



COURT FILE NUMBER 1601-11552

COURT COURT OF QUEEN'S BENCH OF ALBERTA

JUDICIAL CENTRE CALGARY

PLAINTIFF NATIONAL BANK OF CANADA IN ITS CAPACITY AS ADMINISTRATIVE AGENT UNDER THAT CERTAIN AMENDED AND RESTATED CREDIT AGREEMENT DATED JANUARY 15, 2016, AS AMENDED

DEFENDANT TWIN BUTTE ENERGY LTD.
IN THE MATTER OF THE RECEIVERSHIP OF TWIN BUTTE ENERGY LTD.

APPLICANT FTI CONSULTING CANADA INC. in its capacity as Court-appointed Receiver of the current and future assets, undertakings and properties of TWIN BUTTE ENERGY LTD.

DOCUMENT **BENCH BRIEF of the COURT-APPOINTED RECEIVER (Application re: Termination of Certain Secure Energy Agreements and Advice and Directions)**

February 22, 2017

Honourable Mr. Justice A. D. Macleod

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I. INTRODUCTION

1. This Brief is submitted on behalf of FTI Consulting Canada Inc. in its capacity as Court-appointed receiver and manager (**Receiver**) of Twin Butte Energy Ltd. (**Twin Butte**).
2. This Application seeks the Court's approval of termination of certain agreements entered into between a predecessor company to Twin Butte and Secure Energy Services Ltd. (**Secure**) (the agreements being collectively referred to as the **Secure Agreements**).
3. The Secure Agreements were identified as excluded contracts by all the prospective final bidders in the recent Court-approved sales process of Twin Butte's assets (**SISP**)¹. The assets have since been sold free and clear of all encumbrances, pursuant to a Sale Approval and Vesting Order (**SAVO**).²
4. This matter is before the Court because the Secure Agreements are "in the money" and, under a certain clause, purport to create an interest in land. The Receiver's view is that whether or not an interest in land is created, the Secure Agreements should be terminated given the free and clear transfer of assets to the purchaser pursuant to the SAVO, and given the Receiver's exercise of business judgment in favoring termination.
5. The only interest in land arguably created by the Secure Agreements is a right of first refusal that has limited if any commercial value. The Receiver also considered a dedication of well effluent and a gross overriding royalty under the Secure Agreements and have not identified any evidence suggesting that such clauses do create interests in land. Accordingly there is no impediment to termination of the Secure Agreements.
6. As detailed in the Receiver's Report, the Receiver advises that it has exercised its business judgment and has determined it is in the best interests of Twin Butte's stakeholders that the Secure Agreements be terminated.

II. BACKGROUND

Secure Agreements: Non-Compete and DPDG Agreement

7. On or about October 1, 2011, Secure and Emerge Oil & Gas Inc. (**Emerge**), a predecessor company to Twin Butte, executed the following contracts comprising the Secure Agreements:
 - a) a Non-Competition Agreement (**Non-Compete**); and

¹ Order approving Sales and Investment Solicitation Process, dated October 11, 2016.

² Sale Approval and Vesting Order, dated January 19, 2017.

b) a Well Effluent and Water Disposal Agreement (**DPDG Agreement**).

8. The Secure Agreements expire on October 1, 2018. The Secure Agreements arose in connection with an Asset Purchase Agreement between Emerge (Twin Butte) and Secure dated September 11, 2011, transferring certain assets from Emerge as vendor to Secure as purchaser (**APA**) as further detailed in the Receiver's Fourth Report. The assets were associated with or used in connection with: clean water terminals; the receipt, treatment and transportation of oil emulsions; and the treatment of slop oil on behalf of oil and gas producers.

Non-Compete

9. The Non-Compete was entered into pursuant to the APA³.
10. The Non-Compete was intended to shield Secure from competition from Emerge so as to permit Secure to receive the full benefit of the APA and assets sold thereunder.
11. Sections 2 and 3 of the Non-Compete state:

2. Non-Competition

Emerge covenants with the Corporation [Secure] that Emerge shall not, during the Term, directly or indirectly through any subsidiary or affiliate and either alone or in conjunction with any Person, [...] directly or indirectly, carry on, be engaged in or employed by, provide services to, invest in, lend money to or otherwise be interested in or participate in any business, enterprise or activity that competes with the Business in the area set out on the map attached as Schedule "A" hereto.

3. Non-Solicitation

Emerge covenant with the Corporation [Secure] that Emerge shall not, during the Term, induce any person who is an agent, salesperson, contractor, customer, supplier or dealer of or relating to the Corporation as of the date of the Agreement [...] to leave, to stop selling to, stop buying from, or stop utilizing the services of the Corporation or any of its affiliates, or otherwise cease dealing with the Corporation or any of its affiliates in connection with the Business.

12. The Non-Compete expires on October 1, 2018. The Receiver has determined that the Non-Compete has little if any value, particularly given that following the sale of assets pursuant to the SAVO the Twin Butte estate will have no operations and nothing to compete with. Any

³ APA, section 2.5.

damages (the existence of which is denied) can be asserted by Secure in the anticipated claims process.

DPDG Agreement

13. The DPDG Agreement concerns the processing, treatment and disposal of well effluent and water arising in connection with Twin Butte's working interests in certain petroleum substances (**Water and Effluent**). In particular, pursuant to the DPDG Agreement, Water and Effluent generated by Twin Butte's working interest rights would be processed in certain facilities owned by Secure and obtained by Secure from Emerge pursuant to the APA.
14. Among other things, the DPDG Agreement contemplates that:
 - a) Twin Butte deliver certain volumes of Water and Effluent to Secure;
 - b) Secure process the Water and Effluent; and
 - c) Twin Butte pay Secure for certain supervisory and administrative services incurred in respect of the processing of the Water and Effluent.
15. Clause 308 of the DPDG Agreement purports to create a dedication of reserves (**Dedication**):

308. Dedication of Producer [Emerge/Twin Butte] Well Effluent

(a) Producer [Emerge/Twin Butte] hereby dedicates its and its Affiliates' entire working interest share of all Producer Well Effluent and Oilfield Waste Product produced by Producer [Emerge/Twin Butte] from or attributable to its working interests located in the Dedication Area or in any such working interests that it or its Affiliates hereafter acquire located in the Dedication Area ("After Acquired Interests"), such that all such Well Effluent or Oilfield Waste produced by Producer [Emerge/Twin Butte] from locations within the Dedication Area shall be delivered to the Facilities.

(b) The dedication in this Clause 308 is:

(i) with respect to any After Acquired Interests only, subject to any contracts to which any such After Acquired Interests are subject at the time of acquisition (but only for the original term of any such contracts and not for any renewals or extensions thereof); and

(ii) with respect to Oilfield Waste Product, applicable only to the extent Operator [Secure] provides the service to handle

Oilfield Waste Product on commercial terms acceptable to Producer [Emerge/Twin Butte].

(c) In the event Operator [Secure] is unable to accept all or a portion of the Maximum Weekly Volume of Producer's [Emerge/Twin Butte] Well Effluent during any week period during the term of this Agreement, Producer [Emerge/Twin Butte] shall be entitled to use a third party facility for treatment of such Producer Well Effluent over and above those volumes capable of being accepted at the Facilities.

(d) This dedication shall only be in effect for the term of this Agreement.

16. Clause 310 of the DPDG Agreement purports to create a right of first refusal (**ROFR**):

310. Right of First Refusal for Suspended and Abandon [sic] Wells

Producer [Emerge/Twin Butte] hereby grants to Operator [Secure] the right, but not the obligation, to purchase any suspended or abandoned well, including any disposal wells, for an aggregate consideration of \$1.00 plus assumption of all environmental liabilities, where Producer [Emerge/Twin Butte] owns 100% of the working interest, located within the Restricted Area provided that such suspended or abandoned well would be suitable for, and allowed under applicable law, to be used as a disposal or injection well by Operator [Secure].

17. Clause 311 of the DPDG Agreement purports to create a gross overriding royalty (**GORR**):

311. Royalty on third party Produced Water disposal

Producer [Emerge/Twin Butte] hereby grants to Operator [Secure] a gross overriding royalty ("GORR"), as calculated below, on disposal of all Third Party Produced Water which is disposed of down any currently owned Well or After Acquired Interest in the Dedicated and Restricted Areas. The term for the GORR will be Seven (7) years. Producer [Emerge/Twin Butte] and Operator [Secure] acknowledge that the GORR is a covenant attached to and running with the Wells and constitutes an interest in land. The GORR will be calculated as follows: [...]

18. The Receiver's view is that the Dedication and GORR do not create interests in land and will be terminated along with the Secure Agreements.
19. Regarding the ROFR, it likely creates an interest in land and, assuming that is the case, the Receiver requests that the DPDG Agreement be terminated notwithstanding, for the reasons stated in the Receiver's Fourth Report and as detailed below.

Value of Secure Agreements

20. The Receiver's analysis of Secure's financial statements and the impact of terminating the DPDG Agreement indicates that termination would have a small impact on Secure. The Receiver estimates the revenue lost by Secure from termination would be approximately \$700,000 through the end of the contract, without accounting for mitigation efforts. The Receiver has weighed this projected lost revenue against Secure's reported total revenue of approximately \$1,340,000,000 for year ending 2015 and has concluded that Secure would not be materially prejudiced by the disclaimer.⁴
21. The Receiver does not view the Non-Compete as having more than nominal value.
22. On the other hand, the Secure Agreements have been expressly excluded from the Court-approved sale and vesting of the Twin Butte assets to Henenghaixin Operating Corp⁵ (**HOC Transaction**). The Secure Agreements have no value to the Twin Butte estate.
23. Had the Secure Agreements been *included* in the HOC Transaction⁶, the Receiver believes the sales price would have been markedly lower. Accordingly, termination of the Secure Agreements has the effect of increasing the liquidation value of Twin Butte's assets to the benefit of all stakeholders.

III. LAW AND SUBMISSIONS

Receiver's Authority to Terminate

24. Section 3(c) of the appointment order⁷ confirms the Receiver's authority to "cease to perform any contracts of the Debtor".
25. In general, a receiver must have the ability to refuse to adopt contracts in order to give meaning to its power to convey the assets free and clear of other parties' interests.⁸ When deciding to terminate, the receiver must exercise discretion⁹, act reasonably and exercise good business sense.¹⁰
26. In the normal course, the receiver may move before the Court for an order to break or vary an onerous or material contract.¹¹ Where the receiver applies to the Court and is permitted to

⁴ Consolidated Financial Statement for the years ended December 31, 2015 and 2014, dated March 1, 2016 and accessed online at SEDAR: <http://www.sedar.com/DisplayCompanyDocuments.do?lang=EN&issuerNo=00029532>

⁵ Sale Approval and Vesting Order, dated January 18, 2017, by the Honourable Madam Justice G. Campbell.

⁶ To be clear, the Secure Agreements were accessible in the data room created under the SISF but none of the prospective purchasers sought to assume the contracts.

⁷ Receivership Order dated September 1, 2016, by the Honourable Madam Justice B. E. C. Romaine.

⁸ *Royal Bank of Canada v Penex Metropolis Ltd.*, 2009 CarswellOnt 5202, [2009] OJ No 3645, para 20 [*Penex*] [TAB 1].

⁹ *Penex*, para 23, TAB 1.

¹⁰ *Ibid.*

¹¹ Frank Bennett, *Bennett on Receiverships*, (Toronto: Carswell, 2011), page 436, [TAB 2].

disclaim a contract between the debtor and a third-party, the third-party has a claim for damages.¹²

27. The Receiver has determined that it is commercially reasonable and in the best interests of Twin Butte's stakeholders to disclaim the Secure Agreements. However, the Receiver notes the existence of the GORR, ROFR, and Dedication and seeks the Court's confirmation of its view that the GORR and Dedication do *not* create interests in land in respect of same. With respect to the ROFR, the Receiver reiterates that the ROFR has limited (if any) commercial value and even if it does create an interest in land, such interest should be terminated with the DPDG Agreement.

The Dedication Should be Terminated

28. The Receiver's decision to reject the DPDG Agreement is based on a reasonable exercise of business judgment. The DPDG Agreement is burdensome to the receivership and is expressly an excluded contract under the HOC Transaction. Hence the Receiver's decision to terminate it.
29. In addition, permitting the DPDG Agreement to remain active would yield the perverse result that Secure, an unsecured party in the receivership, would receive a windfall not otherwise available but for the receivership, and would have the effect of being paid out ahead of secured creditors. The circumstances warrant termination as being in the best interests of Twin Butte's stakeholders and as being commercially reasonable.
30. Moreover, a plain reading of the Dedication suggests that it does not run with the land because the dedication concerns effluent and waste product, and such items do not constitute real property (they may properly be described as personal property). There is nothing to suggest otherwise.

The ROFR Should be Terminated

31. The Receiver's view is that the ROFR on the abandoned wells in the "Restricted Area"¹³ would create an interest in land. Section 63(1)(a) of the *Law of Property Act*¹⁴ provides that a right of first refusal to acquire an interest in land is an equitable interest in land. It is likely that

¹² *Ibid.*

¹³ As defined in the DPDG Agreement.

¹⁴ RSA 2000, c L-7 [TAB 3].

an interest in a well would constitute an interest in land¹⁵, since the well forms part of the land and any casing cemented in the well would be affixed to the lands.¹⁶

32. That said, it would only be commercially reasonable to permit the Receiver to terminate or repudiate the DPDG Agreement despite a simple ROFR clause over abandoned wells that have marginal commercial value. Barring the Receiver, in the face of commercial realities and the Receiver's authority to terminate, would be unreasonable. This reasoning is supported by the fact that the existence of the ROFR adversely affected the Receiver's ability to properly market Twin Butte's assets for the benefit of the stakeholders generally, as evidenced by the DPDG Agreement being an excluded contract in all of the prospective purchaser's final bids under the SISF.

The GORR Should be Terminated

33. There is no bright line test as to what constitutes an interest in land in the context of gross overriding royalties. The Courts generally review the agreement as a whole in the context of the factual circumstances to determine whether it was possible for an interest in land to have been granted and, if so, whether the intention of the parties was to create an interest in land.¹⁷
34. The Receiver's view is that the GORR does not constitute an interest in land for the following reasons:
- a) The GORR is described as an interest in "Third Party Produced Water which is disposed of down any currently owned Well or After Acquired Interest in the Dedicated and Restricted Areas". The application of the royalty being conditional upon its subsequent disposal in a Well or After Acquired Interest implies that it does not apply immediately upon severance of the Third Party Produced Water from the lands but rather upon its disposal back into the Wells or After Acquired Interest. Therefore, the Third Party Produced Water is properly considered personal property

¹⁵ *Molchan v Omega Oil & Gas Ltd.*, 1988 CarswellAlta 17, [1988] SCJ No 12, 47 DLR (4th) 481, para 16 [TAB 4].

¹⁶ While not expressly referenced in the clause, presumably it is implied that the associated mineral and storage rights for the well would also be assigned to the Operator upon exercise of the ROFR, or else the Operator would not be entitled to use the well for disposal purposes.

¹⁷ *Bank of Montreal v Dynex Petroleum Ltd.*, 2002 SCC 7, paras 12, 14 and 22, [TAB 5]; *Walter Energy Canada Holdings, Inc. (Re)*, 2016 BCSC 1746, paras 48-52, [TAB 6]; *Third Eye Capital Corp. v Dianor Resources Inc.*, 2016 ONSC 6086, [TAB 7].

at the time the GORR is applied. If the underlying interest is not an interest in land, then the GORR applied to such interest cannot be itself an interest in land¹⁸.

- b) The GORR is calculated based on a percentage of the then current market rate for disposal of Produced Water multiplied by the volume of Third Party Produced Water received at the Wells. Therefore, the GORR does not represent a portion of the Produced Water or the value thereof, but rather a percentage of revenues for the performance of a service, an indicator that an interest in land has not been created¹⁹.
- c) The grantee of the GORR does not have any right to take the product in kind.
- d) The GORR is for a limited term.

The Non-Compete Should be Terminated

- 35. The Non-Compete does not create an interest in land or otherwise give rise to special considerations. It also has limited if any value. Accordingly, it should be terminated pursuant to the Receiver's authority under the appointment order.

Deference Afforded Receiver's Decisions

- 36. As Justice Strathy (as he then was) of the Ontario Commercial List stated in approving a receiver's termination of certain contracts, "if a decision by a receiver is within the broad bounds of reasonableness, and if the receiver conducts itself fairly and considers the interests of all stakeholders, the receiver's business decisions will not be interfered with lightly by the Court."²⁰ And, indeed, the Court typically supports the receiver's decision in such circumstances.²¹
- 37. In recommending termination of the Secure Agreements the Receiver has exercised its business judgment in good faith and with a view toward dealing with Twin Butte's property, assets, and obligations in a commercially reasonable manner. The Receiver respectfully submits that this exercise of business judgment be noted by the Court in its deliberations and is a factor favoring the Court's granting the Receiver's relief sought.

¹⁸ *Bank of Montreal v Dynex Petroleum Ltd.*, 2002 SCC 7, TAB 5.

¹⁹ *Bank of Montreal v Dynex Petroleum Ltd.*, 2002 SCC 7, para 22, TAB 5.

²⁰ *Penex*, para 26, TAB 1.

²¹ *Ibid.* See also: *Royal Bank v Soundair Corp.*, 4 OR (3d) 1, [1991] OJ No 1137 (CA), para 14 [TAB 8]; *Ravelston Corp., Re*, 24 CBR (5th) 256, [2005] OJ No 5351 (CA), para 40 [TAB 9].

38. The Receiver's decision to terminate should also be considered in light of the anticipated Court-sanctioned claims process. In the context of that process, Secure can advance any claim for damages in respect of the termination and the Receiver will address those claims in the normal course.

IV. CONCLUSION AND RELIEF SOUGHT

39. For all the reasons stated herein and in the Receiver's Fourth Report, the Receiver respectfully requests the Court's confirmation and approval of the termination of the Secure Agreements.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 13th DAY OF February, 2017.



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