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Lifting the Stay to Allow the CAPL Operator Replacement Provisions to Run their Course

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Case Commented On: *Firenze Energy Ltd v Scollard Energy Ltd*, 2018 ABQB 126 (CanLII)

In this decision Justice Corina Dario granted Firenze's application to lift a stay of proceedings imposed as part of a receivership order pertaining to Scollard in order to allow Firenze to issue a notice or notices with respect to the replacement of Scollard as operator of a number of oil and gas properties subject to the 2007 CAPL Operating Procedure. This decision, together with Justice Macleod's earlier decision in *Bank of Montreal v Bumper Development Corp*, 2016 ABQB 363 (CanLII) (commented on here), calls into question the proposition that it will be difficult to replace an operator under the CAPL operating agreements once a receivership order is in place.

Scollard and Firenze held working interests in a number of properties. The relationship between them in each case was governed by the 2007 CAPL Operating Procedure and in each case Scollard was the operator. Scollard was placed in receivership in September 2017 and since then the Court appointed receiver, FTI, had been marketing Scollard's interest in the assets. The receivership order contained the standard clause to the effect 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…".

The 2007 CAPL Operating Procedure addresses the appointment and replacement of an operator in clause 2. Clause 2 is a complex clause covering three pages of text. It appears from the judgment that Firenze's application was initially an application for leave to allow it to serve a notice under clause 2.02A(a) of the procedure. This sub-clause deals with the "immediate replacement" of the operator on a number of grounds including paragraph (a) which deals with the situation where "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…". The application of clause 2.02A is triggered by a notice from a non-operator specifying the basis for the replacement. Hence, Firenze's application was initially simply an application for leave to allow it to initiate "immediate replacement" based on insolvency. If that were to happen the effect of the notice (subject to some exceptions) is to cause the party with the largest working interest to act as interim operator.

However, in addition to this clause, Justice Dario (and apparently—see at para 19—of her own motion "[a]lthough not initially raised by counsel") identified clauses 2.02A(g), 2.06 and 2.9 as relevant to the application before her. Clause 2.02A(g) is part of the same clause headed "immediate replacement" as is the insolvency provision noted above. Paragraph (g) however applies in the scenario in which "the Operator assigns or attempts to assign its general powers and responsibilities of supervision and management as Operator".

Clause 2.06 deals with three scenarios leading to the "appointment of a new Operator". The first scenario is that of immediate replacement under clause 2.02. Evidently clause 2.06 in this case serves to regularize the interim operatorship (or to agree on another alternative) resulting from the application of clause 2.02A. The second scenario is the situation in which the Operator gives notice of its intention to resign because of a disposition of all or a portion of its working interest, and the third scenario is where the operator indicates that it will resign for other, non-disposition-related, reasons. Clause 2.06 was relevant in Justice Dario's opinion because the receiver was in receipt of a bid from a third party (the "Superior Bidder") for Scollard's assets apparently (at para 4) premised on it being appointed as the Operator of the Facilities. That premise triggered the relevance of clause 2.09 of the Procedure which provides that "Clause 2.06 will apply to the appointment of a successor Operator if the Operator wishes an assignee that is not its Affiliate to succeed it as Operator after its disposition of a Working Interest to that assignee ...".

Once clause 2.06 is triggered the general rule is that the successor Operator will be appointed by a vote of at least two parties with a working interest of more than 50%. However, clause 2.06C provides that if there are only two parties to the Operating Agreement the non-operator is entitled to become the Operator provided that it holds more than a 40% Working Interest "if the appointment is because of the Operator's disposition of its Working Interest".

In sum, Justice Dario was clearly of the opinion that any disposition by the receiver must inevitably trigger clauses 2.02A(g), 2.06 and 2.09 even if the receiver had yet to provide the requisite notice under clause 2.06A of notice of intention to resign because of a disposition by the Operator of its working interest. Furthermore, it followed from clause 2.09 that the receiver was not entitled to market the properties holding out that the purchaser would be entitled to assume the operatorship.

With this background Justice Dario turned to the question of whether the stay should be lifted. That analysis proceeded on the understanding (at para 11) that a desire to enforce a contractual right is not itself sufficient ground for lifting the stay.

Justice Dario first examined the situation with respect to clause 2.02A(a). She noted that while the clause was valid as between the parties it could not be relied upon if it might cause (at para 12) a "distribution of the debtor's assets [that] will be different than the bankruptcy law permits". *Quaere* whether that is actually the result of triggering immediate replacement under this clause. After all, as Justice Dario herself observes at the end of her judgment, while (at para 56) "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 ... the Receiver takes no greater rights than the debtor".

In any event, lifting a stay is not routine. The test for lifting a stay as laid out by Justice Romaine in *Alignvest Private Debt Ltd v Surefire Industries Ltd*, [2015 ABQB 148 (CanLII)] at para 40 (and adopted here by Justice Dario at para 13) "focuses on the totality of the circumstances and the relative prejudice to the parties involved in the receivership" and (at para 41 of *Alignvest*) "[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". In the end (at para 45) Justice Dario concluded that Firenze had not met this burden with respect to clause 2.02A(a).

That was not the end of the matter however since Justice Dario found that Firenze could discharge the burden with respect to an application to lift the stay pursuant to clauses 2.06, 2.09 and 2.02A(g) rather than 2.02A(a). Since Firenze owned a 50% interest in all of the properties except four, clauses 2.06 and 2.09 entitled Firenze to become the operator. The receiver could not transfer a right to the operatorship since, if it purported to do so (at para 21), "the Receiver would be conveying more than the debtor had the right to convey before the receivership". This was sufficient reason for Justice Dario to lift the stay to allow clause 2.06 to operate. Furthermore, Justice Dario also concluded that the stay should be lifted to allow Firenze to trigger clause 2.02A(g) given (at para 31) "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 ...".

In concluding that it was appropriate to lift the stay, Justice Dario followed Justice Mcleod's judgment in *Bumper* in which he had distinguished the older decision in *Norcen Energy Resources Ltd v Oakwood Petroleums Ltd*, 63 Alta LR (2d) 361, [1988 CanLII 3560 (AB QB)] (in which the Court had declined to lift the stay on the basis that *Norcen* involved a reorganization under the *Companies' Creditors Arrangements Act*, [RSC 1985 c C-36] (*CCAA*)), whereas the case before him did not. Here, the purpose of the receivership was to realize the value of Scollard's assets and not to allow the corporation to recuperate and continue in business. In response to this line of reasoning, counsel for the receiver indicated that this might lead the receiver to pursue a *CCAA* application in order to rely more directly on *Norcen*. Justice Dario however suggested that this would hardly be likely to improve the receiver's position. After all, the power to maintain or lift the stay was still discretionary (i.e. one could not read *Norcen* as authority for the proposition that an application to lift a stay should always be denied) and in this case any *CCAA* filing (at para 34)

> 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.

In the end therefore Justice Dario agreed to lift the stay with respect to all of the jointly owned properties except those with respect to which Firenze did not have a greater than 40% working interest. Justice Dario excepted these properties notwithstanding the concerns previously

expressed with respect to (at para 42) "the method by which the Receiver marketed the Facilities despite Firenze's rights upon Scollard's assignment".

Justice Dario's concluding observations merit quoting in full (at paras 46-47):

> 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.
>
> 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.

This conclusion seems fully justified. If the CAPL procedure does not permit the operator to assign the operatorship and thus does not treat the operatorship as part of the property of the operator (and the agreement clearly does neither) then it follows that the non-operator, in the appropriate circumstances outlined in the agreement, should be able to trigger the replacement of operator provisions in the CAPL procedure. And given that in some cases these provisions effectively operate as of right it seems entirely appropriate to grant a stay to allow these provisions to run their course before the receiver completes any sale of an operator's working interest. After all, a receiver can have no greater rights with respect to the property than the debtor.

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