April 9th, 2009

Extraordinary times justify extraordinary remedies: interim measures under the AIPN standard form operating agreement

By Nigel Bankes

Cases Considered:

BG International Limited v. Canadian Superior Energy Inc., 2009 ABCA 127

BG International Limited v. Canadian Superior Energy Inc., 2009 ABCA 73 (Justice Carole Conrad, chambers)

This is the first Alberta and indeed Canadian decision to consider the standard form operating agreement of the Association of International Petroleum Negotiators (AIPN) (2002). The Court of Appeal has upheld the order of Justice Barbara Romaine [unreported, February 11, 2009] sitting in chambers to issue an interim receivership order with respect to Canadian Superior Energy Inc's (CSEI) interest in an exploration property in the offshore area of Trinidad and Tobago. In the course of doing so the order effected a change of operatorship and provided significant interim relief to BG International (BGI) in order to preserve the jointly owned property and to ensure continued drilling and testing operations.

The facts

The case involved a property located off the coast of Trinidad and Tobago. There was a semi-submersible rig on site and CSEI was the operator under the AIPN 2002 form. BGI paid its share of monthly invoices from CSEI but the monies were not forwarded to the rig operator and owner, Maersk. Maersk began default proceedings under the drilling contract with the risk that drilling would be suspended and the rig moved off-site. BGI in turn alleged default under the operating agreement and commenced arbitration proceedings as provided for under that agreement before the London Court of International Arbitration. The alleged defaults included CSEI's failure to pay its share of expenses and commingling of monies in breach of Article 4.8 (presumably Alternative 1) of the AIPN form. BGI also commenced an application in the Alberta Court of Queen's Bench to be heard on an expedited basis for a partial receivership order (relating solely to this project).

The Court, relying on its inherent jurisdiction, granted the Order as well as certain ancillary orders designed to provide security for monies that BGI would advance to allow the operation to continue. In addition, the order had the effect of displacing CSEI as operator. The chambers judge granted the order.

The appeal

On appeal, the Court of Appeal refused to interfere with the decision of the chamber's judge. The Court reasoned that the standard of review for the exercise of such a discretionary power (based on the inherent jurisdiction of the court and that it be "just or convenient" in the circumstances (at para. 17) and *Judicature Act*, R.S.A. 2000, c. J-2, s.13(2)) was an error of law or wholly unreasonable exercise of discretion (at para. 6).

That said, the Court was at pains to emphasise that the appointment of a receiver to protect property pending the outcome of an arbitration was an extraordinary remedy (at para. 17):

> … the appointment of a receiver is a remedy that should not be lightly granted. The chambers judge on such an application should carefully explore whether there are other remedies, short of a receivership, that could serve to protect the interests of the applicant. For example, the order might be granted but stayed for, say, 48 hours to allow the company to cure deficiencies, propose alternatives, or clarify the record.

In the end, and notwithstanding the risk of serious damage to Canadian Superior arising from the mere fact of granting the receivership order, the Court of Appeal held that it was not an unreasonable exercise of discretion. It was in the interest of all parties "that the rig stay on the well and that the well be flow tested" (at para. 18) and this was an effective way of allowing that to happen.

Comment

I will comment in more detail on three matters: (1) the availability of interim relief, (2) replacement of operator, and (3) security for BGI's advances.

The availability of interim relief

Article 18 of the AIPN operating agreement [and my references here are to the standard form, I have no knowledge of how the parties might have amended the terms of the AIPN except as indicated in the judgement] expresses the strong preference that all disputes not resolved through ADR shall be "exclusively and definitively resolved through final and binding arbitration". However, clause 18.2C(10)[9 in the judgement] also provides for an application to a court for interim measures as stipulated below.

> Interim Measures. [Notwithstanding any requirements for alternative dispute resolution procedures as set forth in Articles 18(B) and (C)], [a]ny party to the Dispute may apply to a court for interim measures (i) prior to the constitution of the arbitral tribunal (and thereafter as necessary to enforce the arbitral tribunal's rulings); or (ii) in the absence of the jurisdiction of the arbitral tribunal to rule on interim measures in a given jurisdiction. The Parties agree that seeking and obtaining such interim measures shall not waive the right to arbitration. The

> arbitrators (or in an emergency the presiding arbitrator acting alone in the event one or more of the other arbitrators is unable to be involved in a timely fashion) may grant interim measures including injunctions, attachments and conservation orders in appropriate circumstances, which measures may be immediately enforced by court order. Hearings on requests for interim measures may be held in person, by telephone, by video conference or by other means that permit the parties to the Dispute to present evidence and arguments.

In this case relief was sought pending hearing of the arbitration (at para. 5). The Court of Appeal commented that the reference in the last sentence to electronic hearings did not preclude court applications which were ex parte or effectively ex parte. (It was contended that the original application was effectively heard ex parte because although notice was provided the matter was brought on very quickly and Justice Romaine denied CSEI's application for an adjournment to allow it to file affidavit evidence (at paras 5 & 9)). The Court noted that it was not uncommon for receivers to be appointed on an ex parte basis and there were remedies available to review or withdraw the order (at para. 9).

Replacement of operator

The interim receivership order provides the receiver with extensive powers to operate the property but also provides that "The Receiver is directed to retain BGI to assist it in carrying out its duties" under the order. Accordingly, the order effected a change of operator without going through the change of operator provisions of the AIPN (Article 4) which, as the Court acknowledges, would have taken at least 30 days (at para. 14). Given the difficulty (and the case law attests to this) in triggering the replacement of operator provisions of the CAPL agreements (see the cases including *Norcen Energy Resources Ltd v. Oakwood Petroleums Ltd* (1988), 63 Alta. L.R. (2d) 361 (QB); *Rimoil Corporation v. Hexagon Gas Ltd*, unreported May 5, 1989 (Alta. QB); *Mutual Oil and Gas Ltd v. DSWK Holdings Ltd* (unreported judgement of Justice Kenny, January 5, 1996, rev'd on appeal [1996] AJ 582) (dealing with the challenge provision under CAPL) and *Kaiser Francis Oil Company of Canada v. Bearspaw Petroleum Ltd.* (1999) 240 AR 59 (QB) (dealing with a pre-CAPL agreement)) this approach to the problem has obvious merit from the perspective of the aggrieved joint operator that wants an effective remedy.

CSEI is now under the protection of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). It remains to be seen if this interim order will continue. The Court of Appeal warned that its dismissal of the appeal was not (at para. 20) "intended to limit the powers of the chambers judge or the *CCAA* case management judge. The receivership was to be "interim" only, and it has an internal mechanism for review. The Queen's Bench retains the ability to revoke or amend the order as circumstances dictate."

Security for BGI's advances

The default provisions of the AIPN agreement are quite different from anything in the CAPL form. In particular, Article 8 of AIPN contemplates that when a notice of default is delivered and where the default is not rectified the non-defaulting parties are required cover the shortfall. BGI acknowledged that it had this responsibility and tendered the relevant monies (US$47 million) but sought to do so with the benefit of a Receiver's Certificate which provided BGI with a charge on CSEI's assets, second only to the charge claimed by CSEI's principal banker up to the amount of Cdn $14 million.

CSEI argued that this strategy effectively allowed BGI to put itself in a better position than it would have been in under the terms of agreement. The Court was clearly not concerned about this. It noted (at para. 13) that clause 8.4(H) of the AIPN [referred to as Article 18 in the Court's judgement] agreement stipulated that the remedies provided by the agreement are in addition to any that might be available to the non-defaulting parties "whether at law, in equity or otherwise" but it also suggested that the certificates would not prejudice the interest of third parties:

> The enhanced security collaterally obtained by [BGI] through the use of receiver's certificates has not been shown on this record to create any serious prejudice to [CSEI]. After all, it is [CSEI] that is in default, and [BGI] is prepared to advance significant sums to cure that default, even if it is required to do so by the contract. The chambers judge found that [CSEI] had been commingling joint venture funds, and that [BGI] had a reasonable concern about the protection of future advances. Unlike in most receivership cases, the funds advanced under this enhanced security are to be used to pay other creditors, and would not further subordinate their interests. [at para. 13]

The last sentence may well follow for creditors in relation to this particular property. It is not clear to me that the effect of the certificate is equally neutral in relation to other creditors of CSEI.

Conclusions

This is clearly an unusual case and an extraordinary remedy. The stakes were high and this was an expensive operation. The matter was urgent given that a rig was on location. It will not be every case in which a joint operator, confronted with a defaulting operator, will be able to do an end-run around the terms of the agreement (whether AIPN or CAPL) and secure effective relief through the appointment of a receiver. This remedy will remain an exceptional remedy. However, given the difficulty that faces a joint operator in getting rid of an insolvent joint operator (especially one under *CCAA* protection), it will not be surprising if tough times in the oilpatch and concerns about commingling operators (see my blog of *Brookfield Bridge Lending Fund Inc. v. Vanquish Oil and Gas Corporation*, 2008 ABQB 444) trigger similar applications, even if the circumstances are not quite as compelling. If that happens, the Court will need to come up with something with a little more bite and structure than "just and convenient" since

decisions once made by a chambers judge in expedited circumstances and typically without reasons will be very difficult to overturn on appeal given the applicable deferential standard of review. See *Kerr on Receivers* (17th ed, 1989), esp. c.1, principles.