

COURT FILE NUMBER B301-163430

COURT COURT OF KING'S BENCH OF ALBERTA

JUDICIAL CENTRE CALGARY



C10194

IN THE MATTER OF THE *BANKRUPTCY AND
INSOLVENCY ACT*, RSC 1985, C B-3, AS AMENDED

AND IN THE MATTER OF THE NOTICE OF INTENTION
TO MAKE A PROPOSAL OF CLEO ENERGY CORP.

DOCUMENT BENCH BRIEF OF CLEO ENERGY CORP.

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**APPLICATION BEFORE AN HONOURABLE JUSTICE OF THE COURT
OF KING'S BENCH ON DECEMBER 23, 2024 AT 2:00 IN THE COURT OF
KING'S BENCH, COURT ROOM 1002**

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I. INTRODUCTION

1. On December 8, 2024, the Applicant, Cleo Energy Corp. (“**Cleo**”) filed a Notice of Intention to Make a Proposal (“**NOI**”) pursuant to subsection 50.4(1) of the *Bankruptcy and Insolvency Act* RSC 1985, c. B-3 (“**BIA**”) with the assistance of its legal counsel, Gowling WLG (Canada) LLP (“**Gowling**”) and appointed Alvarez & Marsal Canada Inc. (“**A&M**”) as Proposal Trustee (the “**Proposal Trustee**”)¹. The NOI was necessary to provide stability to Cleo’s business and allow Cleo the chance to restructure.
2. As a result of the filing of the NOI, all proceedings against Cleo and its property were automatically stayed for an initial period of thirty (30) days (the “**Stay Period**”), this includes any contractual rights of setoff any of Cleo’s creditors has against Cleo.
3. Cleo’s oil marketer Trafigura Canada Limited (“**Trafigura**”) advised Cleo at 3:30 MST on Friday, December 20th, 2024 that it will set-off against November production revenue of Cleo’s for almost all pre-filing unsecured debt Cleo owes Trafigura². The payment date for Cleo’s November production is December 24, 2024³. Cleo is entirely dependent on this revenue for the continuation of its business during these proposal proceedings.
4. If Trafigura carries out its threat to set off the entire indebtedness owing to it against Cleo’s November revenue, this will have catastrophic results for Cleo and its stakeholders, and will cause Cleo’s business to immediately cease operations⁴. Cleo requires immediate emergency relief from the Court as submitted herein and in particular, requiring that Trafigura immediately provide Cleo its November production, without set-off.
5. This application is supported by an Affidavit sworn by Chris Lewis (“**Mr. Lewis**”), the sole Director, Executive Chairman, and Chief Executive Officer of Cleo (the “**Lewis December 22 Affidavit**”) and the Affidavit of Chris Lewis sworn in support of Cleo

¹ Affidavit of Chris Lewis, sworn December 22, 2024 (the “**December 22 Affidavit**”), at para 11.

² December 22 Affidavit, at paras 32 and 33.

³ December 22 Affidavit, at para 27.

⁴ December 22 Affidavit, at para 48.

seeking to extend the stay of proceedings and other relief scheduled to be heard on January 6, 2024 (the “**Extension Affidavit**”, together the “**Lewis Affidavits**”).

6. Capitalized terms not defined herein have the meanings given to them in the Lewis Affidavits.

II. FACTS

7. Cleo transports its oil products from its fields to a local sales point using pipelines or trucks. These products are sold to Trafigura, acting as Cleo's oil marketer, under a Commercial Agreement dated July 12, 2024⁵. The revenue from these sales is crucial for Cleo's operations, with payments made to Cleo on the 25th of each month. The payment is owed on the 24th day in December.
8. Since in or around November 2023, Cleo has faced challenges in raising capital for repairs and maintenance of its oil and gas assets. By April 2024, cash flow issues halted these activities, prompting Cleo to seek additional funding. In July 2024, Cleo entered into a Prepayment Agreement with Trafigura, whereby Trafigura agreed to provide Cleo up to three loan tranches of up to \$1,000,000 each for repairs and maintenance. In return, Trafigura would have the right to setoff amounts under the Prepayment Agreement that have mature and are payable as against the sales revenues generated by it selling Cleo's products under the Commercial Agreement and which have matured and become payable. Trafigura has extended only one tranche of \$1,000,000 and repayments under the loan are approximate \$83,333 each month. Trafigura is owed approximately \$750,000 under the Prepayment Agreement⁶.
9. On December 20, 2024, after receiving notice of the NOI, Trafigura's counsel advised Cleo's counsel, and Trafigura advised Cleo, that Trafigura intends to exercise its contractual rights to set-off under the Prepayment Agreement for all of Cleo's debt

⁵ December 22 Affidavit, at paras 14 and 15.

⁶ December 22 Affidavit, at paras 16 – 18.

thereunder as against Cleo's November production in order to collect almost all amounts owing by Cleo under the Prepayment Agreement⁷.

10. Under the intended set-off, Trafigura will set-off the \$757,644.77 (the "**December Payment**") it owes to Cleo under the Commercial Agreement for November 2024 production sales against the \$721,678.99 Cleo owes under the Prepayment Agreement (the "**Intended Set-off**"). After the application of the Intended Set-off, the total amount to be paid by Trafigura to Cleo for the month of November 2024 would be \$35,965.78⁸.
11. If Trafigura is permitted to carry out the Intended Set-off, and Cleo does not receive the full amount of the December Payment, the impacts and prejudice will be catastrophic for Cleo, its creditors and other stakeholders, including the general public⁹.
12. Cleo currently has extremely limited cash resources and without receiving the entire December Payment from Trafigura on December 24, 2024, Cleo will be forced to immediately cease operations¹⁰. This will result in Cleo's restructuring efforts failing and likely cause Cleo to go bankrupt. Creditors will subsequently not receive the maximum benefit that could have been achieved had Cleo been able to continue operations and move forward with the Proposal Proceedings.
13. Cleo's normal monthly production revenues were previously \$1,819,168 a month prior to the beginning of its financial difficulties.¹¹ Cleo has over \$22,000,000 of assets on its balance sheet.¹² Cleo's three largest producing fields have proved developed producing reserve value (before tax) of over \$30,000,000, minus net present value of 10%.¹³

⁷ December 22 Affidavit, at paras 32 and 33.

⁸ December 22 Affidavit, at paras 35.

⁹ December 22 Affidavit, at para 48.

¹⁰ December 22 Affidavit, at para 49.

¹¹ Affidavit of Chris Lewis, sworn December 23, 2024 (the "**December 23 Affidavit**"), at para 31.

¹² December 23 Affidavit, at para 40.

¹³ December 23 Affidavit, at para 42.

14. If Cleo is forced to cease all operations as a result of Trafigura's carrying out the Intended Set-off, Cleo will also not be able to preserve its assets and prevent environmental issues from arising during the winter months through ongoing repair and maintenance¹⁴.

Relief sought

15. This Bench Brief is submitted on behalf of Cleo in support of an Application seeking from this Honourable Court an Order, among other things:
- (a) abridging the time for service of notice of this Application, deeming service of notice of this Application to be good and sufficient, and declaring that there is no other person who ought to have been served with notice of this Application;
 - (b) declaring that Trafigura's right to effect set-off is stayed pursuant to section 69(1) of the *BIA* with respect to the following:
 - (i) the aggregate amounts that are owing by Cleo to Trafigura under the Prepayment Agreement as against the amounts owing by Trafigura to Cleo under the Commercial Agreement for Cleo's November 2024 production; and
 - (ii) the aggregate of all amounts that are owing by Cleo to Trafigura under the Prepayment Agreement as against the ongoing amounts owing by Trafigura to Cleo under the Commercial Agreement for Cleo's continuing production under the Commercial Agreement; and
 - (iii) any amounts owed or allegedly owed by Cleo to Trafigura prior to December 8, 2024, including without limitation, those amounts claimed by Trafigura from Cleo in connection with the Prepayment Agreement (as defined herein);

¹⁴ December 22 Affidavit at para 53.

- (c) declaring that the amounts owing by Cleo to Trafigura under the Prepayment Agreement are unsecured debts;
- (d) declaring that Trafigura is stayed from exercising a right of acceleration under the Prepayment Agreement during the Stay Period pursuant to Section 65.1(1) of the *BIA*;
- (e) directing Trafigura to immediately pay to Cleo the amount of \$757,644.77 owing to Cleo pursuant to the Commercial Agreement for Cleo's November, 2024 production;
- (f) ordering that Trafigura continue to pay to Cleo all amounts currently owing or which may become owing by Trafigura to Cleo in connection with the Commercial Agreement;
- (g) directing that Trafigura pay Cleo's costs on an elevated basis; and
- (h) such further and other relief as Cleo may request and this Honourable Court may grant.

II. ISSUES

16. This Brief addresses whether this Honourable Court should:

- (a) declare that Trafigura's right to effect set-off is stayed pursuant to section 69(1) of the *BIA* with respect to the following:
 - (i) the aggregate amounts that are owing by Cleo to Trafigura under the Prepayment Agreement as against the amounts owing by Trafigura to Cleo under the Commercial Agreement for Cleo's November 2024 production; and
 - (ii) the aggregate of all amounts that are owing by Cleo to Trafigura under the Prepayment Agreement as against the ongoing amounts owing by Trafigura to Cleo under the Commercial Agreement for Cleo's continuing production under the Commercial Agreement; and

- (iii) any amounts owed or allegedly owed by Cleo to Trafigura prior to December 8, 2024, including without limitation, those amounts claimed by Trafigura from Cleo in connection with the Prepayment Agreement (as defined herein);
- (b) declare that Trafigura is in breach of section 65.1(1) of the *BIA*; and
- (c) direct Trafigura to immediately pay to Cleo all amounts owing to Cleo under the Commercial Agreement for Cleo's November 2024 production.

III. LAW AND ARGUMENT

A. Stay of Trafigura Canada Limited Set-off Claims

17. Following the Filing Date and notwithstanding the Stay Period, Trafigura intends to set-off all amounts owing by Trafigura to Cleo under the Commercial Agreement for Cleo's November production in order to collect almost all amounts owing by Cleo to Trafigura under the Prepayment Agreement. Cleo seeks a declaration that Trafigura is stayed from doing so.
18. Pursuant to section 97(3) of the *BIA*, the law of set-off applies to all claims made against a bankrupt's estate as well as to all actions instituted by the trustee for the recovery of any debts owed to the bankrupt:

Law of set-off or compensation

97(3) The law of set-off or compensation applies to all claims made against the estate of the bankrupt and also to all actions instituted by the trustee for the recovery of debts due to the bankrupt in the same manner and to the same extent as if the bankrupt were plaintiff or defendant, as the case may be, except in so far as any claim for set-off or compensation is affected by the provisions of this Act respecting frauds or fraudulent preferences.¹⁵

19. Pursuant to Section 66(1) of the *BIA*, section 97(3) is applicable to a proposal proceeding.¹⁶

¹⁵ *BIA* section 97(3) [TAB 1]

¹⁶ *BIA* section 66(1) [TAB 1]

20. A similar set-off provision is explicitly provided for in section 21 of the *Companies Creditor Arrangement Act* (“CCAA”):

Law of set-off or compensation to apply

The law of set-off or compensation applies to all claims made against a debtor company and to all actions instituted by it for the recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be.¹⁷

21. While the *BIA* does not expressly restrict or abrogate the right to set off debts of an insolvent debtor during reorganization, a restriction on the exercise of set-off rights is implied in section 69(1) of the *BIA*, which extends the stay of proceedings with respect to the ability of creditors to, among other things, seek remedies for the recovery of property of the debtor:

Stay of proceedings — notice of intention

69 (1) Subject to subsections (2) and (3) and sections 69.4, 69.5 and 69.6, on the filing of a notice of intention under section 50.4 by an insolvent person,

(a) no creditor has any remedy against the insolvent person or the insolvent person’s property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy,

(b) no provision of a security agreement between the insolvent person and a secured creditor that provides, in substance, that on

(i) the insolvent person’s insolvency,

(ii) the default by the insolvent person of an obligation under the security agreement, or

(iii) the filing by the insolvent person of a notice of intention under section 50.4,

¹⁷ *Companies’ Creditor Arrangement Act*, RSC 1985, c C-36 section 21 [TAB 2]

the insolvent person ceases to have such rights to use or deal with assets secured under the agreement as he would otherwise have, has any force or effect,¹⁸

22. In *North American Tungsten Corporation Ltd. (Re)*¹⁹, the British Columbia Supreme Court, affirmed later by the Court of Appeal, noted that section 21 of the CCAA does not exempt set-off claims from stays, even when it is acknowledged that those rights exist.
23. In *Re Just Energy Corp.*²⁰, the Ontario Superior Court of Justice concluded that section 21 of the CCAA does not exempt set-off rights from a stay of proceedings.
24. Similarly, in *Carillion Canada Inc.*²¹, the Ontario Superior Court of Justice concluded that while the creditor's contractual set-off were preserved pursuant to section 21 of the CCAA, they were subject to the stay of proceedings granted by the initial order. By unilaterally exercising these set-off rights, the court concluded that the creditor breached the stay and the terms of the initial order and the Ontario Superior Court of Justice granted a cost award of \$50,000 against the creditor for having unilaterally exercised its set-off rights in the face of the stay provisions in the initial order.
25. Although the Ontario Superior Court of Justice in *Carillion* ultimately granted its discretion to allow the set-off notwithstanding the finding that the stayed was breached, it did so only because no unsecured creditors were prejudiced as a result of the set-off. This is will not be the case for Cleo and its stakeholders if Trafigura does exercise set-off, as discussed further below.
26. While the above cases were decided under the CCAA, the two statutes should be read harmoniously,²² and the same analysis applies to the stay of proceedings and stay-off provisions under the *BIA*.

¹⁸ *BIA* section 69(1) [TAB 1]

¹⁹ *North American Tungsten Corporation Ltd. (Re)*, 2015 BCSC 1382 at para 28 [TAB 3]

²⁰ *Re Just Energy Corp.*, 2021 ONSC 1793 (Ont. S.C.J. [Commercial List]) at para 102 [TAB 4]

²¹ *Carillion Canada Inc.*, 2022 ONSC 4617 (Ont. S.C.J.) at paras 70-73 [TAB 5]

²² 9354-9186 *Québec inc. v. Callidus Capital Corp.*, 2020 SCC 10 at para 74 [TAB 6]; *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60 at para 24 [TAB 7]

B. Breach of Section 65.1(1) of the BIA

27. Sections 65.1(1) of the *BIA* provides that if a notice of intention or proposal has been filed in respect of an insolvent person, no person may claim an accelerated payment under any agreement by reason only that a notice of intention or a proposal has been filed in respect of the insolvent person:

Certain rights limited

65.1 (1) If a notice of intention or a proposal has been filed in respect of an insolvent person, no person may terminate or amend any agreement, including a security agreement, with the insolvent person, or claim an accelerated payment, or a forfeiture of the term, under any agreement, including a security agreement, with the insolvent person, by reason only that

(a) the insolvent person is insolvent; or

(b) a notice of intention or a proposal has been filed in respect of the insolvent person.

...²³

28. The Prepayment Agreement includes the following provisions relating to Trafigura's right of set-off:

1 Definitions

1.1 In this Agreement the following words and expressions have the following meanings:

"Advance" means an advance payment made or to be made under this Agreement by the Buyer to the Borrower up to a maximum principal amount equal to the Maximum Amount.

"Advance Date" means the date on which an Advance is made under Section 5.

"Maturity Date" means, in respect of each Advance, the date falling one (1) year from the Advance Date, as the same may be extended pursuant to Section 5.6(c).

[...]

13.2 The Buyer may set off any matured obligation due from the Borrower against any matured obligations owed by the Buyer to the Borrower, regardless of the place of payment, booking branch or currency of either obligation. If the obligations are in different currencies, the Buyer may convert either obligation at a rate available to the Buyer in its usual course of business for the purpose of the set-off. *[emphasis added]*

²³ *BIA* section 65.1(1)[**TAB 1**]

29. By setting-off the amounts Cleo owes Trafigura under the Prepayment Agreement, Trafigura is treating Cleo's debt obligations under that agreement as being accelerated, in breach of section 65(1) of the *BIA*.
30. In its counsel correspondence, Trafigura refers to "one or more Defaults and/or Termination Events" having occurred under the Prepayment Agreement. Trafigura has not identified the events which it considers to constitute "Default and/or Termination Events" beyond a vague reference to "the accuracy of representations or [...] information undertakings, based upon recent materials filed by Cleo in connection with the NOI."²⁴
31. Cleo has continued to abide by all terms of the Prepayment Agreement and the Commercial Agreement at all times and is not in default of its obligations under either the Prepayment Agreement or the Commercial Agreement. Cleo has not received any notice of default from Trafigura or any pre NOI filing demand for payment from Trafigura²⁵.
32. In *Fast Industries Ltd. v. Sparta Engineering Ltd.*, ("Fast Industries") the Applications Judge (then Master) of the Alberta Court of Queen's Bench considered the impact of the automatic stay of proceedings on the filing of a notice of intention to make a *BIA* proposal, and whether it precluded set off against an invoice issued by the debtor after the filing of the NOI. The court determined that where the claim or debt in question is an unenforceable debt by virtue of it not having ripened, matured or come into existence, the debt does not qualify for legal set-off and is caught by the stay of proceedings effective on the date of filing the NOI²⁶.
33. In relation to the Prepayment Agreement, the court's analysis in *Fast Industries* is particularly relevant. The Prepayment Agreement does not allow for a right of set-off because the Advance has not yet matured. The court's determination in *Fast Industries* that only matured and enforceable debts can be set off, reinforces that any attempt to set off under these circumstances would be caught by the stay.

²⁴ December 22 Affidavit at para 41.

²⁵ December 22 Affidavit at paras 42 and 43.

²⁶ *FAST Industries Ltd. v. Sparta Engineering Ltd.*, 2016 ABQB 215 at paras 26-28 [**TAB 8**]

Prejudice of Set-off

34. If Trafigura is permitted to exercise its alleged set-off rights and Cleo does not receive the full amount of the December Payment, the impacts and prejudice will be catastrophic for Cleo, its creditors and other stakeholders, including the general public²⁷.
35. The ensuing lack of operating capital will immediately materially impact Cleo's operations. Cleo currently has extremely limited cash resources and without receiving the entire December Payment from Trafigura on December 24, 2024, Cleo will be forced to immediately cease operations²⁸. This will result in a material adverse change to Cleo's operations for the purpose of these proposal proceedings. Cleo's restructuring efforts will fail and likely cause Cleo to go bankrupt shortly thereafter. Creditors will subsequently not receive the maximum benefit that could have been achieved had Cleo been able to continue operations and these Proposal Proceedings²⁹.
36. If Cleo is forced to cease all operations as a result of Trafigura's alleged set-off right, Cleo will not be able to preserve its assets and prevent environmental issues from arising during the winter months through ongoing R&M³⁰. Cleo will also not be able to safeguard its assets from theft and vandalism as has been recently occurring just prior to the filing of the NOI.
37. By accelerating its debt under the Prepayment Agreement and attempting improper setoff, Trafigura will also prejudice Cleo's other creditors by improperly receiving payment for its unsecured debt in priority to all other creditors.

Emergency Direction to Pay

38. In *Accel Canada (Re)* (Court File Number 1901-16581)³¹, the Honourable Madame Justice Horner granted the debtor company an emergency order directing that the debtor's oil marketing company make immediate payment to the debtor a portion of the debtor's oil

²⁷ December 22 Affidavit at para 48.

²⁸ December 22 Affidavit at para 49.

²⁹ December 22 Affidavit at para 53.

³⁰ December 22 Affidavit at para 53.

³¹ *Accel Canada (Re)* (Court File Number 1901-16581), Emergency Order [TAB 9]

production revenues when the marketing company failed and refused to provide the production revenues.

39. As referenced above, it is critical that Cleo immediately receive its November production revenue from Trafigura, failing which its operations will shut down.

IV. CONCLUSION AND RELIEF SOUGHT

40. Without the aforementioned declarations and order directing Trafigura provide Cleo its November production revenue without setoff, Cleo's Proposal Proceedings will fail to the detriment of all of its stakeholders. Cleo will suffer irreparable harm if it does not receive the November production payment owing to it by Trafigura under the Commercial Agreement without set-off. Cleo's request is reasonable and appropriate in the circumstances and necessary for the benefit of its estate and its stakeholders.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 22nd day of December, 2024.

GOWLING WLG (CANADA) LLP

Per: _____


Sam Gabor/Tom Cumming
Counsel for Cleo Energy Corp.

TABLE OF AUTHORITIES

Tab	Authority
1.	<u>Bankruptcy and Insolvency Act, RSC 1985, c B-3</u>
2.	<u>Companies' Creditor Arrangement Act, RSC 1985, c C-36</u>
3.	<u>North American Tungsten Corporation Ltd. (Re), 2015 BCSC 1382</u>
4.	<u>Re Just Energy Corp., 2021 ONSC 1793 (Ont. S.C.J. [Commercial List])</u>
5.	<u>Carillion Canada Inc., 2022 ONSC 4617 (Ont. S.C.J.)</u>
6.	<u>9354-9186 Québec inc. v. Callidus Capital Corp., 2020 SCC 10</u>
7.	<u>Century Services Inc. v. Canada (Attorney General), 2010 SCC 60</u>
8.	<u>FAST Industries Ltd. v. Sparta Engineering Ltd., 2016 ABQB 215</u>
9.	<u>Accel Canada (Re) (Court File Number 1901-16581), Emergency Order</u>