

CITATION: Dundee Oil and Gas Limited (Re), 2018 ONSC 3678
COURT FILE NO.: CV-18-591908-00CL
DATE: 20180613

SUPERIOR COURT OF JUSTICE – ONTARIO (COMMERCIAL LIST)

RE: IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C., 1985, C. C-36, AS AMENDED,

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF DUNDEE OIL & GAS LIMITED

BEFORE: S.F. Dunphy J.

COUNSEL: *E. Patrick Shea and B. Arnold* for the Applicants

Grant Moffat and Rachel Bengino, for the Monitor FTI Consulting Canada Inc.

J. Wallace for purchaser Lagasco Inc.

S. Kromkamp and B. McPherson for HMQ in right of Ontario

Aubrey E. Kauffman for the National Bank of Canada

M. P. Gottlieb for Canadian Overseas Petroleum Limited

HEARD at Toronto: June 11, 2018

REASONS FOR DECISION

[1] Dundee Oil and Gas Limited brought an application, supported by the Monitor, seeking approval of a sale of substantially all of its assets before me on May 23, 2018. I approved the proposed sale subject to requiring further evidence regarding the requested assignment of executory contracts under s. 11.3 of the *Companies' Creditors Arrangement Act* on June 11, 2018.

[2] The matter came back before me on June 11, 2018 where, based upon the new evidence filed, I approved the transaction including the assignment of the executory contracts with reasons to follow. These are those reasons.

Background facts

[3] Dundee entered into an Asset Purchase Agreement subject to court approval dated April 4, 2018. The sale was the result of a long process that began in August 2017 when Dundee was operating under the protection of the proposal provisions of the *Bankruptcy and Insolvency Act*. Those proceedings were continued under the CCAA on February 13, 2018.

[4] Dundee's assets consist primarily of a large number of petroleum and natural gas leases as well as associated equipment, gathering pipelines, etc. Many of the assets are in fact leased or are otherwise the subject of contractual arrangements between Dundee and the owner of the affected land. Accordingly, a significant aspect of the proposed sale transaction was a requirement that an assignment of the underlying contracts be accomplished by an order pursuant to s. 11.3 of the CCAA.

[5] On May 23, 2018 I indicated to the parties that I was satisfied with the necessity and advisability of ordering the requested relief and the process leading up to it save and except one aspect. In approving an assignment using the authority vested in me by s. 11.3 of the CCAA, I am required to inquire into a number of matters about which I found the record before me that day to be deficient. One landowner, Mr. Whittle, had made a formal objection and availed himself of the opportunity to express his concerns by telephone. He raised a number of objections to what he perceived to be concerns regarding the operational stability of the purchaser and their ability to see to eventual remediation obligations.

[6] During the course of the hearing, the Applicant indicated that the purchaser was prepared to proceed without an order compelling the assignment of agreements between Dundee and Mr. Whittle. The Applicant's position was that the form of agreements used in the case of Mr. Whittle's contracts at least required no consent for a valid assignment. The Purchaser was prepared to run the risk of that assessment proving accurate in Mr. Whittle's case.

[7] In the result, I adjourned the hearing until June 11, 2018 in order to grant the applicant additional time to address the concerns raised by me regarding s. 11.3 of the CCAA. I indicated that there were no other issues.

[8] The specific concerns raised by me were these:

- a. The operation of a natural resource extraction business such as an oil and gas business is one that entails a degree of environmental risk that, in the event of insolvency of the lessee/contract holder may visit the remediation or well-capping costs upon the landowner, a factor that makes the capacity and ability of the proposed assignee to manage those responsibilities a matter of concern when assessing the suitability of the proposed assignee; and

- b. The affidavit material at the motion provided no solid evidence of the expected financial stability or durability of the purchaser post-closing, a rather critical factor to assess in considering the suitability of a proposed assignee.

[9] Three things happened during the intervening delay, two planned one unexpected.

[10] Firstly, the Monitor arranged to notify the landowners of the delay. No further objections were received from that front. Mr. Whittle maintained his objection despite the Applicant's concession that it was not seeking to compel assignment of his agreements.

[11] Secondly, the Applicant filed a Supplementary Affidavit of Jane Lowrie, President and Chief Executive Officer of Lagasco Inc, the purchaser sworn June 5, 2018. This affidavit provided further details regarding the financial status of the purchaser.

[12] Lastly, one of the "runner-up" bidders (Canadian Overseas Petroleum Limited) sent a letter to the Monitor on June 7, 2018 which letter COPL decided to send directly to the court on June 8, 2018 when the Monitor did not agree to bring the letter to my attention directly.

[13] This intervention generated a flurry of reaction or overreaction, depending upon your point of view. It was, in the final analysis, a tempest in a teacup.

[14] The Applicant and National Bank (who strongly supports the sale and, despite the sale, will end up with a significant shortfall on its secured claim) were understandably taken aback by a last-second threat to a transaction they have worked very hard to bring to the threshold of completion and that, from their perspective at least, is clearly the best option available. They asked me not to consider the submissions of a mere "bitter bidder".

[15] They needn't have had so little faith in the editorial judgment of the court. COPL had experienced counsel who was well aware of the stiff currents flowing against any attempt of an unsuccessful bidder to gain standing to upset a transaction. There was no request for standing. The principal message of the communication was an opportunistic one perhaps, but not unfair. In light of the issues raised on May 23, 2018, COPL wanted to remind the Monitor and eventually the court that it remains ready willing and able to move forward with a transaction should Lagasco drop the ball. Of course, COPL did not resist ensuring that a few helpful bits of analysis/argument that might serve to persuade the court to think about moving in that direction also managed to find their way into the communication. It was not an attempt to introduce fresh evidence through the back door.

[16] As I remarked during the hearing, I did not fall off the turnip truck yesterday. The motivation behind the communication was not cloaked nor was its simple object.

[17] A few take-away admonitions from this:

- a. Communications directly with the judge are to be discouraged generally;

- b. Where necessary, such communications should be copied to the service list generally absent some very compelling reason not to do so; but

[18] I would have preferred that this course of conduct had been followed here. The Monitor was copied and the integrity of the process was in no way compromised.

[19] The substantive question before me was whether I ought to approve the provisions of the requested approval and vesting order that would compel the assignment of certain executory contracts under s. 11.3 of the CCAA.

[20] Section 11.3 of the CCAA authorizes the court to assign “the rights and obligations of the company” to an agreement to any person specified in the court order that is willing to accept the assignment. Post-filing contracts, eligible financial contracts and collective agreements may not be assigned in this fashion.

[21] There was no issue in this case with the technical aspects of the case. Proper notice was given. No prohibited categories of contracts were proposed to be assigned. The terms of the proposed assignment were designed to ensure the payment of cure costs would be made. A procedure for resolving any disputes about cure costs was designed to avoid compromising the rights of affected parties.

[22] The issue to be decided was whether this was an appropriate case for me to exercise my jurisdiction to make the order under s. 11.3. Section 11.3 does not provide an exhaustive code of the factors for me to consider. Rather, s. 11.3(3) lists three factors that, among others, I am to consider:

- (a) whether the monitor approved the proposed assignment;
- (b) whether the person to whom the rights and obligations are to be assigned would be able to perform the obligations; and
- (c) whether it would be appropriate to assign the rights and obligations to that person.

[23] In the present case, the Monitor has approved the proposed assignments and has made detailed and thoughtful submissions to me outlining the basis of that approval. The concerns expressed by me on May 23, 2018 did not fall on deaf ears.

[24] The purchaser Lagasco is largely a shell company for the time being. It will own the business being purchased. The evidence before me indicates that substantially all of the purchase price is to be debt financed – partly through financing secured by the equipment to be purchased and partly through a credit facility. On day one there will be little to no equity in the purchaser and the significant leverage will have to be serviced entirely from cash flow.

[25] Taken in isolation, this factor raised grave concerns in my mind as to whether the assignee would be able to perform the obligations or whether, in light of the potential

fragility of the assignee, it would be appropriate to compel the contract counterparties to accept the assignee.

[26] I still have those concerns. I think it helpful that I should elaborate somewhat on what the concerns are and how I have resolved them. The Monitor's dispassionate and frank analysis of the issues has been very helpful in this process.

[27] Section 11.3 of the CCAA is an extraordinary power. It permits the court to require counterparties to an executory contract to accept future performance from somebody they never agreed to deal with. But for s. 11.3 of the CCAA, a counterparty in the unfortunate position of having a bankrupt or insolvent counterpart might at least console themselves with the thought of soon recovering their freedom to deal with the subject-matter of the contract. Unlike creditors, the counterparty subjected to a non-consensual assignment will be required to deal with the credit-risk of an assignee post-insolvency and potentially for a long time. Creditors, on the other hand, will generally be in a position to take their lumps and turn the page.

[28] Of course, insolvency is not always a catastrophe for such counterparties. Sometimes it is a godsend. Assets locked into long-term contracts at advantageous prices may be freed up to allow the counterparty to re-price to current market. In such cases, the creditors are at risk of seeing the debtor lose critical assets while the counterparty receives an unexpected windfall. The business and value of the debtor's assets may evaporate in the process – be it from one large contract lost or many smaller ones.

[29] Bankruptcy and insolvency always involves a balancing of a number of such competing interests. Creditors, contract counterparties - all of these have rights arising under agreements with the debtor that are either actually compromised or at risk of being compromised by insolvency. The CCAA and BIA regimes are predicated on facilitating a pragmatic approach to minimize the damage arising from insolvency more than they are concerned to advance the interests of one stakeholder over another.

[30] It seems to me that a fundamental condition precedent to requiring a contract counterpart to be locked into an involuntary assignment post-insolvency is that the court sanctioning the assignment is able to conclude that the assignee will, in the words of s. 11.3(3)(b) of the CCAA, "be able to perform the obligations". This does not imply iron-clad guarantees. It does not give license to the counterparty to demand the receipt of financial covenants or assurances that it did not previously enjoy under the contract it originally negotiated with the debtor.

[31] A proposed purchaser starting life with close to 100% leverage gives this judge a considerable degree of heartburn when it comes to answering the question of whether the assignee is a person who will be able to perform the obligations. That concern is amplified when one adds the prospect of landowners being made liable for environmental remediation caused by lessees and others on their land.

[32] So, if that is my concern, by what process have I allayed it?

[33] Firstly, the financial information before me is that cash flow from these operations has been quite solid. Dundee's insolvency has not been a result of operating losses.

[34] Secondly, while any projection of future business results will always be subject to a number of contingencies and imponderables outside of the control of the parties, the forecast reserves prepared by Deloitte in this case have been prepared under NI 51.01 which means at the very least that they have been prepared to reviewable standards of reasonableness. The forecasts, such as they are, justify the inference that there is a *reasonable basis* to conclude that the cash flow from the acquired assets will sustain operations and the acquisition debt. It will be a while before an equity cushion will be built though.

[35] Thirdly, the purchaser has a plan to reduce G&A and operating costs to provide a further margin of safety and a level of institutional experience to make such a plan credible.

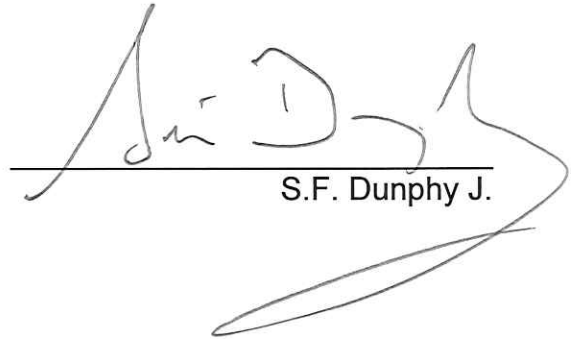
[36] Fourthly, the environmental risk is mitigated somewhat by the fact that Ontario's regulatory model operates on a "pay as you play" basis requiring the building of reserves to handle capping costs as wells move past their expected lives. Dundee has had no trouble in the past funding capping expenses from operations and these expenses are accounted for in the cash flow forecasts used.

[37] Finally, the MNR has agreed to a voluntary assignment of its leases (off-shore) while no on-shore landowners have seen fit to object to the proposed assignments despite quite adequate notice being given.

[38] I must also be mindful that contract counterparties are not expected to *improve* their situation by reason of an assignment. A counterpart to an executory contract that is subject to involuntary assignment under s. 11.3 of the CCAA has managed to find itself contractually bound to an insolvent debtor notwithstanding whatever contractual safeguards were negotiated to avoid that outcome. The debtor is now insolvent. The desire to ensure the assignee is a reasonably fit and proper one should not morph into an exercise in patching up contracts previously negotiated by requiring financial covenants and safeguards never before required.

[39] In all the circumstances, I was led to the conclusion that it would be appropriate to assign Dundee's rights and obligations to the purchaser and that the purchaser is someone who will be able to perform the obligations assigned. I have carefully reviewed the proposed order and am satisfied that the method of ascertaining cure costs and, if needs be, resolving disputes arising about the quantum satisfies the requirements of s. 11.3(4) and s. 11.3(3)(c). There is a fair process to resolve disputes about quantum should they arise.

[40] In the result, I approved the transaction and the form of Approval and Vesting Order presented to me subject to minor amendments made at the hearing.



S.F. Dunphy J.

Date: June 13, 2018