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Worrying About Reclamation and Abandonment Obligations in the Context of Property Assignment Consents

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Case commented on: *Canadian Natural Resources Limited v Harvest Operations Corp*, 2023 ABKB 62 (CanLII)

This decision is principally about when a court can or should grant partial summary judgment. For that reason alone, we anticipate that it will be appealed. But the underlying concern that led to this litigation was (and still is) the decision of Canadian Natural Resources Limited (CNRL) to contest assignments pursuant to a purchase and sale agreement (PSA) between Harvest Operations as the vendor and Spoke Resources as the purchaser. CNRL and Harvest were parties to some 170 agreements affected by the PSA, including 133 land agreements, 30 facility agreements, and 7 service agreements.

CNRL's principal objection to the assignments was "that it had concerns relating to Spoke's ability to meet future financial obligations" (at para 6). CNRL indicated that it "was prepared to agree to the assignments if it received satisfactory evidence of Spoke's ability to meet its prospective financial obligations related to the jointly held assets", or, alternatively, Spoke might "provide CNRL with an irrevocable letter of credit in an amount equal to the expected abandonment and reclamation obligations" (at para 7). Further context for CNRL's concerns was that Spoke was only licensed by the Alberta Energy Regulator to hold licenses shortly before the PSA was concluded and that "[t]he licenses assigned to Spoke by Harvest were Spoke's first and only well licenses and Spoke had no financial or operational history" (at para 8).

This post summarizes the facts associated with this particular transaction and then examines the specific legal issues at stake in this particular set of applications. Justice Barbara Johnston's judgment takes these issues off the table (unless her judgement is appealed), partly in favour of CNRL and partly in favour of the Spoke/Harvest interests, but leaves alive the merits of CNRL's objections to the transfer. We return to that point in the conclusion and suggest that there are good reasons why CNRL will be motivated to continue to argue its case on the merits.

The Facts

Harvest and Spoke entered into the PSA in November 2020 and sought consents to the required assignments in April 2021. As noted above, CNRL objected to the assignments and declined to provide any of the requested consents. Spoke and Harvest ultimately took the view that most of the assignments did not require consent. We infer from the judgment that Spoke and Harvest completed the deal, since, on February 11, 2022, CNRL filed a statement of claim against Harvest and Spoke seeking a declaration that Harvest's assignment of the agreements was of no force and

effect and seeking damages in the amount of $367,210.60. CNRL also filed an application seeking a declaration that it is the operator under the relevant agreements. CNRL withdrew that part of its application when it became the operator by consent.
On June 2, 2022, Spoke, as Harvest's agent, issued six notices of default under five land agreements and one CO & O (Construction, Ownership and Operating) facility agreement alleging that CNRL was in default for withholding consent to the assignments, as well as a declaration that the assignments are valid and that Spoke is a valid assignee. CNRL in turn requested that the notices of default be set aside.

Finally, Harvest and Spoke brought a further application seeking a declaration, or declarations, with respect to those agreements (the "Consent Exempt Agreements") for which Harvest and Spoke contended that no consent was required. This was the principal issue that fell to be resolved by Justice Johnston on this application for partial summary judgment.

Justice Johnston considered that the issues on this application were (1) whether the Default Notices should be set aside, and (2) whether partial summary judgment should be granted for the Consent Exempt Agreements?

The Default Notices

Justice Johnston agreed with CNRL that the default notices should be set aside. The judgment does not provide us with the precise text of the default notices, but it appears that Justice Johnston considered that they were fundamentally flawed insofar as they seem to have claimed that CNRL was in breach of its obligations under the relevant agreements as an *operator*. There were two problems with this characterization.

The first problem is that, under all of the applicable agreements, the power to withhold consent was a power of each joint operator (that is to say, given the definitions in the applicable agreements, each working interest owner). An operator *qua* operator has no such power.

The second problem was that even if the power to withhold consent did accrue to an operator, at the time the default notices were issued CNRL was not the operator; indeed, "CNRL [only] became the operator approximately 15 months after the issuance of the Default Notices" (at para 16). Justice Johnston went on to state:

> [22] …. I agree with CNRL that there can be no default in the absence of being the operator.
>
> [23] I also note that neither the CAPL [Canadian Association of Petroleum Landmen] Operating Procedures nor the PJVA Agreement permit the issuance of prospective default notices. Further, under the Default Notices, an operator has 30 days to cure a default. If CNRL was not the operator, it would have no ability to attempt to cure any default.

Partial Summary Judgment

On the question of partial summary judgment, Justice Johnston, applying *Weir-Jones Technical Services Incorporated v Purolator Courier Ltd*, 2019 ABCA 49 (CanLII) at para 21 and *JBRO*

Holdings Inc v Dynasty Power Inc, 2022 ABCA 140 (CanLII) at paras 49-51, concluded that partial summary judgment was appropriate and available for 114 of the 170 agreements assigned to Spoke on the basis of language in those agreements that allegedly made CNRL's consent unnecessary.

Justice Johnston gave no less than seven supporting reasons for this general conclusion before turning to examine the language of specific categories of agreements. First, the issue was fundamentally one of contractual interpretation, and such cases are well suited to summary judgment (at para 35). Second, while the application dealt with only 114 of the agreements, the language of these agreements was materially different from that of the other remaining agreements. Furthermore, while CNRL's overall concern was the same with all of the agreements (i.e. the financial health of the assignee), CNRL would still be able to address this issue on the merits, "[i]t will simply be unable to argue the assignability of the Consent Exempt Agreements" (at para 36). Justice Johnston offered CNRL the following advice:

> The Court acknowledges concerns of CNRL regarding abandonment and reclamation obligations that it may face in the event of a company becoming financially insolvent or defunct. However, these concerns can still be raised in the trial as part of the context of the overall transaction. Indeed, the issue of the reasonableness of CNRL's conduct in declining to exercise consent can be considered as a whole. However, I do not see how this impacts the interpretation of agreements that were freely negotiated, that contemplate the absence of consent or exceptions to consent and that rely on industry agreements widely used by parties in the oil and gas industry in Alberta. Indeed, parties would be prudent to consider their abandonment and reclamation obligations but such concerns should be addressed at the time of negotiating and entering such agreements, not after the parties have agreed to the terms. (at para 36)

We think that another way to put this point is that all of the agreements in question pertain to particular properties, and the ability to withhold consent to an assignment must be answered on a case-by-case basis. None of the agreements afford a co-owner the right to object to a PSA as such.

Third, by dealing with a large number of agreements this summary application should "streamline and simplify the trial" and thus "significantly advance access to justice, and is the most proportionate, timely and cost-effective approach" (at para 38). Fourth, the issues associated with the consent exempt agreements could be readily bifurcated from the balance of the issues (at para 39). Fifth, CNRL gave little sense of any additional evidence that might be adduced at a trial on the consent exempt agreements. Sixth, there were no credibility issues or complex expert opinions to deal with. And finally, there was no dispute as to which agreements fell within the consent exempt category (at paras 37 – 41).

In applying this general framework Justice Johnston considered four different categories of consent exempt provisions.

CAPL Agreements with a 5% Rule

The first category of agreements related to the 5% rule contained in Article 24 of the CAPL Operating Agreements. The judgment quotes both the 1981 and 1990 versions of the CAPL procedure:

1981: 2402 Exceptions to Clause 2401

> Clause 2401 shall not apply in the following circumstances namely ...
> (d) an assignment, sale or disposition by a party in which the net acres being assigned, sold or otherwise disposed of by that party in the joint lands represents less than five (5%) percent of the total net acres being assigned, sold or otherwise disposed of by that party pursuant to the transaction affecting its interest in the joint lands. (at para 59)

1990: 2402 Exceptions to Clause 2401

> Clause 2401 shall not apply in the following circumstances namely ...
> (d) A disposition by a party in which the net hectares being disposed of by that party in the joint lands represent less than five percent (5%) of the total net hectares being disposed of by that party pursuant to that disposition. (at para 60)

In each case the exception is triggered if the interest in the joint lands covered by the CAPL agreement that the vendor proposes to dispose of by the PSA represents less than 5% of the total net acres included within the PSA. The purpose of the exception is presumably to avoid a scenario in which a purchaser is exposed to the dilution of a package deal involving many different assets by the exercise of right of first refusal (ROFR) rights and withholding consent rights.

Both parties seem to have agreed that the 5% exemption applies on an agreement-by-agreement basis (at para 63), but CNRL apparently took the position that "the total land in each agreement cumulatively cannot exceed 5%" (*ibid*, emphasis added). Justice Johnston rejected the cumulative approach submission for five reasons.

First, the plain and ordinary meaning of the exception supports this interpretation (at para 67). Second, "this interpretation is consistent with the CAPL Operating Procedures as a whole" (at para 68). Justice Johnston did not elaborate on this reason, but presumably it could be supported on the basis that the operating procedure is principally concerned with the properties covered by the agreement and not other collateral properties. Third, commentary to clause 2402 did not support a cumulative reading, and the commentary "which is drafted for use by the industry, provides insight into the intentions of industry when these clauses were drafted. This is some of the evidence of 'surrounding circumstances', per *Sattva*" (at para 69). Fourth, this interpretation is reasonable from a commercial perspective for the reasons described above as to the purpose of the exception and as supported by the commentary (at para 70). Fifth, there is some evidence (presumably provided by Spoke and Harvest) of other transactions that had applied the 5% on an agreement-by-agreement basis and no evidence of a pattern or practice supporting CNRL's proposed interpretation (at para 71).

The PJVA Agreements

The second category of exceptions related to the 15 facility agreements that incorporated Article IX of the 1999 Petroleum Joint Venture Association Operating Procedure (PJVA). Clause 901 of

the PJVA allows the parties to address proposed dispositions by one of three alternatives clauses: no consent, written consent that cannot unreasonably be withheld, or a ROFR in favour of the non-assigning party. However, much like the CAPL procedure, clause 902 of the PJVA creates a set of exceptions to the general rule of clause 901:

> 902. Unrestricted Disposals 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:
> ...
> (d) 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,
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> (e) 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.
>
> However, an Owner making such a disposition pursuant to Subclause (a), (b), (c), (d) or (e) of this Clause shall advise the Operator of such disposition in a timely manner, and shall comply with the provisions of Clause 905.

While CNRL suggested that there were evidentiary issues to be resolved in the application of these provisions, Justice Johnston emphasised that each party had an obligation to put its best foot forward. Furthermore, and with reference to para (e), both Article 207 of the PSA and Spoke's evidence confirmed that Harvest had disposed of its "entire interest" in the relevant facilities along with its entire interest in the wells producing into those facilities (at para 81). That was enough for Justice Johnston to conclude that this issue too was appropriate for partial summary judgment. CNRL also tried to rely on the lack of notice as per the proviso to clause 902 of the PJVA, but here CNRL was to some extent hoisted on its own petard, since the proviso stipulated for notice to the *operator* and CNRL was not the operator at the relevant time (at para 83; see discussion above).

Agreements Without a Consent Requirement

A third category of agreement had no requirement to obtain consent to an assignment, either by way of an express provision or silence. Justice Johnston found that "[i]n these cases, it is clear that the consent of CNRL is not required to assign these agreements" (at para 84).

Agreements with a Deemed Consent Provision

A fourth category of agreement was a single facility agreement that provided that consent to an assignment could be deemed where a party failed to exercise its ROFR rights. Since there was no evidence that CNRL had exercised its ROFR rights, Harvest was free to assign this agreement to Scope.

Waiver?

Finally, Justice Johnston rejected CNRL's argument to the effect that Harvest had waived its rights to rely on the exemption provisions of any of the contracts. This argument was based on the fact that Harvest admitted that it had sent out a blanket request seeking CNRL's consent to the proposed assignments with respect to all of the relevant agreements, and that it did so without examining those agreements to ascertain if CNRL's consent was contractually required. Justice Johnston ruled that this did not meet the test for waiver. Relying on *Saskatchewan River Bungalows Ltd v Maritime Life Assurance Co*, [1994] 2 SCR 490, 1994 CanLII 100 at paras 20 and 27, Justice Johnston noted that "[w]aiver requires there be full knowledge of the rights and an unequivocal and conscious intention to abandon them. Waiver can be retracted if reasonable notice is given to the party in whose favour it operates …" (at para 89). Justice Johnston found Harvest had no unequivocal and conscious intention to waive their rights (at paras 90 and 93).

Conclusions and the Way Forward

In short, Justice Johnston concluded that the Harvest/Spoke interests could not rely on certain default notices since they were directed at a party holding the office of operator. More significantly, Justice Johnston also granted partial summary judgment on the consent exemption provisions of two important standard form industry contracts, the CAPL Operating Procedure and the PJVA form. It remains to be seen whether Justice Johnston's decision to grant partial summary judgment will be appealed.

Regardless of whether this decision on summary judgment is appealed, there are still important issues to be resolved on the merits, in particular whether CNRL could (where there was no applicable exception) reasonably withhold consent to dispositions on the basis of CNRL's concerns as to Spoke's ability to meet its prospective financial obligations. While this issue may yet not go to trial, there are good reasons for thinking that CNRL will regard this as an important test case and pursue this matter.

This issue is important to CNRL because of its overall position in the orphan and inactive asset problem in Alberta. CNRL holds the most well licences for inactive wells in the province: 22,747 inactive wells, out of a total 75,846 inactive wells in Albert (based on the AER's Inactive Well Licence List for February 16, 2023, omitting water wells and training wells). Cenovus comes in second at 5,702, and just eleven companies hold more than half the stock of inactive wells in Alberta.

Because the annual orphan levy is calculated for each licensee based on their share of the total deemed liabilities of industry, CNRL's large number of licences means that CNRL pays a proportionately large share of the orphan levy – most years a number ranging from a fifth to a quarter of the levy. This gives CNRL a financial incentive to try to keep wells and other assets from being orphaned since, when a licensee goes bankrupt and the Orphan Well Association (OWA) covers the abandonment and reclamation costs, a quarter to a fifth of those costs are paid by CNRL.

This reality has pushed CNRL to get involved in trying to strengthen other parts of the liability management framework to keep assets from being orphaned. CNRL intervened in the Sequoia/Perpetual litigation, CNRL has tried to block transfers to companies that it perceives as being a risk for orphaning assets (see here, here), and CNRL's legal counsel has recently co-authored a paper gently suggesting that Alberta toughen up their regime for collecting security.

This case is another instance of CNRL looking to prevent assets from falling to the OWA and harming CNRL's pocketbook, and for these reasons it seems likely that CNRL will continue to pursue the merits of its objections to the transfers.

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