Caveat Emptor Baby

Facility Ownership and Vesting Order Considerations in Quicksilver

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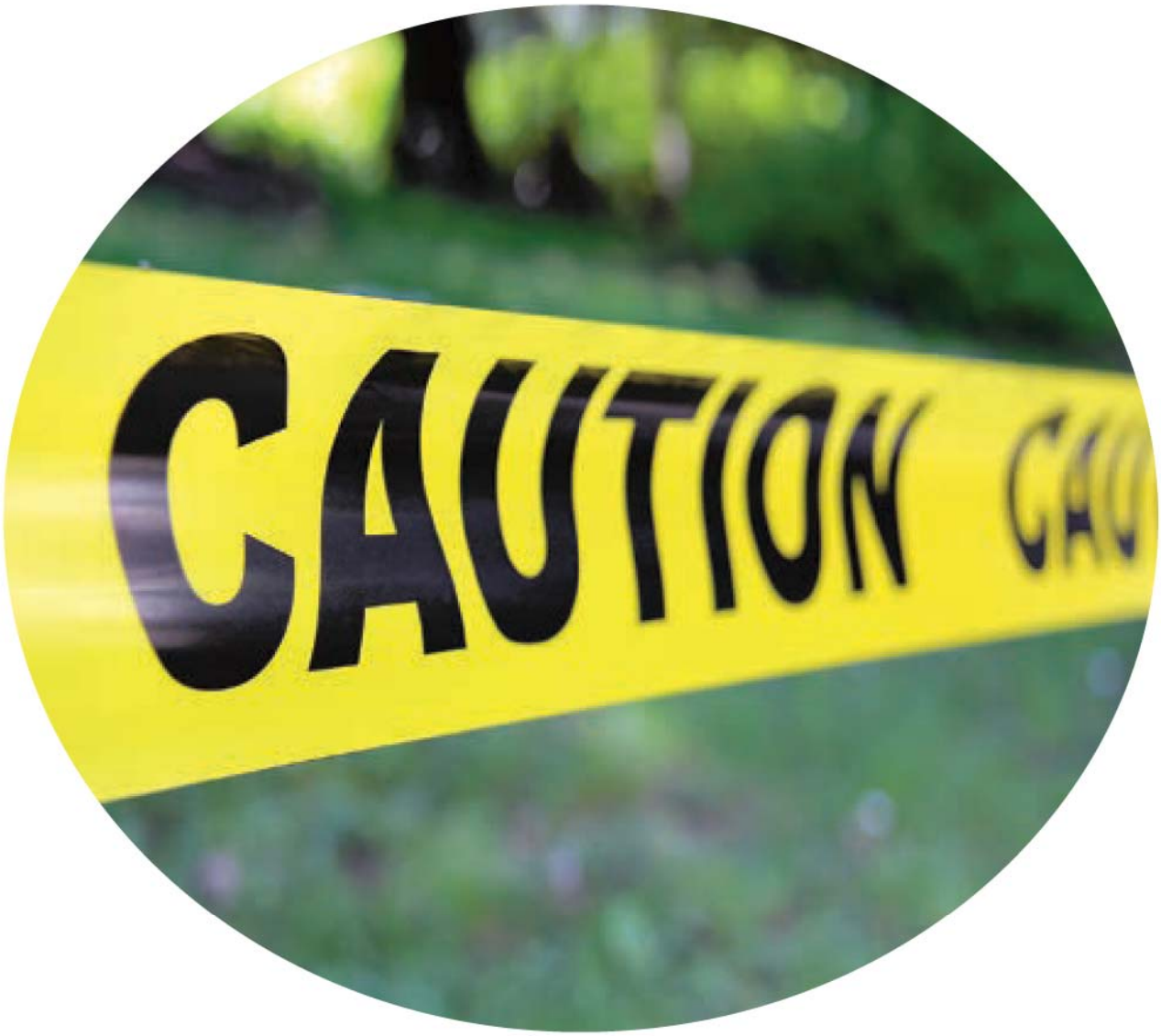

I make the money to feed my children by caring passionately about the wording of sale agreements and due diligence in oil and gas transactions. So imagine my excitement when I read the Alberta Court of Queen's Bench decision of *Quicksilver Resources Canada Inc. (Re)*, 2018 ABQB 653.

Quicksilver not only deals with the definition of Tangibles under two different sale agreements, it also speaks to the scope and responsibility of a purchaser to conduct proper due diligence to ensure it is actually buying what it thinks it is buying. Then, as an added bonus, the decision considers whether a Court issued Approval and Vesting Order can be the basis for a declaration that a third party has no interest or claim in disputed assets. Time to get your oil and gas geek on folks, here we go.

FACTS

The nub of the matter is who bought, or didn't buy, a metering station, pig receiver and metering station license (the "*Disputed Assets*") situate at the end of the Maxhamish Pipeline. Quicksilver originally owned all the assets, contributed some or all of them to a partnership in 2011, then went broke and some or all of the assets were bought by Rockyview Resources Inc. from a receiver (monitor) under a 2016 Vesting Order.

Disputes happen because oil and gas transactions often deal with a very large set of assets comprised of many different sub-categories. Sometimes it is simply impossible to specifically list every item being sold. Or perhaps, as some perfectionists argue, we are complacent and a touch lazy in the business, and don't put the work into producing perfect schedules.

CAVEAT EMPTOR (AND OTHER COOL LATIN TERMS)

I love a catchy start to a story. The honourable Mr. Justice C.M. Jones does not disappoint:

> [1] Most people are familiar with the phrase "*caveat emptor*" or "buyer beware". It is a caution to purchasers of property to ensure that they are getting what they think they have paid for. This dispute arises from exactly the kind of problem to which the phrase refers.

Caveat emptor applies to all assets under a typical sale agreement, excepting only fee simple mineral and surface title which is subject to the Torrens system of indefeasible ownership.

The corollary of *caveat emptor* is yet another Latin term, *nemo dat quod non habet*, meaning "no one gives what they don't have". As stated by Justice Jones:

> [11] Three questions require consideration. First, had QRCI divested itself of the Disputed Assets under the Contribution Agreement *such that the principle nemo dat quod non habet applies and the Disputed Assets could not have been sold* under the APA? [emphasis mine]

Anytime you have Disputed Assets, you need to go back to the vague, goofy definitions in your sale agreement. Remember, if the freaking meter station was listed in a schedule somewhere, there would be no dispute, it would be a sold asset. Disputes happen because oil and gas transactions often deal with a very large set of assets comprised of many different

sub-categories. Sometimes it is simply impossible to specifically list every item being sold. Or perhaps, as some perfectionists argue, we are complacent and a touch lazy in the business, and don't put the work into producing perfect schedules. I believe the former is closer to the truth, but the consequence is disputes over what is sold and not sold.

Aside: Adding a White Map Asset definition and plat to a sale agreement will virtually eliminate Disputed Assets issues, since everything inside the box is sold. Elegant and simple. Sadly, all the crappy environmental liabilities in the box also pass to the purchaser, so use white maps with caution.

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In *Quicksilver*, the Court is tasked with choosing between fuzzy definitions in the initial Contribution Agreement in 2011 and the subsequent Asset Purchase Agreement ("APA") in 2016.

CONTRIBUTION AGREEMENT – USED OR USEFUL

The Contribution Agreement defined "Assets" as follows:

> The "Assets" are set forth on Exhibit 1 (Maxhamish Pipeline), Exhibit 2 (Compression Assets) and shall include the following:
>
> (a) all permits, licenses, authorizations, surface rights (including easements, licenses of occupation and rights-of-way), and buildings, structures, appurtenances and tangible depreciable property situate thereon that are *used or useful* in connection with the operation of the Maxhamish Pipeline... [emphasis mine]

Many, many sale agreements, including my own, use the words "used or useful" in attempting to define the nebulous category of what specific, non-scheduled, tangibles form part of the sold assets. Common problematic items include: (1) surplus equipment and inventory; (2) tangibles meant for non-sold assets which are stored in a sold field office; and (3) ownership in pipelines after the initial flow line, which are used both for sold assets and other wells. Apparently, we can now add meter stations at the end of sold pipelines to this list.

At the end of the day, the Court finds that the Disputed Assets fall within the above definition of used or useful. But just barely:

> [26] I agree that, on its face, the "used or useful" articulation is not particularly helpful. I view Mr. McGregor's evidence as an attempt to describe

what he considers to be the essential components of a pipeline that is used to move natural gas from the field to a distant gathering system. I am persuaded that his explanation of why a metering station might be considered useful in connection with the operation of such a pipeline is reasonable, based on common sense and decoupled from legal analysis.

Pretty scary really. The words "used or useful" are so wishy-washy that the Court pins its decision on affidavit evidence of the VP finance of the vendor, years after the deal closed. Great way to draft a sale agreement. This is why everyone hates lawyers. I truly wish I could construct better words to define non-scheduled tangible assets, but honestly, words are an imperfect tool that, in my view, can never be crafted to deal with unknown and uncertain facts. If you want certainty, get into the interprovincial pipeline business. Not funny? Too soon?

APA – IN THE IMMEDIATE VICINITY

The Respondent in the action, Rockyview, argued that the Disputed Assets did not fall under the tangibles definition in the Contribution Agreement and therefore, were not contributed to the partnership. Rather, the Disputed Assets fell under its APA from Quicksilver (through FTI Consulting Canada Inc., as monitor).

The APA definition for tangibles is as follows:

> [31] Tangible Property is defined in Section 1.1 (nnnn) to be the "Seller's Interest" in the Tangibles, which, under Section 1.1 (oooo), means "the Facilities, and any and all tangible depreciable equipment and facilities that are located within, upon, or *in the immediate vicinity of the Lands*, or that are used or intended to be used in producing, gathering, processing, treating, dehydrating, measuring, transporting, making marketable or storing Petroleum Substances … [emphasis mine]

Bottom line, the mere inclusion of a described asset in a sale agreement schedule does NOT mean the vendor owns that particular asset. You need to independently verify ownership prior to closing, or you are quite simply screwed.

Remember, the Maxhamish Pipeline was already contributed to the partnership. The Disputed Assets is the stuff waaaaay at the end of the pipe, which was quite far away from the block of lands acquired under the APA. The Court was not amused:

> [35] *In my view, a metering station some 30 km away and decoupled from the wells and other facilities cannot reasonably be said to relate directly to the operation of the Lands.* Rather, the Metering Station was used in the operation of the Maxhamish Pipeline…

I MEANT TO BUY EVERYTHING

Rockyview also argued that "*it intended to purchase all of QRCI's assets in British Columbia*". In a prior life, I would rant against such arguments because the APA does not mention all assets in BC anywhere. However, in a world where the Courts tell us we must consider the mutual expectations of the parties under the factual matrix of the transaction, I guess this is a pretty good argument. Not good enough in this case, but worth a try.

Note: A white map plat, or a Province definition, is a great way to remove this uncertainty, subject to getting all the stinky liabilities too.

THE AER FACILITY LICENSE

The most curious aspect of the underlying facts for me, is the fact that the AER facility license for the Disputed Assets was actually scheduled and then transferred to Rockyview under the APA transaction:

> [39] QRCI acknowledges that the Metering Station License was contemplated by the APA, but takes the position that this was an error.

It again refers to the evidence of Mr. McGregor, who indicated in his affidavit that the Metering Station License was "incorrectly and erroneously included in a schedule of assets" in the APA. RRI again objects to this evidence, arguing that it is merely Mr. McGregor's opinion based on his interpretation of the Contribution Agreement.

> [40] In my view, Mr. McGregor's evidence surrounding the alleged mistake seems candid and plausible. It also seems to me to be consistent with my analysis above respecting the Contribution Agreement. In any event, however, I am not persuaded that the Metering Station License formed part of the assets transferred under the APA.

Wow, that is pretty close to the line. Yeah, we scheduled and transferred the facility license, but that did not mean you get the facility. Cough, cough.

DO YOUR FREAKING DUE DILIGENCE

Bottom line, the mere inclusion of a described asset in a sale agreement schedule does NOT mean the vendor owns that particular asset. You need to independently verify ownership prior to closing, or you are quite simply screwed.

Actually double screwed since you not only do not own the Disputed Assets, you cannot even sue the vendor for damages in not being able to convey the assets to you. The Court quotes some very standard "as is, where is" language from the APA to illustrate this point:

> [27] Moreover, I find that RRI could, and should, have resolved any uncertainty regarding what assets might have been transferred to the Fortune Creek Partnership under the Contribution Agreement as part of its due diligence required under the APA.

> [48] In section 5.12 of the APA, QRCI states, inter alia, that it "does not make any representation or warranty, express or implied, of any kind, at law or in equity, with respect to … the title of Seller to the Oil and Gas Assets". Section 5.12 also states that RRI is relying on its own investigations: "Buyer acknowledges and confirms that it is relying on its own investigations concerning the Oil and Gas Assets and it has not relied on advice from Seller or its Representatives with respect to the matters specifically enumerated in the immediately preceding paragraphs in connection with the purchase of the Oil and Gas Assets pursuant hereto. Buyer further acknowledges and agrees that it is acquiring the Oil and Gas Assets on an 'as is, where is' basis." *In my view, none of the other representations or warranties in the APA qualifies QRCI's refutation of any assertion that it holds title to the assets it purports to sell.* [emphasis mine]

VESTING ORDER – NOT

Lastly, the Court comments on the impact of a Vesting Order to convey uncertain title. Interesting question these days as we are all buying from Receivers:

> [57] Perhaps most troubling from the Court's perspective is the inference that the Court is somehow engaged in the due diligence process of confirming title to assets purported to be sold. I would suggest that *it would be an abuse of CCAA orders to interpret them as the Court's confirmation that title the seller does not possess may be vested in the buyer free of claims to ownership by the true owner.* The better interpretation is that a CCAA order may vest off certain claims against title, but does not create title. [emphasis mine]

Good answer. A Vesting Order properly clears off adverse financial claims and obligations, except for the defined permitted encumbrances. However, a Vesting Order cannot, and should not, create ownership in something the vendor did not own.

Caveat emptor baby. ♦

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