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Justice Romaine Weighs in on 'lifting the stay' in the Context of Replacement of Operator Provisions in Oil and Gas Joint Venture Agreements

By: Nigel Bankes

Case Commented On: *Alberta Energy Regulator v Lexin Resources Ltd*, 2019 ABQB 23 (CanLII)

In a crisp and well-reasoned judgment, Justice Barbara Romaine, one of the acknowledged bankruptcy experts on the Court of Queen's Bench, has weighed in on the question of 'lifting the stay' in the context of replacement of operator provisions in joint venture agreements. While she does not rule out lifting the stay in appropriate cases, Justice Romaine emphasizes that this is an exceptional remedy. As such the decision may serve to curb what might have been a growing enthusiasm on the part of non-operators to think that it was easy to lift a stay.

Lexin was put into receivership in March 2017 and the receiver has been marketing Lexin's assets, including wells and facilities since that time (indicating that Lexin is the operator of these wells and facilities). Prior to the receivership the Alberta Energy Regulator (AER) had ordered three gas processing facilities that were all co-owned by Lexin and ExxonMobil shut-in. Midstream purchased these and other assets from ExxonMobil in a deal that closed in February 2018 and in May 2018, Midtsream filed its application to lift the stay. The application initially applied to the facilities and wells, but at the hearing, Midsteam confined itself to the facilities. At the time of the hearing the AER had yet to approve the transfer of the well licences from ExxonMobil to Midstream.

The facilities were all governed by the 1999 form of the Petroleum Joint Venture Association's (PJVA) Construction, Ownership and Operation Agreement (CO & O Agreement). The Agreement provides for replacement of an operator *inter alia* where the operator is put into receivership. Justice Romaine notes (at paras 26 and 33) that such a clause, while valid as between the parties, is void as against the receiver: *Re Knechtel Furniture Ltd* (1985), 56 CBR (NS) 258 (Ont SC); Ex parte *Mackay* (1873), 8 Ch App 643.

Justice Romaine began by summarizing the test for lifting the stay set out in her own earlier judgment in *Alignvest Private Debt Ltd v Surefire Industries Ltd*, 2015 ABQB 148 (CanLII) at paras 40 and 43. The test "focuses on the totality of circumstances and the relative prejudice to the parties involved in the receivership." She went on to summarize guidance from some of the leading cases (at paras 15 – 17):

- The Court should be satisfied that the party applying to lift the stay is likely to be materially prejudiced by the stay or that it would be equitable to lift the stay on other grounds. The burden is on the applicant: *Re Ma*, 2001 CanLII 24076 (ON CA)

- Lifting the stay is not routine: there must be sound reasons to relieve against the stay: *Re Ma*, at para 3.
- Material prejudice requires that the party applying to lift the stay must show that it would be treated differently or some way unfairly or would suffer worse harm than other creditors if the stay is not lifted: *Golden Griddle Corp v Fort Erie Truck & Travel Place Inc* (2005), 2005 CanLII 81263 (ON SC) at paras 18-19. The mere fact that a party is not entitled to exercise a contractual right for which it has bargained is not a sufficient reason to lift the stay. In that respect, the prejudice to the applicant is no different qualitatively from that suffered by other creditors, who also lose, in whole or part, the benefit of their contracts by reason of the debtor's insolvency.

Justice Romaine then discussed two recent Alberta decisions dealing with lifting the stay in the context of the replacement of operator provisions of oil and gas agreements: *Bank of Montreal v Bumper Development Corp*, 2016 ABQB 363 (CanLII) and *National Bank of Canada v Scollard Energy Inc*, 2018 ABQB 126 (CanLII). ABlawg has comments on both of those decisions here and here.

Applying the above tests to the facts, Justice Romaine concluded (at para 47) that "the prejudice to the Receiver and other creditors of Lexin if the stay is lifted outweighs the prejudice, if any, that would be suffered by Midstream if the stay is not lifted, and there are no equitable grounds that would otherwise justify the lifting of the stay."

On the one hand, Justice Romaine suggested that Midstream would suffer little prejudice were the stay to be maintained. She noted that the replacement of operator provision was principally designed to protect the non-operator from the risk of an insolvent operator drawing down a commingled account (for a post on this issue see here), but this risk (at para 35) "ceases to exist when a receiver is appointed." Furthermore, Midstream acquired its interest in the property fully understanding the situation and it could hardly argue that it was being frustrated in its efforts to restart the plants when the AER had yet to approve the necessary transfers of licences.
On the other hand, Justice Romaine concluded that the prejudice to the Receiver (at para 37) "is more significant". First, were the stay to be lifted the Receiver would be subject to (at para 37) "significant capital and operating expenditures which it cannot realistically fund." Second, (at para 38) lifting the stay would complicate the on-going sales procedure and reduce the number of prospective purchasers. Third, if the stay were to be lifted Midstream would actually get a leg-up, an advantage that it would not be entitled to were the property not in receivership. The reasons for this were as follows (at paras 40 – 44):

> [40] If the stay is not lifted, a purchaser of two of the three Facilities, the Hooker Gas Gathering System and the Hooker East Compression and Gas Gathering System, would have a contractual right to replace Lexin as operator of these Facilities.
>
> [41] While clause 303(d) of the 1999 PJVA provides that the Operator shall cease to be operator if it ceases to be an owner, clause 304(c) states that:

> Notwithstanding subclauses 204(g), 304(a) and (b), if there are only two (2) Owners and Operator resigns or otherwise ceases to be Operator, the Owner who was not Operator previously shall automatically become Operator effective the date the previous Operator ceases to be Operator, 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. (emphasis added by Justice Romaine)

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

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

[44] If the stay is lifted prior to the conclusion of the sales process and Lexin is replaced as operator, Lexin and the eventual purchaser would not be able to rely on these operatorship rights.

In sum (at para 47) "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."

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