

COURT FILE NUMBER B301-163430

COURT COURT OF KING'S BENCH OF ALBERTA

JUDICIAL CENTRE CALGARY

 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.

APPLICANT CLEO ENERGY CORP.

**BENCH BRIEF OF THE RESPONDENT,
TRAFIGURA CANADA LIMITED**

**FOR THE HEARING SCHEDULED IN JUDGE'S CHAMBERS
ON January 6, 2025, AT 2:00 PM**

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PART I – INTRODUCTION AND RELIEF SOUGHT

1. Trafigura Canada Limited (“**Trafigura**”) submits this Brief in response to Cleo Energy Corp.’s (“**Cleo**”) Application and in support of Trafigura’s Application, both scheduled to be heard concurrently on January 6, 2025. In its Application, Trafigura, in connection with Cleo’s proceedings under Division I of Part III of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, as amended (the “**BIA**”, and such proceedings, the “**Proposal Proceedings**”), commenced by notice of intention to make a proposal filed on December 8, 2024 (the “**Filing Date**”, and such notice the “**NOI**”), seeks an Order for the following relief:
 - (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) granting a declaration that certain obligations whereby Trafigura must pay Cleo the purchase price for crude oil delivered by Cleo to Trafigura in a given month under the Commercial Agreement (“**Purchase Price**”) which are calculated and become due after the Filing Date according to the schedule agreed to therein are post-filing obligations (“**Trafigura Post-Filing Obligations**”);
 - (c) granting a declaration that certain obligations whereby Cleo must pay Trafigura amounts arising from the Prepayment Agreement which become due after the Filing Date according to the schedule agreed to therein are post-filing obligations (“**Cleo Post-Filing Obligations**”);
 - (d) granting a declaration that the outstanding balance of \$750,000 paid by Trafigura to Cleo pursuant to the Prepayment Agreement as a prepayment of the purchase price for crude oil delivered under the Commercial Agreement (the “**Purchase Price Advance**”) is a Cleo Post-Filing Obligation, as it becomes due on a monthly basis subsequent to the Filing Date; and
 - (e) authorizing Trafigura to exercise its right of set-off under the Prepayment Agreement (as defined herein) pursuant to section 97(3) of the *BIA*, by allowing it to deduct Cleo Post-Filing Obligations (including the Purchase Price Advance) against Trafigura Post-Filing Obligations as they become due on a monthly basis;
 - (f) in the alternative, granting a declaration pursuant to section 69.4 of the *BIA* that the Stay of Proceedings should be lifted in order to allow Trafigura to exercise its right of set-off with respect to the Purchase Price Advance and deduct it from Trafigura Post-Filing Obligations as they become due on a monthly basis;

- (g) in the further alternative, granting a charge in favour of Trafigura in the amount of the Purchase Price Advance, attaching to all of the assets and property of Cleo (the “**Trafigura Charge**”) that shall rank in priority to all other charges, liens, mortgages, security interests and other encumbrances, except for any administrative charge in favour of the Proposal Trustee, its legal counsel and Cleo’s legal counsel in respect of their fees and disbursements and any charge in favour of a potential DIP lender, both of which shall rank in priority to the Trafigura Charge;
- (h) awarding costs of this Application to Trafigura; and
- (i) such further and other relief as counsel for Trafigura may advise.

PART II – FACTS

2. A statement of the facts can be found in the Affidavit of Ethan Post, sworn December 23, 2024.
3. On July 12, 2024, Trafigura and Cleo entered into a commercial agreement (the “**Commercial Agreement**” and together with the Prepayment Agreement, the “**Agreements**”) whereby Trafigura agreed to market and sell Cleo’s oil product. Concurrently, Trafigura and Cleo entered into the Prepayment Agreement wherein Trafigura agreed to make certain prepayments to Cleo which were to be repaid by Cleo either by repayment with cash or by way of set-off against deliveries of oil product by Trafigura to Cleo under the Commercial Agreement. In accordance therewith, Trafigura pre-paid \$1,000,000 to Cleo on August 1, 2024 (the “**Prepayment Agreement**”) of the purchase price for crude oil. For three months, the Agreements worked as intended, and set off rights were applied each month as contemplated.
4. On December 8, 2024 (the “**Filing Date**”), and without any prior notice to Trafigura, Cleo filed a notice of intention to file a proposal (the “**NOI**”) under the BIA. Trafigura notified Cleo of its intention to exercise its set off rights as against the Purchase Price for the November production.
5. Cleo brought an emergency application on December 23, 2024, seeking an Order that Trafigura pays the Purchase Price for the November 2024 deliveries to Cleo, as opposed to setting off the full outstanding Purchase Price Advance against the same. Trafigura brought a cross-application to allow their set off rights. These applications were considered and an endorsement delivered by Justice Hollins without oral argument on December 26, 2024 (the “**Endorsement**”).
6. In her Endorsement, Justice Hollins granted Cleo’s application declaring that the stay of proceedings under section 69 of the BIA prevented Trafigura from enforcing its set-off rights, and ordered that \$757,644.77, representing the estimated Purchase Price for the November 2024 deliveries, be paid by Trafigura to Cleo immediately. Trafigura complied with the Justice Hollins’ Endorsement by payment

directly to Cleo on December 27, 2024, of the Purchase Price calculated for the November 2024 deliveries, adjusted for a previous GST payment.

7. Justice Hollins explicitly did not decide the issue of the ongoing monthly set-off of the Cleo Post-Filing Obligations against Trafigura Post-Filing Obligations and adjourned determination of this issue to a future hearing.

PART IV – LAW AND ARGUMENT

8. Set off rights are specifically preserved in NOI proceedings under section 97(3) of the BIA. In order to give meaning to this section, the Court must consider the nature of the set off rights and the extent to which they are sought to be enforced.
9. A bankrupt's estate includes only the net amount of a debt owing to the bankrupt after proper allowances for the recognized common law right of set-off.¹
10. The leading case on set-off rights in an insolvency proceeding is the 2021 Supreme Court of Canada decision in *Montréal (City) v. Deloitte Restructuring Inc.*,² Pre-filing obligations can be set-off against other pre-filing obligations but post-filing obligations cannot be set-off against pre-filing obligations. Notably, it is still unsettled law whether post-filing obligations can be set off against other post-filing obligations based on contracts entered into prior to the Filing Date.
11. In the present case, Trafigura and Cleo entered into a Prepayment Agreement whereby Trafigura agreed to pay Cleo in advance for the purchase price of crude oil to be delivered by Cleo pursuant to the Agreements. The Prepayment Agreement allowed for prepayments of \$1 million, up to a maximum of \$3 million, in exchange for 100% of the available marketable crude from Cleo's existing assets for the duration of the term of the Commercial Agreement ("**Trafigura Post-Filing Obligations**"). The Trafigura Post-Filing Obligations vary from month to month based on the value of the marketable crude produced by Cleo's existing assets. As such, these monthly obligations are calculated and become due after the Filing Date and are properly considered post-filing obligations.
12. The Prepayment Agreement and Commercial Agreement contain set-off mechanisms allowing for the Purchase Price Advance to be deducted from the Purchase Price from time to time, and specifically in tranches of \$83,000, as they become due on a monthly basis ("**Cleo Post-Filing Obligations**"). Obligations arising from December production are post-filing obligations as they become due on a monthly basis subsequent to the Filing Date.

¹ *Husky Oil Operations Ltd v Minister of National Revenue* (1993), 22 CBR (3d) 153, [1994] 1 WWR 629; affirmed [1995] 10 WWR 161, 128 DLR (4th) 1 (SCC).

² *Montréal (City) v. Deloitte Restructuring Inc.*, 2021 SCC 53, [2021] 3 S.C.R. 736 at para 81 ("**Deloitte Restructuring**").

13. In order for a debt to be considered to exist at the Filing Date, it must be capable of being enforced.³ As neither the Cleo Post Filing Obligations nor the Trafigura Post-Filing Obligations were capable of being enforced prior to the Filing Date, they both constitute post-filing obligations.
14. The prepayment made under the Prepayment Agreement, and therefore the Purchase Price Advance, is not a loan. Trafigura made an agreement to pre-pay for goods it purchased from Cleo under the Commercial Agreement. The Commercial Agreement and the Prepayment Agreement work together to govern the relationship between the parties, which is not a creditor-debtor relationship based on a loan, but a commercial agreement which gives rise to ongoing mutual obligations.
15. Trafigura submits that it is common in the oil and gas industry to enter into different types of commercial business arrangements and that it is the true nature of the relationship in contract that dictates the characterization of such arrangements.⁴ The nature of the relationship between Trafigura and Cleo in the context of the Commercial Agreement and Prepayment Agreement is that of vendor-purchaser, whereby Cleo supplies crude oil and Trafigura pays an agreed upon price for such crude oil. The existence of repayment rights for amounts advanced is not enough to characterize the Prepayment Agreement as a loan.⁵ Even where certain provisions suggest characterizing an agreement as a loan contract, it is the primary purpose of that agreement that dictates this characterization.⁶
16. The Prepayment Agreement sets out the terms under which Trafigura advanced payment of the Purchase Price for crude oil purchased from Cleo under the Commercial Agreement. Trafigura therefore submits that this is its primary purpose. The fundamental nature of the Commercial Agreement and Prepayment Agreement is the purchasing by Trafigura of crude oil from Cleo and the payment terms applicable to such purchase. Trafigura further submits that the fact that a contract allows for pre-payment or prepayment facilities does not negate the fundamental nature of the transaction being that of vendor-purchaser even if the effect of the availability of such prepayment facility is to provide a mechanism of alleviating cash-flow issues.⁷

³ Endorsement at para 16.

⁴ See e.g., *Yukon Zinc Corp., Re*, 2015 BCSC 836 at para 137 where the British Columbia Superior Court holds that a purchase agreement that allowed for pre-payment and prepayment facilities did not detract from the fundamental nature of the agreement, being an agreement to purchase zinc concentrate [*Yukon Zinc*].

⁵ See e.g., *Iberdrola Energy Projects Canada Corporation v. Factory Sales & Engineering Inc. d.b.a. FSE Energy*, 2018 BCCA 272 at para 53 where the British Columbia Court of Appeal holds that a payment agreement is not a loan merely because there exists the right to be repaid [*Iberdrola*].

⁶ See e.g., *Iberdrola* at para 63.

⁷ See e.g., *Yukon Zinc* at para 137 where the British Columbia Supreme Court holds that the existence of pre-payment provisions or advance payment facilities in the context of purchase agreements does not detract from the fundamental nature of the agreement, being that of a purchase agreement. This is true even where such pre-payment or advance payment facilities provide a mechanism of alleviating cash flow issues on the part of the party receiving such pre-payments or advanced payment appearing as a financial arrangement.

17. Multiple provisions in the Prepayment Agreement explicitly contemplate repayment by way of set-off, from time to time, in particular Recital B, section 2.1, section 5.3(b), and section 13.2 all of which are reproduced below.⁸

(B) Subject to the terms of this Agreement, [Trafigura] has agreed to make Advances to [Cleo] in the manner set out in Section 5 (*Advances*), and the Advances shall be repaid by [Cleo] to [Trafigura] either by repayment with cash or by way of set-off against deliveries of Products by [Cleo] to [Trafigura] under the Commercial Contract.

(...)

2.1 The Prepayment Facility

Subject to the terms of this Agreement, [Trafigura] agrees to make Advances to [Cleo] in an aggregate amount not to exceed the Maximum Amount as a prepayment of the purchase price for the Products under the Commercial Contract. The Obligations may be repaid in whole or in part, and from time to time, either by cash repayment by [Cleo] or by setting off amounts due to [Cleo] from [Trafigura] as payment for deliveries by [Trafigura] of Products under the Commercial Contract (or by a combination thereof, all as set forth in Section 5.3.

(...)

5.3 Scheduled Payments

(...)

(b) [Trafigura] shall be entitled to deduct on the last day of each Delivery Period the Relevant Amount for each Advance for that Delivery Period plus any accrued interest and any other Unpaid Amounts from the purchase price for the Products delivered by the Borrower pursuant to the Commercial Contract. [Trafigura's] obligation to pay for the Products under the Commercial Contract shall be satisfied and extinguished to the extent of such deductions.

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

⁸ Affidavit of Ethan Post, sworn on December 23, 2024 [Post Affidavit], Exhibit B at Preamble and ss 2.1, 5.3(b).

18. Reading the Prepayment Agreement as a whole, including the provisions set out above, and in conjunction with the Commercial Agreement (which is an ancillary agreement to the Prepayment Agreement), it is clear that set-off rights underpin the entire repayment process. This is not a loan where there is an extension of credit with defined repayment terms and which are not connected with the sale and purchase. This was a facility which was designed by its very nature to be repaid by way of deducting the Purchase Price Advance from the Purchase Price, as they become due, from time to time.
19. If the Court were to deny Trafigura its right of set-off in the circumstances, it would in effect require Trafigura to pay for crude oil Trafigura purchases from Cleo under the Commercial Agreement twice and allow Cleo to benefit from the Agreements, while denying Trafigura its negotiated rights arising therefrom. This cannot be a reasonable outcome in the circumstances and would negatively impact commercial agreements regarding payment of goods moving forward.
20. An entitlement to the contractual right of set-off will be recognized where there is mutuality between the liabilities owed, and where such contractual set-off is demonstrated to extend to the agreements creating the liabilities sought to be set-off.⁹ Determination of mutuality requires consideration of the relationship and agreement between the parties.¹⁰
21. In *SemCanada* the Alberta Court of Queen's Bench recognized the contractual right of set-off where it is established that the set-off provisions are broad enough to extend to the agreements in question.¹¹ The Prepayment Agreement is supplemental to the Commercial Agreement and set-off against amounts owed under the Commercial Contract is contemplated expressly in the terms of the Prepayment Agreement.
22. A contracting party's entitlement to the contractual right of set-off has been recognized in the context of commercial business arrangements entered into in the context of the mining and oil and gas industries. In *Trevali Mining Corporation (Re)*,¹² the British Columbia Supreme Court emphasized the requirement for mutuality in upholding contractual set-off rights. The British Columbia Supreme Court did not allow the claimant to assert set-off rights relating to certain HST liabilities on the basis that collection of HST is done in the capacity as an agent for the Canada Revenue Agency. As such, there was no mutual cross-obligations in existence among the parties as it related specifically to the HST

⁹ See e.g., *SemCanada Crude Co., Re*, 2009 ABQB 397 at paras 26 and 29-30, leave to appeal to ABCA refused (*Trilogy Energy LP v. SemCAMS ULC*, 2009 ABCA 275) where the Alberta Court of Queen's Bench holds that there was no entitlement to contractual set-off on the basis that the parties to the contracts in question contracted in different capacities under each agreement, thus there was no mutuality [*SemCanada*].

¹⁰ See e.g., *SemCanada* at paras 44-56 where the Alberta Court of Queen's Bench holds that the debts sought to be set-off did not arise from closely-related contracts or the same transaction and thus were not sufficiently related to establish set-off rights.

¹¹ *SemCanada* at para 26

¹² *Trevali Mining Corporation (Re)*, 2024 BCSC 2252 at para 79 [*Trevali*].

liabilities. However, in coming to this conclusion, the British Columbia Supreme Court recognized the validity of the set-off provision in question as it related to certain other liabilities where mutuality did exist, and which were successfully set-off by the claimant.¹³

23. Trafigura submits that mutual cross-obligations exist under the Prepayment Agreement and the Commercial Agreement and that such cross-obligations are owed from each party to the other in the same right or capacity. Further, as both the Trafigura Post-Filing Obligation and Cleo Post-Filing Obligation arose subsequent to the Filing Date, it would be unfair to require Trafigura to comply with its post filing obligations while allowing Cleo to benefit from these obligations without being required to comply with its own post-filing obligations. Trafigura submits that the appropriate outcome in the circumstances is to allow Trafigura to set-off the Trafigura Post-Filing Obligations against the Cleo Post-Filing Obligations on a go-forward basis.
24. The Owed Amount was and is due and owing, regardless of whether it had matured, as, for the purpose of set-off, a debt is payable regardless of whether it is payable now or at a future time.¹⁴
25. If required, Trafigura submits that, pursuant to section 69.4 of the BIA, this Honourable Court should grant a declaration pursuant to section 69.4 of the BIA that the stay of proceedings in favour of Cleo (the “**Stay**”) does not operate to bar Trafigura from exercising its right of set-off under the Prepayment Agreement. Trafigura will be materially prejudiced if the Stay is not lifted, as the contractual rights it bargained for will be stripped of all meaning, and it will be forced to pay for the same goods twice.¹⁵
26. In the further alternative, Trafigura submits that if this Honourable Court is unable to consider this issue on the merits on January 6, 2025, ensure that Trafigura’s right to claim set-off at a later date is not prejudiced, Trafigura submits that it should be granted the Trafigura Charge. The Trafigura Charge should rank in priority to all other charges, mortgages, liens, security interests and other encumbrances, except for any Administrative Charge or DIP Lender Charge, both of which shall rank in priority to the Trafigura Charge. Without the Trafigura Charge, Trafigura’s right to argue set-off at a later date could essentially be rendered moot if Cleo becomes bankrupt and its assets (which are oil and gas assets encumbered by significant environmental obligations) are sold for less than Cleo’s roughly \$24 million in debt, especially if the assets are sold for less than the secured debt, in which case Cleo would see no recovery and its ability to claim set-off would be entirely extinguished.

¹³ *Trevali* at para 75.

¹⁴ See e.g., *Re North American Tungsten Corp*, 2015 BCSC 1382 at paras 10-11, aff’d 2015 BCCA 390.

¹⁵ See e.g., *Montreal (Ville) c Restructuration Deloitte Inc*, 2021 SCC 53 at paras 63-82 where the Supreme Court of Canada holds that pre-post set-off is prohibited (unless otherwise ordered by the Court) and that section 21 of the *Companies Creditors’ Arrangement Act*, RSC 1985, c C-36 (which is largely identical to section 97(3) of the BIA) authorizes pre-pre set-off.

PART V – CONCLUSION

27. Without the sought relief, Trafigura will be irreparably prejudiced, its contractually bargained for set-off rights will be rendered moot and it will be required to pay for crude which it has already paid for. Meanwhile, Cleo will receive all of the benefits under the Agreements, without having to answer to the extensive set-off rights it promised to Trafigura in return. As a result, the relief sought by Trafigura is reasonable and appropriate in the circumstances.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 6th day of January, 2025.

STIKEMAN ELLIOTT LLP



Per: _____

Karen Fellowes, K.C.

Counsel for the Respondent/Applicant,
Trafigura Canada Limited

TABLE OF AUTHORITIES

Tab No.	Description
1)	<i>Re North American Tungsten Corp</i> , 2015 BCSC 1382 at paras 10-11, aff'd 2015 BCCA 390
2)	<i>Re 728835 Ontario Ltd.</i> (1998), 111 OAC 155 (Gen Div)
3)	<i>Husky Oil Operations Ltd v Minister of National Revenue</i> (1993), 22 CBR (3d) 153, [1994] 1 WWR 629; affirmed [1995] 10 WWR 161, 128 DLR (4th) 1 (SCC)
4)	<i>Montreal (Ville) c Restructuration Deloitte Inc</i> , 2021 SCC 53