acknowledging its obligation to pay its portion of costs and expenses in the litigation. Eon's failure to pay oil revenues did not arise from any financial difficulties but from a dispute about whether any revenues were owed. There is no evidence that Eon has had any financial difficulties.

316 Ferrybank acknowledged its precarious financial circumstances. Its financial difficulties were evident over the years, well before the litigation commenced. Ferrybank's concerns about the financial impact should it be required to pay a deposit go back as far as 2000. It was the impetus for Ferrybank entering into the JOA. Ferrybank was focused on, and chronically worried about, the risk of an LLR deposit since the beginning of the parties' relationship.

317 By its own evidence, Ferrybank will be bankrupt if required to pay an LLR deposit. Ferrybank has been withholding Eon's share of revenues as a contingency against the possibility it may be required to pay a deposit. Ferrybank, however, says it will be liable for a deposit only if it cannot remove Eon from management of the wells. Thus, it denies it is insolvent. I do not agree. Ferrybank has not established that removing Eon from management of the wells will avoid the risk of a deposit. Further, Ferrybank is not entitled to remove Eon from this role.

318 Ferrybank has not established that Eon has failed to meet any of the meet any of the three conditions to its management imposed in the JOA. Specifically, it has not established that Eon failed to operate the wells in accordance with good operating practice or the regulations or failed to pay expenses in a timely manner.

319 The risk of an LLR deposit is an inherent business risk Ferrybank took in agreeing to the terms of the JOA. There were no guarantees when the parties acquired their joint interest in these wells that the wells would always contribute positive LLRs to off-set the negative LLRs of Ferrybank's own poor wells.

320 Aside from Ferrybank's inability to pay an LLR deposit, it has been chronically late in paying Eon its share of the revenues that Ferrybank collected.

 

# TAB 3

# Court of Queen's Bench of Alberta

**Citation: Firenze Energy Ltd v Scollard Energy Ltd, 2018 ABQB 126**



**Date:** 20180221
**Docket:** 1701 11639
**Registry:** Calgary

In the Matter of an Application by Firenze Energy Ltd.

Between:

**National Bank of Canada**

Plaintiff

- and -

**Scollard Energy Ltd.**

Defendant

- and -

**Firenze Energy Ltd.**

Applicant

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**Memorandum of Decision**
**of the**
**Honourable Madam Justice C. Dario**

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## Introduction

[1] Firenze Energy Ltd ("**Firenze**") applies to the Court to lift a stay of proceedings imposed by a receivership order previously granted by this Court. Lifting the stay would allow Firenze to

issue a notice with respect to a change of operatorship regarding oil and gas wells, licenses and related facilities for which each of Scollard Energy Ltd. (“**Scollard**”) and Firenze have a working interest (the “**Facilities**”).

[2] Since November 2014, Firenze and Scollard have been joint working interest owners in the Facilities in the areas of Alberta known as West Pembina and Bigoray. The relationship of Firenze and Scollard regarding the Facilities is governed by a Joint Operating, Farm-Out and Royalty Agreement (“**JOA**”), which incorporates the 2007 CAPL Operating Procedure. Under this agreement, the working interest owners appointed Scollard as the Operator of the Facilities.

[3] On September 1, 2017, the court appointed FTI Consulting Canada Inc. as receiver of Scollard (the “**Receiver**”) pursuant to a receivership order. National Bank of Canada (“**NBC**”) is Scollard’s senior secured lender. The receivership order stays, *inter alia*, the exercise of “all rights and remedies” against the debtor.

[4] The Receiver has been marketing Scollard’s working interests in various oil and gas wells and facilities, including the Facilities in which it has a joint working interest with Firenze, as part of a sale and investor solicitation process (the “**Receivership SISP**”). There is a current offer for certain of the Facilities by a third party (the “**Superior Bidder**”) that greatly exceeds other offers, including an offer made by Firenze for some of the same Facilities. The Receiver states that the Superior Bidder’s bid is premised on it retaining the right to be Operator of the Facilities.

[5] Firenze asserts that under Clause 2.02A(a) of CAPL 2007 it has the right to replace Scollard as Operator due to Scollard’s insolvency. This clause is triggered by service of notice on the other working interest holders, including Scollard. It asks that this Court lift the stay put in place by the receivership order so that it can serve that notice. Firenze also seeks confirmation that it shall be named as Operator of those Facilities and direction that the Receiver deliver to Firenze all records pertaining to the Facilities. In further submissions, Firenze asserts its rights to assume operatorship on assignment of the Facilities pursuant to section 2.06 and 2.09 of CAPL 2007.

[6] For the reasons that follow, I decline to lift the stay such that Firenze may serve notice under clause 2.02A(a). I do, however, lift the stay such that Firenze may serve the necessary notices to remove Scollard as Operator under clause 2.02A(g), and if subsequently required pursuant to 2.06 and 2.09 of CAPL 2007. I confirm that Firenze is entitled to assume operatorship of all Facilities in which it has a greater than 40% working interest subject to providing notice to any other working interest owner per the terms of the JOA. I further direct that, at such time as Firenze assumes that right of operatorship for the respective Facilities, the Receiver deliver the relevant records pursuant to the terms of CAPL 2007.

**Issues**

[7] The primary issue in this case is whether Firenze has satisfied this court that it should lift the stay of proceedings in order for Firenze to serve the notices pursuant to clause 2.02A of CAPL 2007 or for other reasons. Two secondary issues are whether operatorship constitutes “property” subject to the stay in the first place, and whether lifting the stay would violate the anti-deprivation principle.

**Analysis**

**Lifting the Stay**

[8] Clause 9 of the receivership order states that,

> All rights and remedies (including, without limitation, set-off rights) against the Debtor, the Receiver, or affecting the Property, are hereby stayed and suspended…

[9] CAPL 2007 clause 2.02A states that,

> …The Operator will be replaced immediately after service of notice from any Non-Operator to the other parties to such effect if:
>
> (a) the Operator becomes bankrupt or insolvent, commits or suffers any act of bankruptcy or insolvency, is placed in receivership or seeks debtor relief protection under applicable legislation (including the *Bankruptcy and Insolvency Act (Canada) and the Companies' Creditors Arrangement Act*, (Canada)), and it will deemed to be insolvent for this purpose if it is unable to pay its debts as they fall due in the usual course of business or if it does not have sufficient assets to satisfy its cumulative liabilities in full…

[10] Clause 2.02A(a) and its predecessor provisions have been enforced by the courts, permitting replacement of the debtor Operator, upon an act of insolvency being committed in circumstances in which no stay of enforcement was in place. See for example the decisions in ***Eon Energy Ltd v Ferrybank Resources Ltd***, 2016 ABQB 585 (existing operating partner made a proposal in bankruptcy but no evidence of stay, also versions of CAPL before 1990 called for immediate replacement without a notice requirement), and ***Tri-Star Resources Ltd v JC International Petroleum Ltd***, [1987] 48 Alta LR (2d) 355 (the court found an act of insolvency occurred, however, there were no proceedings under either the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 ("*BIA*") or *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 ("*CCAA*"), and therefore there was no stay of enforcement to be lifted).

[11] Firenze is unable to serve its notice to replace as any remedy it may have against Scollard is stayed by the receivership order. Generally speaking, a contractual provision cannot defeat the operation of the statutorily embodied and court enforced stay of proceedings. "That the stay operates to deny a party a particular contractual remedy otherwise available to it is not a sufficient reasons [sic] to lift the stay": ***Alignvest Private Debt Ltd v Surefire Industries Ltd***, 2015 ABQB 148 at para 44.

[12] The existence of the contractual right of transfer upon insolvency (or any of the other conditions set out in clause 2.02A(a)) is not in itself a sufficient basis to lift the stay. The existence of such an *ipso facto* clause (an arrangement divesting property in the event of bankruptcy or insolvency) – while valid between contracting parties – is void against the bankruptcy or insolvency trustee on policy grounds. The same is true if the agreement purports to forfeit a person's rights in the event of insolvency. See ***Re Knechtel Furniture Ltd.*** (1985), 56 C.B.R. (N.S.) 258 (Ont. SC) (settlor of a trust fund of which he is a beneficiary may not provide that his interest shall pass to others in the event of insolvency); ***Ex Parte Mackay*** (1873), 8 Ch. App. 643, 21 W.R. 664 (contract between creditor and debtor unenforceable to extent it provides that, in the event of bankruptcy, the distribution of the debtor's assets will be different than the

bankruptcy law permits); and Houlden, Morawetz & Sarra, *The 2017-2018 Annotated Bankruptcy and Insolvency Act* Toronto: Thomson Reuters, 2017) at F§108 page 455.



[13] As such, the court must look beyond the rights the parties intended to convey in clause 2.02A(a) to determine whether the stay should be lifted. There must be sound reasons to relieve against the stay imposed pursuant to a receivership order; lifting the stay is not routine: ***Alignvest*** at para 42; ***Ma, Re***, [2001] 143 OAC 52, 24 CBR (4th) 68. As stated by Justice Romaine in ***Alignvest***, the test to lift such a stay "focuses on the totality of the circumstances and the relative prejudice to the parties involved in the receivership": at para 40. That case sets out that "[t]he 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."

[14] There are few cases that consider lifting a stay of enforcement in a factual matrix similar to the present case.

[15] In ***Norcen Energy Resources Ltd v Oakwood Petroleums Ltd***, [1989] 63 Alta LR (2d) 361, cited to 1988 CanLII 3560 (AB QB), the Operator Oakwood had become insolvent. Despite this, it had remained serving as Operator for some time throughout its financial difficulties. It however ultimately entered *CCAA* proceedings. Norcen attempted to replace it as Operator pursuant to a predecessor of CAPL 2007 clause 2.02A(a). Oakwood countered with a stay application under the *CCAA*.

[16] Forsyth, J acknowledged that granting the stay was discretionary, and that there was room in the terms of the *CCAA* to refuse to grant a stay "in circumstances where it would be unfair to stop a party from pursuing its contractual rights": at para 56. The Court however ultimately granted the stay for a two month period, allowing Oakwood the chance to restructure itself.

[17] The decision in ***Bank of Montreal v Bumper Development Corp***, 2016 ABQB 363 appears to contrast the findings in ***Norcen*** until one considers the facts of that case. ***Bumper*** concerned two working interest holders, Eagle and Bumper; Bumper was the Operator. Bumper went into receivership, and its interest was sold to a third party. Eagle sought to become Operator pursuant to clause 2.02A(a).

[18] Macleod J held that "Eagle was entitled to become the Operator of the wells and Battery upon Bumper becoming insolvent or being placed in receivership" on the terms of the contract and in light of the fact that the "Operators conduct operations on behalf of all parties and in so doing, frequently deal with money belonging to the non-operating parties": at para 17. In that case, however, Eagle also asserted its right to become the Operator pursuant to "provisions dealing with the disposition of Bumper's interest". The court found that Eagle had "the right to elect to become Operator rather than consenting to the assignee or the purchaser becoming Operator": at para 7. Much like in that case, the right to elect to become the Operator is a material, if not determinative factor in the present case, as will be discussed below.

**Wells in which Firenze holds more than a 40% working interest**

[19] I pause the analysis of lifting the stay pursuant to Clause 2.02A(a) of CAPL 2007 to address the more central issue in this case. Although not initially raised by counsel, I note that under CAPL 2007, at no time (even if solvent) is an Operator able to transfer operatorship to an assignee (unless an affiliate) without the approval of the other working interest owners, which

must be achieved by a vote of at least two parties with a working interest of more than 50% working interest: CAPL 2007 clauses 2.06C and 2.09. If there are only two Operators when the Operator resigns or is removed, the other party may become the Operator on the service of notice so long as it holds more than 40% of the working interest.

[20] In the present case, Scollard and Firenze are 50-50% working interest owners for most of the 23 wells and associated Facilities in question. For all but four of the wells and associated Facilities, Firenze is a more than 40% working interest owner.

[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 to 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.

[22] Courts have ruled on many occasions that the assignment of the contractual rights of a party in receivership is made subject to the contractual rights of the counter parties, such as the right to withhold consent or the right to first refusal: ***Coopers & Lybrand Ltd. v. William Schwartz Construction Co***., [1980] 116 DLR (3d) 450 31 AR 466, (ABQB); ***Chase Manhattan Bank of Canada v Sunoma Energy Corp,*** 2001 ABQB 142; ***Barafield Realty Ltd v Just Energy (B.C.) Limited Partnership***, 2015 BCCA 421. Operatorship, a contractual right, may not be assigned outside of the terms of the contract.

[23] I similarly find that the Receiver cannot transfer more than Scollard's interest in this case. Firenze has the contractual right, under clauses 2.09 and 2.06C, to demand it become the Operator of all but four of the wells and associated Facilities at the time of Scollard's transfer of its working interest to a non-affiliate.

[24] The parties were provided an opportunity to make subsequent submissions on this point and the Receiver argues that the issue of the transfer of the operatorship should be left for a later day—when there is a finalized purchase agreement to propose to the court for its approval. The right of Firenze to assume operatorship under clause 2.06 is triggered by service of notice at the time when appointment of a new operatorship is to take effect. The Receiver argues that the stay similarly precludes this notice, and that the time for such a transfer has not yet arisen. It also argues that once the prospective purchaser is known to Firenze, Firenze will want that party to assume the role of Operator. Firenze confirms that it will seek to enforce the right to transfer the operatorship to itself at the time of the purchase and assignment if it is not granted the right to do so now. The question of whether to lift the stay is thus again raised.

[25] The CAPL 2007 terms are an industry standard. All industry participants therefore have at least constructive knowledge of the ramifications of these contracts, and particularly the provisions relating to assignment. This includes Scollard, Firenze, the Receiver, the security holders and the Superior Bidder. Subject to a statutory regime that may override contractual agreements, these parties are aware that, under CAPL 2007, the non-operator working interest owner may demand operatorship be transferred to it upon assignment.

[26] The Receiver has made conflicting statements as to whether or not it is marketing the operatorship. Most recently, it stated that it has not made any representations to the Superior

Bidder that it can assign operatorship of the Facilities. Yet, in the first Receiver's report, the Receiver wrote that it had marketed Scollard's interest based on the fact that Scollard was the Operator. The Receiver now argues that if operatorship is transferred to Firenze, it will have to go through the expense of re-marketing the Facilities to the detriment of the creditors. Further, the Receiver's report stated that it "had no discussions or negotiations with Firenze to exclude the operatorship from any sale nor has the Receiver agreed that operatorship would be transferred to Firenze upon closing of any sale resulting from the Receivership SISP", and that the Superior Bidder will not pursue its bid if Firenze becomes Operator. This suggests to me a misunderstanding by the Receiver of the rights of the respective parties under the CAPL 2007 provisions, and not a reason to deprive Firenze of its contractual rights.



[27] Firenze has a contractual right to assume operatorship upon the assignment of Scollard's working interest to an unaffiliated third party. The Receiver may not therefore assign the operatorship without the consent (or at least acquiescence) of Firenze. Regarding the argument that this application to serve notice is premature and should be heard once a formal offer to purchase is before the Court, delaying the decision will have the effect of unnecessarily prolonging the litigation and, assuming the transfer of operatorship to Firenze is upheld by the Court at that time, the Receiver will have to start its marketing endeavors again given that the Superior Bidder will not – according to the Receiver – purchase the subject Facilities unless it includes the right of operatorship. The Receiver's position will actually then prejudice the interests of the creditors through this unnecessary cost and delay. This would not be a beneficial result for anyone. Once it discovers the identity of the prospective purchaser, it may be, as the Receiver suggests, that Firenze will want that third party to assume the role of Operator. The procedures set out in CAPL 2007 provide for this. Operatorship can either be determined by the parties after the sale, or the parties can negotiate this now, but not independent of Firenze and any other working interest owner.

[28] The purpose of the stay is not to render contractual provisions void, but only to stay them during the course of the receivership, unless prejudice would result or another equitable basis exists to lift the stay. I find material to the balancing of the equitable considerations that Scollard's working interests in the Facilities have been marketed in a manner that suggests that the right of operatorship would flow to the purchaser, together with Firenze's clear statement that it will subsequently seek to enforce its right to assume operatorship. I acknowledge that the Receiver has now committed to communicate to the Superior Bidder Firenze's right and intention to assume operatorship under the terms of CAPL 2007, but note that this commitment was only made as a result of this application.

[29] One distinction in the factors of this case from the considerations in ***Bumper*** is that, in ***Bumper***, the non-operator working interest owner, Eagle, met with the receiver before the sale proceedings and negotiated a deal whereby Eagle would become the Operator even if it were not the successful bidder for the underlying assets. Macleod J found that the successful bidder did not have a reasonable expectation that it was purchasing the operatorship: at para 22. Such a negotiated deal with the receiver was not however required; the non-operator working interest owner could rely on its contractual rights upon assignment. Further, there was no requirement for Eagle to wait until the assignment was imminent. As Macleod, J stated at para 18:

> 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.

[30] Similarly, in this case, I find that there is no requirement for Firenze to have to wait until the verge of assignment to a third party to exercise its rights, particularly in light of its rights pursuant to clause 2.02A(g) of CAPL 2007 (discussed below).

[31] These factors are a sufficient basis to lift the stay to preserve Firenze’s contractual rights to assume operatorship under clause 2.06. Material prejudice would result if the Court does not intervene; there is a sufficient equitable basis to require the Court lift the stay. Additionally, the circumstances of this case trigger Firenze’s rights under clause 2.02A(g) of CAPL 2007, which states that the Operator is liable to immediate replacement on notice if, “the Operator assigns or attempts to assign its general powers and responsibilities of supervision and management as Operator” except in accordance with clauses 2.06 and 2.09, subject to certain exceptions. I find that in this case, the manner in which the Receiver has marketed the assets of Scollard, notwithstanding Firenze’s early notification of its intent to transfer the right of operatorship to itself, is not in accordance with clauses 2.06 and 2.09 of CAPL 2007. As such, the Court also lifts the stay in order to allow Firenze to serve its notice pursuant to clause 2.02A(g).

[32] Macleod, J in ***Bumper*** concluded that, “it would be unfair to deprive Eagle of its clear contractual right to be Operator of both the wells and battery. To do so would be tantamount to appropriating Eagle's right for the benefit of Bumper's creditors”: at para 23. The court in that case went on to distinguish ***Norcen***, noting that the stay in that case was granted under the *CCAA*, an “extraordinarily flexible” section and act, designed to allow a corporation to recuperate and continue business, rather than to allow creditors to realize on a corporation’s assets as in a receivership under the *BIA*. The Receiver in this case argues that the terms of the stay in the present case are at least as flexible as those in the case of ***Norcen***; however, I view the purpose of the stay as at least as relevant as the actual terms of the stay, which differs materially in this case as compared to that in ***Norcen***.

[33] The Receiver suggests that if the court lifts the stay based on Firenze’s application, the Receiver may pursue *CCAA* proceedings to stay Firenze’s application, relying on ***Norcen*** as authority for the proposition that the stay would not be lifted in *CCAA* proceedings in this scenario. Section 11.3 of the *CCAA*, however, which allows the assignment of agreements, is discretionary and s. 11.3(3) obliges the court to consider certain factors when deciding to make an order. In ***Veris Gold Corp (Re),*** 2015 BCSC 1204, the court affirmed at para 58 the “twin goals of assisting the reorganization process ...while also treating a counterparty fairly and equitably.” (See also ***Century Services Inc v Canada (Attorney General***), 2010 SCC 60 at para 70.)

[34] It is not clear to me how proceeding with a *CCAA* filing would assist the position of the Receiver in this case. Such a filing would be a liquidating *CCAA* application, the underlying rationale of which is to facilitate disposition—a similar goal to receivership; as opposed to a non-liquidating *CCAA* application, the underlying rationale of which is to attempt to restructure and continue the company. The court in ***Norcen*** indicated that the stay enforced in that case was to facilitate restructuring and would only be in place for several months, after which time the company could perhaps continue as a going concern. The difference between these two goals significantly alters the equitable analysis.

**Remaining Wells**

[35] This brings us back to the analysis of lifting the stay pursuant to Clause 2.02A(a) of CAPL 2007. While there is a sufficient basis to permit the transfer of operatorship to Firenze for all Facilities in which it has more than a 40% working interest, there are four wells and associated Facilities for which is interests are 40% or less. Thus, it cannot rely upon its rights to assume operatorship pursuant to clauses 2.06, 2.09 and 2.02A(g) with respect to those Facilities. The prejudicial and equitable considerations must therefore be considered in light of all the circumstances to determine whether there is a sufficient basis to lift the stay pursuant to clause 2.02A(a) in this case.

[36] When this Court has allowed the transfer of operatorship pursuant to clause 2.02A(a) when no stay is involved: ***Tri-Star***; ***Eon***, it has been in part on the basis of financial risk. In ***Eon***, K Nixon, J noted that, "the reason for removal of an Operator in the case of insolvency is the risk to the co-owners if an insolvent Operator co-mingles funds thereby putting at risk the co-owner's share of revenues": at para 311.

[37] While this risk is vastly reduced in this case by the fact that the operating accounts are now overseen by a Court-appointed receiver, the non-Operator working interest owners remain generally prejudiced by the insolvency. Other creditors may still seek to realize on the joint funds, prompting legal cost and uncertainty. As well, it is possible that the receiver will pursue different investment and operational decisions than a party with a long-term interest in the vitality of the Facilities. These are statements of general application – no specific evidence of these events occurring was provided to the court in this case.

[38] Firenze argues that it would be prejudiced by a transfer by Scollard of its right of operatorship as there are some companies it would not choose to work with and certainly not want making decisions pertaining to its working interest as the Operator. The contract pertaining to operatorship is an executory contract, but the parties have in clause 2.06 provided for the necessity of the approval of the other working interest owners in the event of a change in operatorship (except in the limited circumstances described in 2.09) because of this factor.

[39] Turning to the equitable considerations, the Receiver argues that Firenze has not provided any evidence of any material changes to the operations while the receiver has acted in the capacity of Operator, and that it has sufficient funds to operate in the normal course. It also states that the Superior Bidder has a much higher LMR rating than Firenze; although Firenze's LMR (liability management rating) rating exceeds the minimum AER required 2.0 LMR rating.

[40] The Receiver notes that Firenze was aware of the Receiver's activities in marketing these assets, and was involved in both the Pre—Receivership (in March 2017) and Receivership SISP. It provided its formal notice to transfer operatorship under the CAPL Agreement (on October 18, 2017) 20 days after the Receivership SISP commenced and the marketing materials were circulated (on September 28). While Firenze participated in the Receivership SISP, it was not the Superior Bidder. The Receiver is suggesting the timing of this application follows on that bid process for Firenze to improve its bid position. I note that Firenze's provided verbal notice to the Receiver of its intent to transfer operatorship 10 days before the Receivership SISP was commenced, although it did not verbally specify to which wells this notice applied. (The subsequent written notice was for all Facilities in which Firenze had a working interest.) The Receiver states it advised Firenze the next day that it would need to seek leave of the court to lift

the stay. Similar to the applicant's conduct in ***Bumper***, Firenze did not "wait in the weeds" but acted reasonably.

[41] The Receiver also argues that the security holders would be adversely affected by lifting the stay, as the Superior Bidder is willing to pay a premium for the Facilities if they come with rights of operatorship. In later argument, however, the Receiver suggested that it had never represented to the Superior Bidder or others that the operatorship could be assigned. I note that the confidential document provided by the Receiver to the Court disclosing the competing bids received by the Receiver for various facilities (including some but not all of the Facilities) did not include sufficient information for the Court to assess the similarity of the facilities to which the bids pertained, making it difficult for the Court to evaluate the nature of this suggested adverse effect.

[42] Although this impacts primarily the Facilities in which Firenze has a greater than 40% working interest, I consider the method by which the Receiver marketed the Facilities despite Firenze's rights upon Scollard's assignment (as addressed above) to also impact the equitable evaluation, even for the Facilities unaffected by such rights on assignment.

[43] The nature of the parties in relation to the bankruptcy is also relevant to the equitable analysis. In ***Alignvest***, Romaine, J declined to lift a stay as,

> ...[the applicant] wishes the stay to be lifted so that it can upgrade its position vis-à-vis Alignvest, despite its failure to perfect its security interest. The situation is similar to that described in *Re Ivaco Inc*. 1 CBR ($5^{th}$) 204 at para 7, where Farley, J. refused an application to lift a stay to allow an insurer to terminate insurance policies and benefit from an unearned premium, commenting that this would give an unsecured creditor "an inappropriate leg up on the other unsecured creditors, not to mention a leg up over secured creditors with priority": at para 47.

[44] In contrast to the above scenario, which favors maintaining the stay, Firenze is not a security holder trying to obtain any advantage over other creditors by seeking to enforce a contract.

[45] As stated at the outset, lifting the stay is not routine. While Firenze has raised certain considerations to lift the stay pursuant to clause 2.02A(a), I do not find these factors – when viewed in the totality of the circumstances - sufficient to lift the stay due to material prejudice or other equitable considerations in this case.

## Conclusion

[46] Having considered the totality of the circumstances, including the potential prejudice to Firenze, the balance of equitable considerations in this case requires lifting the stay such that Firenze may serve notice on Scollard and any other working interest holders of its intention to replace Scollard as Operator pursuant to clauses 2.06, 2.09 and 2.02A(g) for all wells and associated Facilities in which Firenze holds more than a 40% working interest. Regarding the remaining four wells and associated Facilities of which Firenze does not hold more than a 40% working interest, I find Firenze has not satisfied me that it will be materially prejudiced or that the other equitable factors in this case merit transferring operatorship to it in this case. The balancing of these equitable considerations tips toward maintaining the stay. It is possible that

there will be circumstances in which the equities would fall in the other direction, necessitating lifting the stay.

[47] In all cases of lifting the stay to serve the requisite notices, I clarify that I am lifting the stay such that Firenze may comply with the procedure set out in CAPL 2007. Firenze's actions are therefore subject to the rights of any other contractual parties and/or working interest holders, if any, in the Facilities pursuant to the terms of the JOA, including CAPL 2007. None of the parties has advised whether a third or additional parties have any working interests in any of the Facilities

**Property**

[48] The Receivership Order appointed FTI Consulting Canada Inc. the receiver of "all of the Debtor's current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situate, including all proceeds thereof (the Property)."

[49] As an initial position, Firenze argued that the right of operatorship is not "property" forming part of the debtor's estate, and therefore that the stay does not apply to it. Thus, to the extent that the right of Operatorship is not "property" under the *BIA,* it would be appropriate for the Court to lift the stay provisions of the Receivership Order that asserts jurisdiction over such rights.

[50] The Receivership Order is granted pursuant to section 243 of the *Bankruptcy and Insolvency Act,* RSC 1985, c B-3 (*BIA*). That act defines "property" as,

> any type of property, whether situated in Canada or elsewhere, and includes money, goods, things in action, land and every description of property, whether real or personal, legal or equitable, as well as obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, in, arising out of or incident to property; (bien): *BIA*, s 2.

[51] The Receiver argues that operatorship is property under that definition, as it is "an interest and/or obligation arising out of or incidental to property". That it is an asset of value, it says, is supported by the fact that the Superior Bidder has offered a much greater price than Firenze for certain Facilities in the West Pembina area. I note the Receiver did not specify and it is unclear how many of the Facilities are overlapping in these two competing offers (or in fact any of the competing offers), so it is not possible to truly assess the differential in value of these offers. Conceptually, however, that the right of operatorship has value seems apparent.

[52] *Chitty on Contracts* 32nd ed vol I, (London: Sweet & Maxwell, 2015) states that "although contracts create only rights in personam, these rights are treated by the law as themselves items of property, an example of things in action or choses in action": at para 1-222. The Court of Appeal has indicated that contractual rights are property, at least when they are enforceable by specific performance: ***Zeidler v Campbell***, 63 Alta LR (2d) 1 at 5 (ABCA). Of note, contractual rights are included in the estate of a bankrupt, indeed, "sometimes the most valuable property in an estate will be the contractual rights possessed by the bankrupt as of the date of bankruptcy": ***Ford Credit Canada Ltd v Welcome Ford Sales Ltd***, 2011 ABCA 158.

[53] Similarly, with some limited exceptions, such as contracts of a personal nature[1], the benefits of contracts are considered property of the bankrupt and vest in the trustee. The trustee is entitled to perform any such executory contracts: ***Re Thomson Knitting Co***, [1925] 2 DLR 1007, 5 CBR 489 (ON CA); ***Potato Distributors Inc v Eastern Trust Co,*** (1955), 35 CBR 161, 1 DLR (2d) 147 (PEI CA) and annotation at 35 CBR 166; and *The 2017-2018 Annotated Bankruptcy and Insolvency Act* at F§98 p 451.

[54] These authorities suggest that operatorship, as a contractual right, is property under the receivership order. Although this issue was not fully argued before me, I see no basis upon which to find otherwise than that this right is property for the limited purpose of assessing the scope to which the stay applies.

**Anti-Deprivation Principle**

[55] As a final argument, the Receiver raises the anti-deprivation rule. In essence, this rule precludes the operation of a provision in an agreement that is triggered only upon insolvency and results in a transfer of value from the insolvent person to others. This type of provision is void as it violates the public policy of equitable and fair distribution amongst unsecured creditors in insolvency situations: ***Canadian Imperial Bank of Commerce v Bramlea Inc***, [1995] 33 OR (3d) 692, 44 BLR (2d) 188.

[56] Although the Receiver did not provide sufficient evidence of the "value" of the right of operatorship, the parties initially agreed that there was some (although Firenze subsequently resiled from this position, stating that the role involves both obligations and entitlements). To me it is somewhat obvious that although the right of operatorship has value that can translate into an increase in the price that can be obtained from the sale of the working interests, this value is not Scollard's (and thus, not the Receiver's) to be assigned. Again, the Receiver takes no greater rights than the debtor.

[57] I am not prepared to exercise the anti-deprivation rule to entitle the Receiver to take a greater interest than Scollard. Firenze holds independent rights under Clauses 2.06 and 2.09 of CAPL 2007. Under those provisions, the transfer of the role of operatorship is dependent on the parties working interest holdings and other conditions set out in the provisions. Firenze's right to demand a transfer of operatorship upon the assignment of the working interests exists independent of the insolvency and consequent receivership. As stated above, the purpose of the stay is not to render contractual provisions void, but only to stay them during the course of the receivership. The operatorship cannot be assigned without triggering the rights of Firenze. These rights include the right to demand a transfer of operatorship to itself. The Receiver is not therefore being deprived of the advantage of any right by lifting the stay in this case. Allocating value to the property of Scollard in respect of the right of operatorship in this case would not be preventing a deprivation, rather it would more likely be providing a windfall to Scollard's creditors.

[1] Personal contracts cannot be assigned in insolvency without the consent of the counterparty where that party relied upon the "reputation, ability and solvency" of the assignor. Such contracts have been found to exist in the mining context: ***Tolhurst v Associated Portland Cement Manufacturers, Ltd*** [1904] UKHL 456; ***Black Hawk Mining Inc v Manitoba (Provincial Assessor),*** 2002 MBCA 51. Whether the Operatorship portion of the JOA should be considered distinct from the remainder of the executory contract nature of the JOA generally, and whether it contains indicia of a personal contract was not argued in this case.

[58] This conclusion applies to the Facilities in which Firenze owns a 40% or more interest (which comprise 19 of the 23 wells and associated Facilities). For the other Facilities, the court has determined it would not be lifting the stay in this case, so the anti-deprivation principle need not be considered.

[59] The parties may appear before me to speak to costs of this application if they are not able to come to a resolution of that issue in a timely manner.



**Dated** at the City of Calgary, Alberta this 21st day of February, 2018.

**C. Dario**
**J.C.Q.B.A.**

**Appearances:**

James Hanley
for the Applicant, Firenze Energy Ltd.

John Cassell
for the Plaintiff, National Bank of Canada

Randal Van de Mosselaer/Emily Paplawski
For the Respondent, FTI Consulting Canada Inc
Receiver and Manager of Scollard Energy Ltd.

# TAB 4

1985 CarswellOnt 190
Ontario Supreme Court, In Bankruptcy

Knechtel Furniture Ltd., Re

1985 CarswellOnt 190, [1985] O.J. No. 1265, 20 E.T.R. 217,
32 A.C.W.S. (2d) 323, 56 C.B.R. (N.S.) 258, 8 C.C.E.L. 193

# Re KNECHTEL FURNITURE LIMITED

Saunders J.

Heard: June 27, 1985
Judgment: August 14, 1985
Docket: No. 31-214827

Counsel: *F.A. Highley*, and *K.L. Schlemmer*, for applicant.
*J.R. Varley*, for respondent.

Subject: Corporate and Commercial; Insolvency; Employment; Estates and Trusts; Property

Application by trustee in bankruptcy for directions respecting entitlement to surplus of employee pension plan.

***Saunders J.*:**

1 This is an application under s. 16 of the Bankruptcy Act for advice and direction as to the interest of the trustee in the surplus under an Employee Pension Plan (the "plan") maintained by the bankrupt, Knechtel Furniture Limited ("Knechtel"). Fasken & Calvin (the "representative") was appointed by the court to represent the interests of the eligible employees, participants, pensioners and beneficiaries under the plan.

2 The plan was established in 1966. On or about 30th March 1983 Knechtel was placed in receivership by a secured creditor. It was then insolvent. No further contributions were made to the plan after that date. On 7th May 1984 Knechtel made an authorized assignment in bankruptcy. Subsequently, the Pension Commission of Ontario declared the plan to be wound up as at 31st March 1983 and authorized the actuary for the plan to prepare a wind-up report. The report revealed a surplus of $471,300 after all beneficiaries had been fully paid out in accordance with the terms of the plan.

3 The plan was established under a trust agreement between Knechtel and Royal Trust Corporation of Canada ("Royal Trust"). The plan called for moneys to be contributed by each of Knechtel and the employees, which moneys were to be deposited with Royal Trust for the purposes described in the plan. Contributions by employees were by payroll deduction based on annual earnings. Contributions by Knechtel were based on actuarial opinions and were to be in amounts sufficient to cover current service costs of the future-service pensions and to amortize the past-service liability for past-service pensions. In short, Knechtel was required to "top up" the fund so that full benefits would be available to participants.

4 Paragraph 4 of art. XV of the plan provided:

> 4. The Company intends to maintain the Plan in force indefinitely but necessarily reserves the right by action of its Board of Directors to amend, suspend, or discontinue the Plan should future conditions warrant such action in the opinion of the Company.

5 Paragraph 6 of art. XV provided for what was to take place in the event of termination of the plan and upon complete discontinuance of contributions. An actuarial investigation was to be made and the funds applied to specified

 

purposes as set out in subparas. (i)-(viii). As previously stated, the assets of the fund were sufficient to fully pay out all beneficiaries in accordance with the terms of the plan and to leave a surplus remaining. The Pension Commission has now advised the actuary to distribute the assets to the beneficiaries but to defer distributing the surplus, pending the outcome of this application.

6 The distribution of surplus was provided for in subpara. 6(ix) of art. XV. It stated:

> (ix) All moneys which remain after the purposes enumerated in Paragraphs (i) to (viii) of this Section 6 of Article XV have been accomplished shall be paid over to the Company, its successors or assigns. Provided, however, that in the event that the Company, at the date of dissolution of the Plan, shall have become bankrupt or insolvent, or shall have taken the benefit of any Statute providing for arrangements with creditors, or shall have been wound-up, either voluntarily or by order of the Court, then in such event all moneys which remain after the purposes enumerated in Paragraphs (i) to (viii) of this Section 6 of Article XV have been accomplished shall not be paid over to the Company, its successors or assigns, but shall be allocated to provide equitable increases in the benefits of those persons and in the respective order, enumerated in this Section 6 of Article XV.

7 The issue on this application is the entitlement to surplus. There is no problem in the interpretation of subpara. 6(ix) of art. XV. The surplus is to be paid over to Knechtel provided that certain events have not occurred at the date of dissolution. If any of the events have occurred, the surplus is to be allocated to provide equitable increases in the benefits of the persons who have already received a distribution under para. 6. One of the events did occur in that Knechtel had become insolvent on 31st March 1983, the date of dissolution of the plan. On a plain reading of the provision of subpara. 6(ix), Knechtel is not entitled to the surplus and it should be paid over to the employee beneficiaries under the plan. It is the position of the trustee that the provision that the surplus is to be paid to the beneficiaries on the insolvency of Knechtel is void and not binding on the trustee to the extent that it relates to contributions made by Knechtel.

8 The plan was established and administered under a trust agreement between Knechtel and Royal Trust. Contributions were made to the trust fund by each of Knechtel and the employee participants. The contributions, when made, were impressed by a trust. Knechtel and the participants were the settlors of the fund. The employees were beneficiaries of the fund. Knechtel was also a beneficiary. On termination, after all employee benefits were paid and distributed, Knechtel had a right to surplus unless certain events had occurred.

9 Counsel for the representative argued that Knechtel had no interest in the fund. While the plan may have been established for the sole benefit of the employees and the surplus provisions might have been inserted as a "housekeeping" measure to deal with a situation that was considered unlikely and remote, I am unable to see how the surplus provision can be ignored or how it can be said in the light of that provision that Knechtel had no interest in the trust fund during the life of the plan and prior to termination.

10 The trustee submits that the provision in subpara. 6(ix) is unenforceable and not binding on the trustee. An agreement that provides that upon a person becoming bankrupt his property should pass to a third party is void against a bankruptcy trustee as being in violation of the bankruptcy laws. That policy principle applies equally to an agreement that purports to forfeit a person's rights in the event of insolvency. Thus, a settlor of a trust fund of which he is a beneficiary, may not provide that his beneficial interest shall pass to others in the event of insolvency. That is the situation here. The principle is well-established: see *Higinbotham v. Holme* (1812), 19 Ves. 88, 34 E.R. 451, Chancery Cases 87; *Whitmore v. Mason* (1861), 2 J. & H. 204, 70 E.R. 1031; *Re Jeavons; Ex parte MacKay; Ex parte Browne* (1873), 8 Ch. App. 643; and *Re Harrison; Ex parte Jay* (1880), 14 Ch. D. 19 (C.A.). It has been applied in Ontario: see *Re Hoskins* (1877), 1 O.A.R. 379 (C.A.); *Re Laing; Ex parte Laing* (1921), 51 O.L.R. 11, 2 C.B.R. 38, 64 D.L.R. 637 (S.C.); and *Re Ted Weale Ltd.*, [1952] O.W.N. 560, 32 C.B.R. 206, [1952] 3 D.L.R. 839 (S.C.).

11 The trustee does not contend that the application of the principle will result in the entire surplus becoming the property of the bankrupt's estate. It is only the interest settled by Knechtel that may not be distributed under subpara. 6(ix). The provision is not void with respect to the contributions settled by the employees: see *MacKintosh v. Pogose*,

 

[1895] 1 Ch. 505 at 511. The trustee is, therefore, only claiming an interest in proportion to the contributions made by Knechtel to the plan. On the basis of the principle, he should succeed in that claim.

12 Counsel for the representative submits, however, that the trustee has no status to claim against the surplus. The allocation under subpara. 6(ix) is to be made as at the date of dissolution. At that date, the trustee had no status and it is submitted that the allocation must be made without regard to any status later achieved and that the trustee must take its rights as they existed at the date of bankruptcy.

13 In applying the policy principle on which the trustee relies, the courts have, on several occasions, mentioned that although an agreement or arrangement diverting property in the event of bankruptcy or insolvency may be valid as between the parties, it is void against the trustee on policy grounds. If there had been no bankruptcy, Knechtel, as it had become insolvent on 31st March 1983, could not have claimed the surplus on termination and it would have been allocated to the employee beneficiaries. The trustee's claim is based on the policy principle and may be enforced irrespective of the right of Knechtel existing at the date of bankruptcy. As the surplus fund is available and undistributed, the trustee has status to claim against it.

14 The representative relied on *Brooke v. Pearson* (1859), 27 Beav. 181, 54 E.R. 70; and *Re Detmold; Detmold v. Detmold* (1888), 40 Ch. D. 585, where, in each case, a bankruptcy trustee had been denied status where there was a provision alienating an interest conditional upon the event of bankruptcy. Those cases are distinguishable. In each of those cases, the interest had been validly alienated for reasons other than bankruptcy before the bankruptcy occurred. There was, therefore, no interest that the bankrupt could have claimed at the date of his bankruptcy and the trustee in those circumstances had no better right.

15 The principle relied on by the trustee is that an owner may not qualify his interest in property by a provision that it will pass to a third party in the event of bankruptcy. On the other hand, an owner may agree to transfer property on the condition that the transferee is not bankrupt. That was the situation in *Cox v. Fonblanque* (1868), L.R. 6 Eq. 482. A legacy was given to Fonblanque "if not an uncertificated bankrupt at the testator's death". Fonblanque was bankrupt at the testator's death and he was held not entitled to the legacy. Counsel for the representative submits that there is a similar situation in this case. He submits that before Knechtel is entitled to the surplus, it must satisfy the condition precedent of not being insolvent. With respect, that view requires a tortuous reading of subpara. 6(ix), but in any event does not assist in determining the issue. The reason that the policy principle is said to apply to this situation is not because Knechtel is the beneficiary of the fund, but because it is the settlor as well. If there had been no contributions by Knechtel, the situation would have been similar to the *Cox* case and the trustee would have had no claim to the fund. Knechtel, however, had a vested interest in the fund subject to divestment in the event of insolvency. It is the divesting provision that is attacked on policy grounds by the trustee.

16 Counsel for the representative submits that the policy principle should not be extended to the situation in this case. First, because, unlike many of the cases in which it has been applied, the provision with respect to the surplus was not inserted in the plan to defeat creditors. On the contrary, the uncontradicted evidence was to the effect that the provision was inserted to provide additional benefits to employees who would probably suffer great hardship if the plan were to be wound up after Knechtel had become bankrupt or insolvent.

17 I find it difficult to see why the hardship would necessarily be any less if the plan had been terminated when Knechtel was solvent. The effect on the employees in each case would depend on all the surrounding circumstances.

18 Second, counsel submits that because the plan was designed to be for the sole benefit of the employees and they received assurances and commitments from management that this would be so. In 1966, Knechtel issued a booklet to employees which said:

21. *What is the future of the Plan?*

 

> The Company expects to continue the Plan indefinitely, but in the event of future legislation or other circumstances, beyond the Company's control, necessarily reserves the right to amend or discontinue the Plan.
>
> In any event, all contributions made by the Company with respect to accrued benefits are irrevocable and must remain in the Trust Fund for the sole benefit of members and their beneficiaries.

19 The extract from the booklet fails to mention the provision in the plan entitling Knechtel to be paid the surplus except in certain events. I would expect that in 1966 and thereafter, until financial difficulties overtook Knechtel, that not much thought was given to the possible termination of the plan or the distribution of surplus. Nevertheless, there are provisions in the plan dealing with that eventuality that cannot be ignored.

20 Third, it is said that the policy principle is based on old English cases which are inappropriate in the current social context. Employee pension plans are part of the conditions of modern life and are protected against encroachment by legislation. It is said that the court should be slow to apply principles that would deprive employees of possible pension benefits. While such a view is understandable, it also may be said that the court should not lightly deprive creditors of funds to which they may be entitled. When a business fails, employees and creditors alike may suffer hardship.

21 In my opinion, the policy principle is sound and the fact that it was pronounced well over a century ago should not affect its validity. If the drafters of the plan had intended the employees to benefit from the surplus and not Knechtel, it would have been an easy matter to have allocated any surplus on termination to the employee participants. As drafted, subpara. 6(ix) has the effect of diverting moneys to the employee beneficiaries that would otherwise have gone to Knechtel. It is a situation where the policy principle may be applicable. The employee participants have received their benefits in full under the plan. If Knechtel had ceased operations without becoming insolvent, those participants would have had no claim to the surplus. The effect of applying the provision in subpara. 6(ix) is to give the employees a right to funds as against the creditors of Knechtel that they would not have had if there had been no insolvency. I am not persuaded that the policy principle should not be applied in this case and in fact, consider that it is proper to do so.

22 An order should issue declaring that the trustee has an interest in the surplus fund rateably in proportion to the contributions made by the bankrupt to the plan, such percentage contribution to be calculated by the actuary under the plan. If there is any difficulty in complying with this order, either party may apply to the court for further directions.

23 Both the trustee and the representative should have their costs of this application out of the surplus fund on a solicitor-and-client basis subject, in the case of the representative, to the provisions of para. 3 of the order by which it was appointed.

*Directions given.*

# TAB 5

2018 ABQB 356
Alberta Court of Queen's Bench

Alberta Treasury Branches v. COGI Limited Partnership

2018 CarswellAlta 847, 2018 ABQB 356, [2018] A.W.L.D. 1958,
[2018] A.W.L.D. 2002, [2018] A.W.L.D. 2024, 291 A.C.W.S. (3d) 647

# Alberta Treasury Branches (Plaintiff) and COGI Limited Partnership, Canadian Oil & Gas International Inc., and Conserve Oil Group Inc. by its Receiver and Manager MNP Ltd. (Defendants / Applicants) and Firenze Energy Ltd. (Respondent / Cross-Applicant)

K.M. Horner J.

Judgment: May 1, 2018
Docket: Calgary 1501-12220

Counsel: G. Brian Davison, Q.C., Ryan Algar, for COGI Limited Partnership et al
James Hanley, for Firenze Energy Ltd.
Gunnar Benediktsson, for Crescent Point Energy Corp.
Ashley Garbe, for Alberta Energy Regulator

Subject: Civil Practice and Procedure; Contracts; Insolvency; Natural Resources

APPLICATION by receiver for payment of amounts owing under terms of joint operating agreements; CROSS-APPLICATION by current operator for contractual and/or equitable set-off and for lifting of stay of proceedings.

***K.M. Horner J.*:**

## I. Introduction

1 This is an application and cross-application relating to the operation of certain jointly owned oil and gas producing properties following the insolvency of one of the Joint-Operators. The Applicant/Cross-Respondent, MNP Ltd. (the "*Receiver*"), acts as the receiver and manager for the insolvent Joint-Operator, COGI Limited Partnership and Canadian Oil & Gas International Inc. (together, "*COGI*"). The Respondent/Cross-Applicant, Firenze Energy Ltd. ("*Firenze*"), is the current Operator under the relevant joint operating agreements.

2 The Receiver is seeking, among other things, $849,208.44, which it claims is the amount owed by Firenze to COGI due to the operation of the jointly owned oil and gas properties. Meanwhile, Firenze is seeking to have its indebtedness set-off against debts it claims are owed by COGI. Firenze is also seeking to lift the stay of proceedings that currently prevents it from enforcing the payment of what it claims are COGI's share of the costs arising from the operation of the jointly owned oil and gas properties.

3 For the reasons that follow, I grant the Receiver's application in part and dismiss Firenze's cross-application.

## II. Background

### *A. Relationship Between COGI and Firenze*

4 COGI and Firenze are (or were) joint owners and operators of oil and gas properties in the Carmangay, Joffre, Nevis/Claresholm, Marten Creek, and Gull Lake areas of Alberta, as well as in Weyburn, Saskatchewan. Pursuant to the

 

Marten Creek and Gull Lake joint operating agreements, COGI and Firenze are 50% working interest partners in those two properties. COGI originally acted as Operator under the Marten Creek and Gull Lake joint operating agreements.

5 The Marten Creek and Gull Lake joint operating agreements both adopt the 1990 CAPL Operating Procedure ("*CAPL 1990*"), which governs the relationship between the parties. In the current circumstances, the most relevant provisions of CAPL 1990 are Articles 202(a), 505(b), 1201, and 1901-02:

(a) Article 202(a) provides for the replacement of the Operator upon bankruptcy, insolvency, or receivership.

(b) Article 505(b) allows the Operator to contractually set-off debts owed by the Joint-Operator if the Joint-Operator fails to pay its portion of the operating expenses. It also prevents a Joint-Operator from claiming set-off against the Operator.

(c) Article 1201 allows the Operator to initiate the procedure for abandoning wells by issuing an abandonment notice to the Joint-Operator, which in effect proposes to abandon certain wells and divide the costs of doing so equally between the parties.

(d) Articles 1901 and 1902 allow the Operator to classify the Joint-Operator as a delinquent party if the Joint-Operator cannot be located or contacted. This classification allows the Operator to withhold the delinquent party's operational proceeds of sale in trust, as well as to recover certain outstanding joint operating expenses from those trust funds.

***B. COGI's Insolvency and the Marten Creek/Gull Lake Properties***

6 In March 2015, Firenze stopped paying its share of the operating costs for the Marten Creek and Gull Lake properties.

7 On August 28, 2015, Romaine J. granted an order providing COGI with protection from its creditors pursuant to the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 [*CCAA*].

8 On October 26, 2015, Macleod J. granted an order placing COGI in receivership and appointing MNP Ltd. as receiver and manager (the "*Receivership Order*"). Paragraph 10 of the Receivership Order imposes a stay of proceedings that precludes creditors from enforcing "all rights and remedies" against COGI, which specifically includes "set-off rights."

9 On December 23, 2015, COGI filed an assignment into bankruptcy pursuant to section 49 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [*BIA*]. MNP Ltd., as receiver and manager, was appointed as trustee of COGI's estate. The Receiver subsequently retained Niven Fischer Energy Services Inc. ("*Niven Fischer*") to manage COGI's oil and gas assets.

10 On January 5, 2016, I granted a consent order whereby Firenze invoked Article 202(a) of CAPL 1990 in order to replace COGI as Operator under the Marten Creek and Gull Lake joint operating agreements (the "*Operatorship Transfer Order*"). However, the Alberta Energy Regulator (the "*AER*") subsequently objected to the transfer of the relevant well licenses from COGI to Firenze. As a result, COGI continued to act as Operator for several months after the Operatorship Transfer Order was issued.

11 On April 12, 2016, the Receiver demanded payment for what it claims Firenze owes to COGI. Firenze rejected the Receiver's demand on the grounds that it had set-off rights against COGI that significantly reduced the claimed amount.

12 On September 1, 2016, the transfer of most of COGI's well licences became effective and Firenze assumed the role of Operator (the "*Effective Transfer Date*"). Although seven wells remain licenced to COGI, Firenze still acts as Operator for those wells. Much of the $849,208.44 claimed by the Receiver represents the overheard costs incurred while COGI remained Operator between the time of the Operatorship Transfer Order and the Effective Transfer Date.

  

13 I note that following the AER's objection to the license transfers, the Receiver and Firenze discussed the feasibility of Firenze becoming Operator prior to the transfer of the licences. However, nothing was ever agreed between the parties. Further, at no time did Firenze come back before this Court in an attempt to enforce the Operatorship Transfer Order on notice to the AER prior to the Effective Transfer Date.

14 In October 2016, Firenze issued abandonment notices to the Receiver for 29 wells on the Marten Creek and Gull Lake properties that had become uneconomic or were previously suspended (the "*Abandonment Notice*"). This abandonment process was done in accordance with Article 1201 of CAPL 1990 and Firenze duly sought COGI's share of the abandonment costs.

15 The amounts demanded by Firenze as a result of the Abandonment Notice included speculative future costs that had yet to be incurred. The Receiver responded by informing Firenze that issuing the Abandonment Notice represented the improper invocation of a contractual right that was stayed pursuant to paragraph 10 of the Receivership Order.

16 On November 1, 2016, Firenze issued a Notice to Revoke Take-in-Kind, which retroactively revoked COGI's right to take its production in kind from the Marten Creek and Gull Lake properties (the "*Revocation Notice*"). In taking this action, Firenze again purported to invoke its contractual rights pursuant to Articles 1901 and 1902 of CAPL 1990. This process was effected by classifying COGI as a delinquent party, which allowed Firenze to hold COGI's portion of the proceeds of sale from the Marten Creek and Gull Lake properties in trust.

***C. The Carmangay, Joffre, Nevis/Claresholm, and Weyburn Properties***

17 Part of the $849,208.44 claimed by the Receiver includes pre-receivership amounts related to the operation of the Carmangay, Nevis/Claresholm, and Weyburn properties. In response, Firenze claims that it is entitled to set-off amounts related to the purchase and sale agreements arising from COGI's sale of its interest in the Weyburn and Nevis/Claresholm properties to Firenze.

***D. Positions of the Parties***

18 The Receiver argues the $849,208.44 that Firenze allegedly owes to COGI is a valid and payable debt, which cannot be further set-off by Firenze. This argument is premised on the position that Firenze did not become Operator of the Marten Creek and Gull Lake properties until the Effective Transfer Date (i.e. September 1, 2016), which prevents Firenze from setting-off any amounts owed by COGI prior to that date.

19 Any set-off claims arising after September 1, 2016 are also precluded by the stay of proceedings in the Receivership Order. Further, there is no basis to provide Firenze with an equitable right of set-off due to its refusal to pay its share of the operating costs for the Marten Creek and Gull Lake properties after March 2015.

20 Firenze argues that the Receiver's claim of $849,208.44 is not valid because it neglects Firenze's right to contractually and equitably set-off certain other amounts, including those related to the Weyburn and Nevis/Claresholm purchase and sale agreements. Firenze also claims for damages due to COGI's anticipatory breach of the Marten Creek and Gull Lake joint operating agreements. As a result, Firenze asks this Court to only decide the relevant principles of equitable and contractual set-off, and refrain from making a determination on the exact amounts owed without a more fulsome hearing.

21 Firenze's argument is premised on the position that it became *de jure* (if not *de facto*) Operator of the Marten Creek and Gull Lake properties at the time of the Operatorship Transfer Order (i.e. January 5, 2016). Therefore, it should enjoy the relevant contractual right of set-off as of that date.

22 Firenze's cross-application argues that the stay of proceedings should be lifted in order to retroactively ratify the Abandonment Notice and Revocation Notice as effective to their date of issue. This argument is premised on the position

  

that lifting the stay is a practical necessity in the circumstances. Failure to lift the stay would effectively prevent Firenze, as Operator, from taking necessary steps in relation to the joint-operating assets in the ordinary course of business.

23 The Receiver argues there are no grounds for Firenze's cross-application because the denial of a contractual remedy is insufficient to justify lifting the stay of proceedings. Lifting the stay is not a routine matter and Firenze must cite exceptional circumstances to justify it, which Firenze has failed to do. As a result, the Receiver asks this Court to declare that the Abandonment Notice and the Revocation Notice were improperly issued in violation of the stay and, therefore, of no effect.

24 Crescent Point Energy Corp. also made brief submissions in support of the Receiver's position.

**III. Issues**

25 The hearing of this matter raises two issues that must be determined:

1) Does Firenze have a valid claim for set-off and, if so, to what extent?

2) Should the stay of proceedings be retroactively lifted in order to ratify the Abandonment Notice and the Revocation Notice?

**IV. Analysis**

26 This matter was heard over the course of a half-day. The evidence before the Court included affidavits of various employees from Firenze and Niven Fischer, as well as transcripts of questioning of those employees. The contents of many of the affidavits and transcripts contradict and challenge each other's fundamental calculations and conclusions.

27 I agree with Firenze's argument that it would be inappropriate to make a determination on the exact amounts owing without a more fulsome hearing. There is insufficient evidence before the Court at this time to make a proper determination on certain of the more controversial matters. Therefore, my reasons will only address general legal principles as they are applicable to Firenze's claim for set-off and the cross-application to lift the stay of proceedings. If my decision is insufficient to allow the parties to agree on the amounts owing amongst themselves, then they may re-apply to this Court for a more fulsome hearing in the future.

***Issue #1: Does Firenze Have a Valid Claim for Set-Off and, if so, to What Extent?***

28 Firenze claims both contractual and equitable set-off. Its claim for contractual set-off relates to amounts stemming from the Marten Creek and Gull Lake joint operating agreements. These contractual amounts include things such as outstanding surface lease rentals and property taxes.

29 Firenze's claim for equitable set-off relates to amounts stemming from the Nevis/Claresholm and Weyburn purchase and sale agreements. These equitable amounts include: (1) adjustments to the Nevis/Claresholm purchase and sale agreement due to the cost of paying an unanticipated lien; and (2) adjustments to the Weyburn purchase and sale agreement due to the cost of replacing a defective Group Treater.

*A. Contractual Set-Off*

30 Firenze's claim to contractual set-off rests in Article 505(b) of CAPL 1990, which allows the Operator to set-off debts owed by the Joint-Operator. As a result, any contractual claim that Firenze may have will be dependent on when precisely it replaced COGI as Operator under the Marten Creek and Gull Lake joint operating agreements.

31 Article 202(a) of CAPL 1990 grants Firenze the contractual right to replace the insolvent COGI as Operator "upon notice to such effect being served by any party to the other parties . . . " However, upon COGI entering CCAA protection on August 28, 2015, this contractual right was stayed. Therefore, Firenze required the Receiver's consent or a court order

  

to effect the transfer of operatorship: *Bank of Montreal v. Bumper Development Corp.*, 2016 ABQB 363 (Alta. Q.B.) at paras 16-18 [*Bumper Development*] (which deals with CAPL 2007); *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 92 A.R. 81, 1988 CarswellAlta 318 (Alta. Q.B.) at paras 48-50 (which deals with CAPL 1981).

32 Based on Article 202(a) of CAPL 1990, Firenze argues that, at the latest, it became Operator as of the date of the Operatorship Transfer Order (i.e. January 5, 2016). The Receiver counters that, due to the intransigence of the AER, COGI remained Operator until the Effective Transfer Date (i.e. September 1, 2016). After all, COGI incurred all of the costs and liabilities associated with being Operator up to that date. This issue is also relevant in that it will determine whether the Receiver can claim those operatorship overhead costs incurred by COGI between the date of the Operatorship Transfer Order and the Effective Transfer Date.

33 I note that updates to the 2007 version of the CAPL Operating Procedure recognize the fact that insolvency-triggered change of operatorship is not an instantaneous process: see Craig Spurn, Jana Prete & Melissa Zerebeski, "The 2007 CAPL Operating Procedure" (2009) 46.2 Alta L Rev 427 at 432-34. Instead, change of operatorship appears to be a function of result rather than intention.

34 I find that Firenze became Operator as of the Effective Transfer Date. As a result, Firenze would only be eligible to claim contractual set-off as of that date (with those rights still subject to the stay of proceedings). The Operatorship Transfer Order did entitle Firenze to become Operator as of the date of that order. However, operatorship never actually transferred until September 1, 2016 due to the impediment of AER regulatory action.

35 The AER delayed the regulatory transfer of the necessary well licences for another nine months after the Operatorship Transfer Order. As a result, COGI remained legally liable for operatorship and was unable to abdicate those liabilities to Firenze. COGI and Firenze attempted to resolve this impasse between themselves, but were unable to do so before the Effective Transfer Date. Further, Firenze chose not to bring the matter back before this Court in order to overcome the regulatory impediments. Therefore, at this juncture, it would be inappropriate to interfere with the discretionary regulatory authority of the AER.

36 The simple fact is that, between the Operatorship Transfer Order and the Effective Transfer Date, COGI continued to exercise the duties of Operator. It also bore the costs and liabilities associated with operatorship. Firenze was fully aware that COGI continued to pay those costs during that time. Yet Firenze now retroactively seeks all of the contractual benefits of operatorship without having assumed any of the requisite burdens. Such a result would be inconsistent with the fundamental purpose and function behind Article 505(b) and CAPL 1990 as a whole.

*B. Equitable Set-Off*

37 A party may explicitly or implicitly contract out of their right to both contractual and equitable set-off: *National Foundation for Hepatitis C (Trustee of) v. GWE Group Inc.*, 1999 ABQB 66 (Alta. Q.B.) at paras 25-27 (Alta Master).

38 Article 505(b)(iv) of CAPL 1990 precludes a Joint-Operator from claiming a right to set-off in response to an Operator's claims for unpaid amounts. Therefore, Firenze cannot claim in equitable set-off what it contracted out of in CAPL 1990. Firenze can only claim equitable set-off where it is eligible to also claim contractual set-off (as it relates to the Marten Creek and Gull Lake joint operating agreements). What remains is Firenze's equitable set-off claim regarding the Nevis/Claresholm and Weyburn purchase and sale agreements.

39 Paperny J.A. outlined the test for equitable set-off in *Trilogy Energy LP v. SemCAMS ULC*, 2009 ABCA 275 (Alta. C.A.) at para 22, refusing leave to appeal *SemCanada Crude Co., Re*, 2009 ABQB 397 (Alta. Q.B.):

> The chambers judge correctly set out the test for equitable set-off, being the principles laid out in *Holt* at 212. These are that [cites omitted]:

  

1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands.

2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed.

3. A cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross claim.

4. The plaintiff's claim and the cross-claim need not arise out of the same contract.

5. Unliquidated claims are on the same footing as liquidated claims.

40 Most relevant in the present circumstances is the third principle of equitable set-off, which is the "clearly connected" requirement. I find there is no clear connection between COGI, in its role as Operator pursuant to the Marten Creek and Gull Lake joint operating agreements, and Firenze, in its role as purchaser pursuant to the Nevis/Claresholm and Weyburn purchase and sale agreements. Further, it would not be manifestly unjust to allow the Receiver to enforce COGI's claims as Operator without taking into consideration Firenze's claims as purchaser.

41 The lack of a clear connection and manifest injustice is the result of the unique nature of operatorship pursuant to a joint operating agreement. Operatorship is legally distinct from that of a vendor pursuant to a purchase and sale agreement. The unique nature of an Operator was described by Romaine J. in *SemCanada Crude Co., Re*, 2009 ABQB 397 (Alta. Q.B.) at paras 38-68, leave to appeal refused *Trilogy Energy LP v. SemCAMS ULC*, 2009 ABCA 275 (Alta. C.A.).

42 In short, COGI, as vendor, entered into the relevant purchase and sale agreements in its own corporate capacity. Whereas COGI, as Operator, acted under the relevant joint operating agreements for a distinct, special purpose. Operatorship requires that the operating partner act as an administrator over accounts and assets owned by all joint-partners that are subject to the joint operating agreement. This status creates different obligations and liabilities for the Operator when compared to if it was only acting in its own corporate capacity.

43 The special status of COGI, as Operator, creates an important and well recognized legal distinction that prevents a clear connection with its activities as vendor. Firenze may have a separate cause of action against COGI for what it claims is owed pursuant to the purchase and sale agreements. However, the unique status of operatorship, and ensuring the proper function of joint operating agreements in insolvency situations, militates against allowing Firenze to advance its claims in equitable set-off.

44 I make no finding regarding whether Firenze would be able to satisfy the other elements of the equitable set-off test.

***Issue #2: Should the Stay of Proceedings be Retroactively Lifted?***

45 The Receivership Order's stay of proceedings restrains Firenze from invoking its contractual rights under CAPL 1990, including by issuing the Abandonment Notice and Revocation Notice: *Baytex Energy Ltd. v. MNP Ltd.*, 2012 ABQB 539 (Alta. Q.B.) at para 19 [*Baytex*], citing *Skyservice Airlines Inc., Re*, 2011 ONSC 703 (Ont. S.C.J. [Commercial List]) at paras 77-89, aff'd 2012 ONCA 283 (Ont. C.A.).

46 Firenze therefore requires either the consent of the Receiver or the leave of this Court before issuing the Abandonment Notice and Revocation Notice. However, Firenze received neither the required consent nor leave prior to taking the action that it did. As a result, Firenze now asks this Court to lift the stay *nunc pro tunc* and ratify its otherwise invalid Abandonment Notice and Revocation Notice.

47 Firenze argues the lifting of the stay is necessary because it must be allowed to act in the ordinary course of business in order to fulfill its obligations under the Marten Creek and Gull Lake joint operating agreements. Since both

 

agreements pre-date the Receivership Order, the Receiver remains subject to those agreements: see *Associated Investors of Canada Ltd., Re* (1989), 69 Alta. L.R. (2d) 318, 1989 CarswellAlta 362 (Alta. Q.B.).

48 Firenze also cites the decision in *Bumper Development* at para 19 as authority for the proposition that the stay should be lifted because there is no reason to interfere with its contractual rights when those rights are not affected by security.

49 I note that Firenze concedes its justification for issuing the Abandonment Notice and Revocation Notice is primarily economic in nature. There is currently no outstanding regulatory requirement to abandon the wells cited in the Abandonment Notice. Further, the Revocation Notice is primarily being used to retain enough of the production revenue to cover COGI's outstanding operational expenses and share of the prospective abandonment costs.

50 The Receiver opposes Firenze's cross-application to lift the stay on the grounds that there is no sound reason to grant such an order. It cites *Alignvest Private Debt Ltd. v. Surefire Industries Ltd.*, 2015 ABQB 148 (Alta. Q.B.) at para 44 [*Alignvest QB*], aff'd on other grounds *York Realty Inc. v. Alignvest Private Debt Ltd.*, 2015 ABCA 355 (Alta. C.A.) [*Alignvest CA*], as authority for the proposition that the loss of a pre-receivership contractual right is insufficient justification for lifting the stay. Further, the Receiver argues that lifting the stay would provide Firenze with an inappropriate "leg up" on COGI's secured and unsecured creditors by allowing it to retain funds otherwise owed to COGI.

*A. There are Insufficient Grounds to Lift the Stay*

51 In *Alignvest QB* at paras 40-42, citing the Ontario Court of Appeal's decision in *Ma, Re* (2001), 24 C.B.R. (4th) 68, 2001 CarswellOnt 1019 (Ont. C.A.), Romaine J. outlined the relevant test for determining whether to lift a stay of proceedings:

> 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.
>
> Guidance can be drawn from the provisions of section 69.4 of the *BIA* 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: *Ma, Re*, [2001] O.**J. No. 1189 (Ont. C.A.).
>
> Lifting the stay is not routine: there must be sound reasons to relieve against the stay: *Ma, Re* at para 3.
>
> [The applicant] concedes that in order 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 Plaza Inc.* (2005), 29 C.B.**R. (5th) 62 (Ont. S.C.J.) at paras 18 - 19.

52 In *Alignvest QB* at paras 44-48, Romaine J. found that depriving the applicant of rights that it had specifically bargained for under a lease did not constitute material prejudice. The applicant entered into the contract knowing the risks. A similar conclusion can be drawn in the present circumstances.

53 Firenze has provided insufficient evidence that it is likely to be materially prejudiced by the stay or that there is an equitable basis to lift the stay and ratify the Abandonment Notice and Revocation Notice. There is a distinct lack of special harm that Firenze will suffer if the stay is not lifted. After all, Firenze concedes that it has acted primarily for economic reasons, which is a justification that was rejected by Strekaf J. (as she was then) in *Baytex* at paras 18-19.

54 In other words, there is no regulatory requirement dictating the immediate abandonment of the wells subject to the Abandonment Notice. Firenze is abandoning those wells only because it claims its actions are economically prudent. Even assuming that the abandonment must go forward in the future, those costs may very well be shared by whatever entity steps into COGI's place (which Firenze freely acknowledges).

 

55 Further, COGI's failure to pay its portion of the operating costs is a risk that every Operator must endure when faced with the insolvency of a Joint-Operator. It does not constitute material prejudice or equitable grounds sufficient to justify lifting the stay to allow the Revocation Notice. Firenze should not, without more, be able to retain funds to satisfy its own claims at the expense of COGI's other creditors (who may be equally entitled to those funds).

56 Firenze's current situation can be distinguished from that of the applicant in *Bumper Development*, wherein Macleod J. did order the stay to be lifted *nunc pro tunc*. In that case, the stay was lifted to grant the applicant its contractual right to take over as Operator under CAPL 2007 (a right which this Court has already granted to Firenze). Had Macleod J. not lifted the stay, it would have caused the applicant material prejudice, as the applicant would have lost its right to operatorship despite having an agreement with the receiver to the contrary. Further, lifting the stay would not have prejudiced the insolvent Joint-Operator's creditors, as the operatorship was not something otherwise secured and transferable.

**V. Conclusion**

57 I grant the Receiver's application as it relates to defining Firenze's right to contractual and equitable set-off. However, any declaration of the exact amounts owing will require a more fulsome hearing. Further, I dismiss Firenze's cross-application to lift the stay of proceedings *nunc pro tunc*.

58 Firenze became Operator pursuant to the Marten Creek and Gull Lake joint operating agreements as of the Effective Transfer Date (i.e. September 1, 2016). Therefore, Firenze is only eligible to claim any related right to contractual and/or equitable set-off as of that date.

59 Firenze is not eligible to use amounts claimed pursuant to the Weyburn and Nevis/Claresholm purchase and sale agreements to equitably set-off amounts owed pursuant to the Marten Creek and Gull Lake joint operating agreements.

60 The Abandonment Notice and Revocation Notice are subject to the stay of proceedings and were issued without the consent of the Receiver or the leave of this Court. Further, there are insufficient grounds to lift the stay and retroactively ratify those orders. Therefore, the Abandonment Notice and Revocation Notice are declared to be of no effect.

61 If the parties cannot agree on costs then they may apply to this Court for a determination thereof.

*Application granted in part; cross-application dismissed.*

# TAB 6

2015 ABQB 148
Alberta Court of Queen's Bench

Alignvest Private Debt Ltd. v. Surefire Industries Ltd.

2015 CarswellAlta 485, 2015 ABQB 148, [2015] A.W.L.D. 2108, [2015] A.W.L.D. 2109, [2015] A.W.L.D. 2152, [2015] A.J. No. 316, 16 Alta. L.R. (6th) 1, 23 C.B.R. (6th) 66, 251 A.C.W.S. (3d) 197, 39 B.L.R. (5th) 87, 3 P.P.S.A.C. (4th) 308, 608 A.R. 292

# Alignvest Private Debt Ltd., Plaintiff and Surefire Industries Ltd., Defendant

B.E. Romaine J.

Judgment: March 4, 2015
Docket: Calgary 1301-11285

Counsel: Howard J. Sniderman, Q.C., John Frame, Jonathan Calvert for York Realty Inc.
Sean F. Collins, Pantelis Kyriakakis for Alignvest Private Debt Ltd.
Thomas S. Cumming, Clifton Prophet for Duff & Phelps Canada Restructuring Inc.

Subject: Corporate and Commercial; Insolvency; Property

APPLICATION by secured creditor for order directing bankrupt's landlord to remit deposit amount paid by bankrupt to trustee and for order declaring that deposit was unregistered security and subordinate to creditor's claim.

***B.E. Romaine J.*:**

**1. Introduction**

1 After a short history of insolvency proceedings, Surefire Industries Ltd. was placed into bankruptcy with Duff & Phelps Canada Restructuring Inc. ("D & P") appointed as Trustee of Surefire's estate. The primary issue in this application and cross-application is the characterization of a deposit made under a lease between Surefire and York Realty Ltd. which was disclaimed by the Trustee, specifically whether York is entitled to retain the deposit or whether it must be remitted to the Trustee as part of Surefire's estate, subject to the claim of a secured creditor.

**II. Relevant Facts and Applications**

2 Surefire was granted an initial order under the *Companies' Creditors Arrangement Act* in August, 2013. The CCAA proceedings were terminated in September, 2013 and D & P was appointed as receiver and manager of Surefire's assets.

3 During the course of the receivership, D & P caused Surefire to continue to occupy the premises that were subject to the lease, and caused Surefire to pay rent to York. The lease was part of a sale of Surefire's property to York and the lease back of the property, effective on February 15, 2013.

4 On December 23, 2013, Surefire was declared bankrupt, with D & P appointed as Trustee. The Trustee disclaimed the lease on January 2, 2014. As of the date of the disclaimer, all rent owning had been paid to York.

5 When Surefire was in receivership, York applied for an order that it was entitled to retain a deposit of $3,187,500 described under the lease, notwithstanding the stay of proceedings imposed by the receivership. The deposit in issue was not paid in cash but by way of an adjustment to the cash to close the purchase of the lands.

  

6 That application was adjourned by order dated December 16, 2013, which provided that, if it was determined that the deposit was not forfeit prior to the commencement of CCAA proceedings, the issue of whether the stay of proceedings in force under the receivership should be lifted to allow York to forfeit the deposit should be determined as if no bankruptcy had ensued.

7 Alignvest Private Debt Ltd. is a secured creditor of Surefire with a general security agreement over its assets. Alignvest registered its GSA under the *Personal Property and Security Act (Alberta)* ("PPSA") on March 27, 2013. York did not register any security interest in the deposit under the PPSA.

8 On March 20, 2013, York and Alignvest entered into an agreement whereby York consented to and acknowledged the validity of Alignvest's security and subordinated its interest in that security until Surefire's obligations to Alignvest were paid in full.

9 Alignvest applies for an order directing York to pay $3,187,500 to the Trustee, either in its previous capacity as receiver or alternatively as trustee in bankruptcy, and for an order declaring that the deposit is an unregistered security interest under the PPSA, subordinate to Alignvest's perfected secured claim.

10 The Trustee takes the position that the deposit is intangible personal property as defined in the PPSA in which Surefire has an interest and to which Alignvest's security attaches. Alternatively, the Trustee submits that York should pay a sum of money equal to the deposit to the Trustee for distribution.

**III. Issues**

a) Is the deposit security for the performance of obligations under the lease or prepaid rent?

b) Is the deposit subject to the provisions of the PPSA?

c) Should the stay imposed by the receivership be lifted?

**IV. Analysis**

***A. Is the deposit security for the performance of obligations under the lease or prepaid rent?***

11 The relevant provisions of the lease are as follows:

6. Security Deposit/Rent Credit

(a) The Tenant will pay to the Landlord ... a deposit of ... $3,187,500 plus goods and services tax (the Security Deposit"), which Security Deposit is to be held without interest by the Landlord as security for the performance by the Tenant of its obligations under the Lease ... Subject to the foregoing, the Security Deposit will, provided that the Tenant has paid all amounts due to the Landlord under this Lease and is not otherwise in default..., be applied during the term as follows:

[applied to monthly rent commencing on the 13 $^{th}$ month of the term, and certain following months during the term of the tenancy]

(b) The Tenant shall be credited ... $5000,000.00 ...towards its Rent obligations during the first two months of the Term...

12 In the event of a default, the lease provides that York may retain the Security Deposit and advance rent (if any) for its own use.

  

13 The prepaid rent for the first two months of the lease were credited to York at the closing of the sale and lease back transaction.

14 York relies on *Abraham, Re*, [1926] 3 D.L.R. 971 (Ont. C.A.) and cases that follow *Abraham* for the proposition that a non-refundable deposit, to be applied either to rental payments throughout the term of a lease or alternatively to any defaults of the tenant, is prepaid rent and the property of the lessor from the day that it is paid under the lease.

15 In *Abraham*, the lease provided for a deposit that would be credited to rent payable in the last year of the lease, but which could be forfeited as liquidated damages in the event of a bankruptcy. The Court noted that "in all cases the Court strives to give effect to the actual contract of the parties according to its real nature and legal effect": para 10. The issue before the Court was whether the deposit was a penalty or a genuine pre-estimate of liquidated damages. However, the Court took the position that it was obvious under the lease that the deposit was never to be repaid to the tenant. If there was no default, it would be applied to rent. If there was default, it would be applied to damages arising from breach of contract. The Court concluded that:

> (i)f effect is to be given to the contract between the parties, in no possible event is this money to be actually repaid to the tenant, and the assignee of the tenant has no greater right than the tenant himself. No matter what the parties have called it, it was a partial prepayment of rent and nothing more.

It should be noted that this case pre-dates the modern provisions of bankruptcy law that allow disclaimer of leases.

16 The Trustee and Alignvest submit that the governing authority is the decision in *Champion Machine & Tool Co., Re* (1971), 15 C.B.R. (N.S.) 136 (Ont. S.C.), where *Abraham* was distinguished.

17 In *Champion*, the lease provided for a "security deposit" as security to guarantee the performance of covenants in the lease, which "shall be retained by the Lessor and become the property of the Lessor" in the event of a breach of covenant, but would otherwise be applied to rent for the last month of the lease. The issue was whether the trustee in bankruptcy could set off prepaid rent against the landlord's claim for accelerated or occupation rent.

18 The Registrar found that the deposit was to be held as security for a breach of the covenant not to become bankrupt. As a bankruptcy had occurred, the lease provided that the deposit was to become the property of the lessor. However, the law in Ontario in force at the time precluded the landlord from having a claim for damages for the unexpired term of this lease. Thus:

> .. (t)he lessor has not exacted prepaid rent from the lessee, but a deposit as a guarantee against the happening of an event which has now occurred, that is the bankruptcy of the lessee and it is my view that the trustee is entitled to set-off the amount of the deposit forfeited to the lessor against the claim of the lessor for accelerated rent: para 19.

19 In the result, the benefit of the deposit accrued to the trustee.

20 What the cases make clear is that the Court must look to the wording of the lease to determine the intention of the parties with respect to the deposit, whether it should be characterized as pre-paid rent, liquidated damages or security and whether it would be non-refundable in the hands of the tenant and thus with respect to the trustee in bankruptcy: *Ébénisterie Renouveau inc., Re*, 2009 QCCS 1454 (C.S. Que.) at paras. 53, 59.

21 The following provisions of the lease imply that the deposit is a security deposit and not prepaid rent:

> a) The relevant section of the lease is entitled "Security Deposit/Rent Credit" and the deposit is defined as a Security Deposit. While the paragraph heading also refers to "Rent Credit", that is a reference to section 6(b). Thus, section 6 distinguishes between the "Security Deposit" in section 6(a) and prepaid rent by credit in section 6(b). Section 6 (a) specifies that the deposit will be held "as security for the performance by the Tenant of its obligations under the Lease."

b) The deposit was also referred to as a "Security Deposit" in the Final Statement of Adjustments rendered in connection with the transaction.

c) Although the lease allowed York to "retain the Security Deposit" for its own use in the event of a default in the lease, including the failure to pay rent. York did not exercise this option when rental payments were late by a few days prior to the receivership, and the failure to pay rent was remedied.

d) The lease provides that the deposit "will be applied during the term [of the lease]" to rent for certain months of the tenancy. Those months were not reached before the lease was disclaimed by the receiver. The lease does not immediately credit the deposit to future months, but only to rent falling due in the future. The deposit can only be applied to rent in these designated future months if the tenant is not otherwise in default.

22 York submits that there are factors that imply that to the deposit should be characterized as prepaid rent, or as a non-refundable deposit:

a) Security for obligations to be performed under a lease is not a good or service that would give rise to the requirement of the payment of GST, yet the deposit included the payment of GST. While this may be true, the lease anticipates that the deposit could be applied to rent in certain circumstances, or to designated months if the lease continued to the end of its term, making the payment of GST necessary. This provision can be considered as no more than a prudent pre-estimate of the amount that would be necessary if the deposit was applied in that manner.

b) York submits that it had the right without notice to retain the deposit for its own use in the event that any of the events of default listed in section 10 of the lease occurred. That right was stayed by the CCAA proceedings and the receivership, but York submits that

i) it was its intention to retain the deposit when Surefire failed to pay rent on June 18, 2013 and August 16, 2013. However these rent payments were made on June 19, 2013, and August 22, 2013 respectively, and accepted by York, as were rent payments made by the receiver through the term of the receivership until the lease was disclaimed. There is no evidence of York exercising its right to retain the deposit after these failures to pay rent, other than in an affidavit filed by the president of York, Glenn Woolsey in which he states that this was "the position that [he] took". However, Mr. Woolsey conceded in questioning that York had not taken the deposit from Surefire as it was entitled to do prior to accepting late payment of rent.

ii) Surefire became insolvent prior to the CCAA and receivership proceedings, giving rise to York's right to retain the deposit. Again, York has conceded that it had not enforced its rights under the lease prior to the commencement of insolvency proceedings.

c) Mr. Woolsey deposed that it was York's intention that the deposit be non-refundable. Evidence of the subjective intention of the parties does not aid in the interpretation of a contract, and there is no language in the lease that indicates that the deposit is non-refundable.

d) York submits that there is no possible event where the deposit would be repayable to Surefire. However, one such scenario would be the early termination of the lease by the landlord, for example under paragraph 23, when the tenant is not in breach of the lease. Another scenario is the situation that has now occurred, where the lease has been disclaimed by Surefire's trustee in bankruptcy and such disclaimer has been confirmed by the Court. Thus, if the term of the lease is interrupted, by the landlord or by operation of law or court order, with no actionable breach by the tenant, the deposit will not be forfeited.

23 I am satisfied by the provisions of the lease that the deposit cannot be characterized as prepaid rent, that it is not non-refundable in any scenario and that it is properly characterized as security to guarantee the performance by Surefire

 

of its obligations under the lease, similar to the deposit described in *Champion Machine & Tool Co., Re*. While the lease may provide that the landlord may retain the deposit upon the tenant taking the benefit of or becoming subject to an insolvency statute, the CCAA and receivership proceedings stayed that remedy.

***B. Is the deposit subject to the provisions of the PPSA?***

24 The PPSA applies to every transaction that creates a security interest: section 3. A "security interest" includes an interest in money or an intangible that secures payment or the performance of an obligation: section 1 (tt). As the deposit is security for the performance of obligations under the lease, it would fall into the category of "security interest", absent an exclusion from the PPSA regime. If the deposit falls within the definition of "security interest," York should have filed a financing statement to perfect its interest under the PPSA, since security interests in intangible personal property cannot be perfected by possession. Since York failed to do so, York's claim would be subordinate to that of Alignvest and ineffective against the Trustee.

25 York submits that the deposit falls within the exclusion from the PPSA regime set out in section 4(g) of the Act, which provides that the PPSA regime does not apply to:

> ... the creation of an interest in a right to payment that arises in connection with an interest in land, including an interest in rental payments payable under a lease of land, but not including a right to payment evidenced by investment property or an instrument.

26 York's argument appears to be that, since the deposit is dealt with under the lease and the lease is an interest in land, any payments made under the lease, including either as a security deposit or prepaid rent, are excluded from the PPSA pursuant to section 4(g).

27 York relies on *Bank of Montreal v. Dynex Petroleum Ltd.*, [1997] 6 W.W.R. 104 (Alta. Q.B.), at para 45, rev'd on different grounds in (1999), [2000] 2 W.W.R. 693 (Alta. C.A.), for the proposition that leases are interests in land and therefore lease payments to lessors pertinent thereto arise in connection with an interest in land. However, as the Trustee points out, *Dynex* drew a distinction between rental payments to lessors and interests that are not interests in land in the same sense as or equivalent to rental payments. In *Dynex*, overriding royalty interests were not considered to arise in connection with an interest in land.

28 Similarly, while York relies on *Couiyk v. Couiyk*, [1999] B.C.J. No. 2737 (B.C. S.C.) at para 19 for the proposition that an identically-worded section of the British Columbia PPSA is intended to ensure that streams of payment arising in connection with an interest in land are excluded from the scope of the legislation, the Court in that case noted that the subsection should be narrowly construed, and refused to apply it to funds "not remotely akin to lessor rental payments": para 20.

29 The Trustee submits that the deposit:

a) does not "arise in connection with an interest in land", and

b) is not a "right to payment".

30 The Trustee points out that the deposit is not a rental payment, but collateral in which York has a security interest for the performance of all Surefire's obligations under the lease. Such obligations can include, not only the failure to pay rent, but the tenant's breach of non-financial obligations, its insolvency, the seizure of the tenant's property by a creditor and the abandonment of the premises. The deposit can only be applied to rent if the tenant is not in default under the lease. Section 6(a) provides that the deposit is "security for the performance by the Tenant of its obligations" under the lease. There is a distinction between a "right to payment" and "security for that right" and the wording of the lease refers to the deposit as "security". Even though the disclaimer of the lease has extinguished any right to rent

 

beyond that provided by the *Bankruptcy and Insolvency Act*, the deposit remains as security under the lease, subject to these applications asserting competing claims.

31 The interest that must be considered in determining whether the deposit is an excluded interest failing within section 4.(g) of the PPSA is the interest in the deposit, not an interest in the lease as a whole. This is consistent with the approach taken in *Dynex* and in *Couiyk*, where lease or rental payments were considered to fall within the exclusion, while other kinds of interests did not.

32 This approach is also consistent with the implied purpose of the exclusion. If an interest is in an excluded interest like an assignment of rents, it can be caveated as an interest in land. The ownership of prepaid rent passes on payment, so registration is not necessary. The deposit, not being an interest in land but simply an intangible personal property interest held to secure Surefire's obligations, cannot be protected in these ways but only through registration under the PPSA.

33 In *Ministre du Revenu national c. Caisse Populaire du bon Conseil*, 2009 SCC 29 (S.C.C.), the Court considered whether a certain contractual agreement gave rise to a "security interest" for the purposes of the *Income Tax Act*.

34 The Court noted that the question required that the terms of the contract be carefully considered to determine whether the parties intended to confer on one party an interest in the property of the other that secures payment or performance of an obligation. If the substance of the contract demonstrated an intention to create an interest in property to secure an indebtedness, a security interest existed.

35 In the course of his analysis, Rothstein J, stated that, if the intention of the parties was to create a security interest to ensure that a right of compensation or set-off would be an effective remedy, the characterization of the interest as a security interest would not change "simply because the parties have chosen one mechanism for realizing on the security, rather than another. What must be considered in the substance of the agreement": para 25.

36 He disagreed with the dissenting opinion that "any agreement that provided for contractual set-off is categorically excluded from the personal property security legislation of the common law provinces": para 41. He commented at para 42 that:

> Given the functional approach to personal property security arrangements in these statutes, it is difficult for me to see how any transaction that confers an interest on a creditor in a debtor's property to secure an obligation could be categorically excluded unless that type of transaction has been defined and <u>expressly excluded</u> by the legislation itself. To my knowledge, an agreement that provides for security together with a right of set-off to realize on that security is not expressly excluded in any of the common law provincial personal property security statutes. What is required by the common law provincial personal property security statutes is a decision about whether a particular contract or agreement in a given case functions as a security interest. (emphasis added)

37 In other words, a security interest is not "tainted" by the inclusion of other elements, such as its application to rent if certain conditions occur, if the deposit functions in substance as a security interest.

38 I am satisfied from the wording of Section 6 of the lease and the function of the deposit under the lease that the deposit is not a "right to payment" but functions as security for Surefire's performance of its obligations under the lease. Thus, it is a "security interest" subject to the provisions of the PPSA and not excluded by section 4(g). It is subordinate to Alignvest's perfected security interest, as well as other interests that at law enjoy priority over an unperfected security interest.

39 York submits, without evidence, that requiring it to perfect its rights in the deposit by registration would upset the efficiency of commercial and residential leasing law, as it asserts that landlords do not register anything at the Personal Property Registry when they take a deposit under the lease. As I have indicated, whether a deposit falls within the section 4(g) exclusion depends upon its character and is largely to be determined by the specific provisions of the lease. The characterization of the deposit under this lease should not be taken as determinative of the characterization of deposits

under other forms of lease, and is limited to this specific lease and the intervention of a secured creditor with a perfected security interest.

***C. Should the stay imposed by the receivership be lifted?***

40 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.

41 Guidance can be drawn from the provisions of section 69.4 of the BIA 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: *Ma, Re*, [2001] O.J. No. 1189 (Ont. C.A.).

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

43 York concedes that in order 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 Plaza Inc.* (2005), 29 C.B.R. (5th) 62 (Ont. S.C.J.) at paras 18 - 19.

44 York submits that if the stay remains in place, it would be deprived of a right under the lease that it had specifically bargained for. In that respect, the prejudice to York is no different qualitatively from that suffered by other creditors, who also will lose, in whole or part, the benefit of their contracts by reason of Surefire's insolvency. That the stay operates to deny a party a particular contractual remedy otherwise available to it is not a sufficient reasons to lift the stay.

45 York submits that it has suffered quantitatively more than other creditors, and describes the loss of its stream of income over the term of the lease and the ongoing expenses necessary to maintain the property.

46 While the magnitude of York's potential losses is substantial, absent mitigation by virtue of re-leasing the premises, that is a matter of degree in a worse-case scenario. With respect to unfairness, it must be noted that York entered into the lease with prior knowledge of Surefire's financial circumstances and the risk inherent in such a situation.

47 This is not a situation where York has not been paid ongoing rent due during the course of the receivership. Simply put, it wishes the stay to be lifted so that it can upgrade its position vis-à-vis Alignvest, despite its failure to perfect its security interest. The situation is similar to that described in *Ivaco Inc., Re* (2003), 1 C.B.R. (5th) 204 (Ont. S.C.J. [Commercial List]) at para 7, where Farley, J. refused an application to lift a stay to allow an insurer to terminate insurance policies and benefit from an unearned premium, commenting that this would give an unsecured creditor "an inappropriate leg up on the other unsecured creditors, not to mention a leg up over secured creditors with priority."

48 In the circumstances, there are no unusual or compelling reasons that would warrant lifting the stay in the receivership, and I decline to do so.

**V. Conclusion**

49 In summary, the deposit is security for obligations under the lease and not prepaid rent. It does not fall under an exclusion to the provisions of the PPSA, and as a security interest should have been perfected by registration. As it was not, it is subject to Alignvest's perfected security interest. I decline to lift the stay under the receivership to allow York to exercise its rights under the lease with respect to the deposit, as York has not established material prejudice or inequity sufficient to justify lifting the stay.

50 If the parties are unable to agree on costs, they may make written submissions on that issue.

*Application granted.*

  

**End of Document**

# TAB 7

2001 CarswellOnt 1019
Ontario Court of Appeal

Ma, Re

2001 CarswellOnt 1019, [2001] O.J. No. 1189, 104 A.C.W.S. (3d) 261, 143 O.A.C. 52, 24 C.B.R. (4th) 68

# In the Matter of the Bankruptcy of James Hoi-Pang Ma, of the City of Mississauga, in the Regional Municipality of Peel, in the Province of Ontario

James Hoi-Pang Ma (Bankrupt (Appellant)) and Toronto Dominion Bank (Applicant (Respondent))

Abella, Charron, Sharpe JJ.A.

Judgment: March 23, 2001
Judgment: April 4, 2001 (Written Reasons)
Docket: CA C34958

Proceedings: affirming (2000), 20 C.B.R. (4th) 267 (Ont. Bktcy.); affirming (2000), 19 C.B.R. (4th) 117 (Ont. Bktcy.)

Counsel: *Chi-Kun Shi*, for Appellant
*Bruce S. Batist*, for Respondent
*William J. Meyer*, *Q.C.*, for Trustee in Bankruptcy

Subject: Insolvency; Civil Practice and Procedure

APPEAL by bankrupt from order lifting stay of proceedings against bankrupt, 2000 CarswellOnt 4416, 20 C.B.R. (4th) 267 (Ont. Bktcy.).

**Endorsement. *Per curiam*:**

1 The appellant argues that when considering an application to lift a stay under s. 69.4 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B-3, the applicant is required to establish a *prima facie* case for the proposed action. *Bowles v. Barber* (1985), 60 C.B.R. (N.S.) 311 (Man. C.A.) is cited in support of this proposition. It is argued that to the extent Ontario cases such as *Arrojo Investments v. Cardamone* (1995), 33 C.B.R. (3d) 46 (Ont. Gen. Div.) apply a more lenient standard, they are inconsistent with decisions from other provinces.

2 In our view there is no requirement to establish a *prima facie* case and no inconsistency in the case law. We do not agree that *Bowles v. Barber* imposes a *prima facie* case requirement. More importantly, that requirement is not imposed by the statute. Under s. 69.4 the court may make a declaration lifting the automatic stay if it is satisfied (a) that the creditor is "likely to be materially prejudiced by [its] continued operation" or (b) "that it is equitable on other grounds to make such a declaration." The approach to be taken on s. 69.4 application was considered by Adams J. in *Re Francisco* (1995), 32 C.B.R. (3d) 29 (Ont. Bktcy.), at 29-30, a decision affirmed by this court (1996), 40 C.B.R. (3d) 77 (Ont. C.A.):

> In considering an application for leave, the function of a bankruptcy court is not to inquire into the merits of the action sought to be commenced or continued. Instead, the role is one of ensuring that sound reasons, consistent with the scheme of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B-3, exist for relieving against the otherwise automatic stay of proceedings.

3 As this passage makes clear, lifting the automatic stay is far from a routine matter. There is an onus on the applicant to establish a basis for the order within the meaning of s. 69.4. As stated in *Re Francisco*, the role of the court is to ensure that there are "sound reasons, consistent with the scheme of the *Bankruptcy and Insolvency Act*" to relieve against

  

the automatic stay. While the test is not whether there is a *prima facie* case, that does not, in our view, preclude any consideration of the merits of the proposed action where relevant to the issue of whether there are "sound reasons" for lifting the stay. For example, if it were apparent that the proposed action had little prospect of success, it would be difficult to find that there were sound reasons for lifting the stay.

4 In the case before us, Justice Lane found that the Deputy Registrar was correct in finding that the applicant would suffer sufficient prejudice to justify an order lifting the stay. This finding accords with s. 69.4 and is supported by the record. We see no basis for interfering with his conclusion. The appeal is therefore dismissed with costs.

*Appeal dismissed.*

# TAB 8

2012 ABQB 539
Alberta Court of Queen's Bench

Baytex Energy Ltd. v. MNP Ltd.

2012 CarswellAlta 1500, 2012 ABQB 539, [2012] A.W.L.D. 5023, 220 A.C.W.S. (3d) 15

# Baytex Energy Ltd., Applicant and MNP Ltd. as Receiver and Manager of Sterling Eagle Petroleum Corporation, Respondent

J. Strekaf J.

Heard: July 18, 2012
Judgment: August 29, 2012
Docket: Calgary 1101-1011

Counsel: Josef G.A. Kruger, Q.C., Adrienne Wong, for Applicant
C. Russell, Q.C., for Respondent

Subject: Corporate and Commercial; Civil Practice and Procedure; Contracts; Insolvency; Natural Resources

APPLICATION by creditor for order confirming validity of notices of abandonment issued to debtor through receiver/manager.

***J. Strekaf J.*:**

**1. Introduction**

1 Baytex Energy Ltd applied to lift the stay of proceedings in the receivership of Sterling Eagle Petroleum Corporation so that it could apply for an order compelling MNP Ltd, in its capacity as Receiver and Manager of Sterling, to accept the transfer of certain wells in the Darwin area of Alberta. MNP does not oppose the lifting of the stay effective May 18, 2012 for the purpose of the bringing of this application and that order was granted by me at the outset of the hearing of the application.

**2. Relevant Facts**

2 Baytex and Sterling were parties to two agreements (a Farm-in and Option Agreement dated October 11, 1995 and a Pooling Farm-out and Participation Agreement dated February 26, 1996), both of which incorporated the CAPL Operating Procedure. Baytex was the operator of the lands governed by the two agreements. Baytex and Sterling each had a 50 percent working interest in various producing wells and in four non-producing wells that had been drilled pursuant to the said agreements.

3 Sterling was placed into receivership pursuant to a Consent Receivership Order dated June 27, 2011, which appointed MNP as the Receiver and Manager. The Receivership Order contained the usual terms including a provision that all rights and remedies against Sterling were stayed and suspended except with the written consent of the Receiver or leave of the Court.

4 The Receivership Order was brought to the attention of Baytex on August 31, 2011.

5 Article XII of the CAPL Operating Procedure sets out the procedure for the abandonment of wells. It states in part:

  

> 1201 PROCEDURE FOR ABANDONMENT - If a party proposes to abandon a well on the joint lands ... it shall give notice of the proposed abandonment to the other parties. Within thirty (30) days of receipt of the notice, each of the other parties shall elect, by notice to the other parties, whether it wishes to take over the well. Failure by a party to respond to such notice shall be deemed to be an election by that party to take over, or participate in the takeover, of the well.

6 On January 24, 2012 Baytex delivered to MNP four notices of proposed abandonment of the four wells pursuant to the two agreements which were addressed to Sterling care of MNP. Attached to each Abandonment Notice were authorizations for expenditures (AFEs) setting out the costs of abandonment. The AFEs indicated that the total funds required from each of Baytex and Sterling to abandon the four wells was $145,479.

7 Baytex received an inquiry regarding the Abandonment Notices from a representative of the Receiver on February 14, 2012.

8 On February 29, 2012, Baytex sent letters to Sterling care of MNP advising that the failure to respond to the Abandonment Notices with the 30 day period set forth in the CAPL Operating Procedure was deemed an election to take over the wells.

9 On March 6, 2012, the Receiver sent a letter to Baytex advising that the Receivership Order restrained parties from taking proceedings against Sterling or from exercising any contractual or other rights or remedies and refused to accept the transfer of the wells.

10 In addition to the wells for which Abandonment Notices were delivered, there are five producing wells on the lands governed by the 1996 Agreement which have been producing gas and generating revenues which were paid to the Receiver prior to and since the issuance of the Abandonment Notices.

11 On May 1, 2012, a notice was sent by counsel for MNP as Receiver and Manager to Baytex's counsel advising that the Receiver would consent to the lifting of the stay in the Receivership Order so that Baytex could proceed to issue Abandonment Notices under the CAPL Operating Procedure with respect to the four wells.

**3. Issues**

12 The principle issue to be determined on this application is whether Baytex was restrained from issuing the Notices of Abandonment by virtue of the Receivership Order. If not, is the Receiver entitled to relief from forfeiture, or should the Court direct the Receiver to accept transfer of the wells effective February 29, 2012.

**4. Positions of the Parties**

13 Baytex argues that a Receiver is obliged to adopt or disclaim executory contracts of a debtor company within a reasonable period of time. As seven months had passed since the Receiver was appointed during which time the Receiver received and accepted monies from wells produced under the 1996 Agreement and took no steps to disclaim either agreement, the Receiver elected to affirm the agreements and, as such, was subject to the provisions of the Agreements when the Notices of Abandonment were received. As a result, MNP, on behalf of Sterling, elected to take over the well by failing to respond within the 30 day deadline.

14 MNP's position is that the delivery of the Notices of Abandonment were ineffective as they were issued without leave of the Court or the consent of the Receiver and Manager and were contrary to the stay prohibiting the exercise of rights and remedies against Sterling in paragraph 9 of the Receivership Order and that it would not be appropriate for the Court to grant leave to authorize the issuance of the Notices *nunc pro tunc* .

15 MNP does not dispute that a receiver is required to disclaim or affirm an executory contract within a reasonable period of time and even acknowledges that it may have incurred contractual liabilities as a consequence of accepting

 

benefits under the 1996 Agreement. However, it submits that such implications do not have the effect of automatically overriding the express language in paragraph 9 of the Order requiring consent or leave before any rights are exercised against Sterling.

**5. Analysis**

16 It is the terms of the Receivership Order that govern the affairs of Sterling. Paragraph 9 of the Receivership Order states:

> All rights and remedies (including, without limitation, set-off rights) against the Debtor, the Receiver, or affecting the Property, are hereby stayed and suspended except with the written consent of the Receiver of leave of this Court, provided that nothing in this paragraph shall (i) empower the Receiver or the Debtor to carry on any business which the Debtor is not lawfully entitled to carry on, (ii) exempt the Receiver or the Debtor from compliance with statutory or regulatory provision relating to health, safety or environment, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

17 The issue on this application is whether the delivery of a Notice of Abandonment which has the effect of triggering an obligation to respond within 30 days or be deemed to elect to takeover the well constitutes the exercise of a "right and remedy" within the meaning of paragraph 9 of the Order.

18 Baytex argues that it was not exercising a contractual right when it issued the Abandonment Notices but that it was complying with its duties as a well operator pursuant to the provision of the *Oil and Gas Conservation Act*, RSA 2000, c 0-6. Section 27 states that a licensee shall abandon a well when directed by the Energy Resources Conservation Board (ERCB) or required by regulation. Section 30 provides that the well suspension costs, abandonment costs and reclamation costs are to be paid by the working interest participants in accordance with their proportionate share in the well. The attachments to the Notices of Abandonment state that the wells were on the ERCB suspension list and that it would be more cost effective to fully abandon the welbore than to suspend. This language suggests that the decision to abandon rather than suspend was a commercial rather than a regulatory decision. In any event, at issue is not whether the abandonment of the wells was required by the ERCB but Baytex's purported exercise of its contractual right to compel Sterling to take over the wells by issuing a Notice Of Abandonment in accordance with the CAPL Operating Procedure.

19 The circumstances are analogous to those in *Skyservice Airlines Inc., Re*, 2011 ONSC 703, 78 C.B.R. (5th) 193 (Ont. S.C.J. [Commercial List]) at paragraphs 77 - 89 where Morawetz J concluded that actions taken to terminate an aircraft lease constituted the exercise of a right that was contrary to a stay granted in a receivership action. Similarly, delivery of the Notices of Abandonment constituted the exercise of a contractual right against Sterling. As it was done without prior consent of MNP or leave of the Court as required by the Receivership Order, it is of no effect.

20 I am further of the view that it would not be appropriate to lift the stay and grant leave *nunc pro tunc* to authorize the issuance of the Notices of Abandonment as of January 24, 2012. Doing so would prejudice Sterling who would become obligated to assume Baytex's fifty per cent share of the well abandonment costs in the amount of $145,479 as a result of a notice issued contrary to the stay. As MNP has acknowledged that it would consent to the issuance of the Notices of Abandonment, Baytex will be at liberty to reissue the same. I see no prejudice to Baytex, beyond depriving it of the ability to transfer its share of the well abandonment costs to Sterling despite its failure to comply with the requirements of the Receivership Order. There is no evidence that Baytex was prevented from seeking consent of the MNP or Court authorization prior to issuing the Notices. The circumstances are distinguishable from those in *Brookside Capital Partners Inc. v. Kodiak Energy Services Ltd. (Receiver-Manager of)* (2006), 2006 ABQB 572, 25 C.B.R. (5th) 273 (Alta. Q.B.).

21 In the circumstances, it is not necessary to consider the other issues raised on this application.

22 Baytex's application is dismissed.

*Application dismissed.*

  

**End of Document**