December 21, 2015

Unpaid AFE Amounts Constitute Liquidated Demands With No Right of Set-Off Under the 1990 CAPL Operating Procedure

By: Nigel Bankes

Case Commented On: *Talisman Energy Inc v Questerre Energy Corporation*, 2015 ABQB 775 (MC)

This decision of Master Prowse offers an interesting example of careful parsing of the pleadings, and the agreed and contested facts, with a view to identifying possible issues for which summary judgment may be granted - while leaving the factually contested issues for a later trial. As in *SemCAMS ULC v Blaze Energy Ltd.* 2015 ABQB 218, (and see my post on that decision here) contractual language deeming billings to be liquidated demands and the "no set-off" provisions commonly found in oil and gas and other commercial agreements were important elements in the decision.

The precise legal relationship between Talisman (T) and Questerre (Q) as it emerges from Master Prowse's judgment is less than clear. There is, for example, reference to a farmout agreement as well as joint operations, and perhaps the arrangement is therefore some form of farmout and participation agreement or alternatively the operations in questions are occurring on joint lands post-earning. But either way, the terms of the farmout seem irrelevant because, whether described as an earning operation under a farmout agreement, or as something else, the drilling operations in question here were joint operations within the meaning of the 1990 version of the CAPL (Canadian Association of Petroleum Landmen) operating procedure, and the parties seem to have been in agreement that their rights and obligations were covered by the terms of this agreement (hereafter 1990 CAPL).

Under the terms of the 1990 CAPL, T provided Q with an Independent Operations Notice (ION) and an attached Authorization for Expenditure (AFE) to drill the Fortierville well on the basis that Q would be responsible for 25% of the cost. Consistent with CAPL 1990 (see CAPL 1990, Article IX, Casing Point Election) the AFE did not cover completion. Q indicated that it would only participate in the operation if the operation included completion and a number of other add-ons including microseismic monitoring and a comprehensive evaluation program. While T indicated that it did intend to complete the well (and might need to issue a supplemental AFE), at no point did T actually issue a revised AFE. Q subsequently executed the unmodified AFE. T drilled the Fortierville well and a second well, the Ste Gertrude well, on the same conditions (i.e. an AFE that referred only to drilling but with T's assurance that T would proceed to completion). Having drilled the wells in 2010, T decided to defer completion until 2011. In May 2011 T sent Q IONs and AFEs for the completion operations on both wells. T subsequently withdrew them and proceeded to carry out the completion operation with unexecuted AFEs and IONs.

In its action T sought to recover from Q 25% of the costs of the drilling and completion operations for the two wells. Q resisted and in response filed a counterclaim apparently to the effect that T's promise to complete the two wells amounted to a misrepresentation and perhaps also sought some sort of equitable set-off although, as Master Prowse notes (at para 37), "Questerre neither pleads nor argues equitable set-off".

In this application T, relying on the terms of cl. 505(b)(iv) of the CAPL 1990 sought summary judgement for Q's 25% share of the costs. That clause (with Master Prowse's underlining added) provides as follows:

> [The Operator may] maintain an action or actions for such unpaid amounts and interest thereon on a continuing basis as such amounts are payable, but not paid by such defaulting Joint-Operator, as if the obligation to pay such amounts and the interest thereon were liquidated demands due and payable on the relevant dates such amounts were due to be paid, <u>without any resort of such Joint-Operator to set-off or counterclaim</u> (emphasis added by Master Prowse).

On this basis Master Prowse was prepared to conclude that Q was liable for 25% of the AFE drilling costs (i.e. up to casing point election). He concluded that there was a dispute as to liability for completion costs since T did not follow the CAPL procedure on this point. Liability for those costs would require a trial (at paras 8 & 11).

As for Q's counterclaim (which was perhaps (at para 28) a basis for "the remedy of rescission, which will sweep away the farmout agreement and the 'no set-off' clause contained in that agreement"), Master Prowse concluded that it was doomed to failure because the representation relied on (the promise of intention to complete) did not fit the elements of a pre-contractual misrepresentation which might have justified rescission. And if there could be no rescission, then Q must be bound by the "no counterclaim as a defence to the operator's demand" language of the CAPL agreement. Master Prowse did acknowledge, however, that Q might in fact have a counterclaim (at para 35) for breach of an obligation to complete (although *quaere* whether even this is true since elsewhere the judgment (at para 10) suggests that T did in fact complete the wells), but this would be determined by trial; but until then it could not, as I understand Master Prowse, be used to resist the liquidated demand claim for 25% of the drilling costs of the two wells.