

Court of King's Bench of Alberta

Citation: Cleo Energy Corp (Re), 2024 ABKB 773



Date:
Docket: B301 163430
Registry: 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.**

**Endorsement
of the
Honourable Justice M.H. Hollins**

[1] Cleo Energy Corp. is an oil and gas company operating in Alberta. It sells some of its products to Trafigura Canada Limited and Trafigura pays on the 24th day of each month for the gas products purchased in the month prior.

[2] In addition to this arrangement, which is governed by a Commercial Agreement, Trafigura also loaned \$1M USD to Cleo in August of 2024 (the Loan), as Cleo has been in financial and operational difficulties for most of this year.

[3] The Loan, governed by a Prepayment Agreement, provided that Cleo would make a installment repayment of principle every month (approximately \$91,000). It also gave Trafigura the right to set-off further amounts against its obligations to Cleo under the Commercial Agreement, which set-off amount is calculated based on the monthly production,

[4] The Loan matures on July 1, 2025. However, on December 8, 2024, Cleo filed and served a Notice of Intention to make a proposal under the *Bankruptcy and Insolvency Act*, RSC 1985, c.B-3 as amended (BIA). As a result, there is a stay of proceedings of any actions against Cleo for 30 days therefrom. The court application for an order extending that time is scheduled for January 6, 2025.

[5] In the meantime, however, Trafigura has advised Cleo that it intends to set-off the entire balance of the Loan (\$750,000) against its payment due to Cleo on December 24, 2024. Absent this set-off, that payment would be \$757,644.77 but with the set-off, Trafigura is proposing to pay \$35,965.78.

[6] Cleo takes the position that the statutory stay applies to Trafigura's right to set-off the balance of the outstanding Loan amount and therefore Trafigura's attempt to do so contravenes the BIA. Trafigura says that this is a pre-filing debt under the Prepayment Agreement and therefore its contractual rights to set-off are not affected by the stay.

[7] Both parties allege significant prejudice if their respective position is not upheld – Cleo because without this \$757,644.77 payment, it will cease operations before the January 6, 2025 court date and Trafigura because, if it pays the full December amount now, it is unlikely to recoup this money as an unsecured creditor in the ongoing proceedings.

[8] For the reasons that follow, I agree with Cleo that Trafigura is not at liberty to set-off the entire Loan balance against its December payment and that the \$757,644.77 payment is due immediately.

Analysis

[9] Trafigura relies primarily on s.97(3) BIA:

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.

[10] This is equally applicable to a proposal proceeding such as this; s.66(1) BIA.

[11] Thus, there is no question that Trafigura has a right of set-off but for how much? Trafigura argues that the whole amount of the outstanding balance can be set off either (1) because it is an existing debt, whether due now or later; or (2) because Cleo's pre-filing breaches of the Prepayment Agreement entitle Trafigura to accelerate the outstanding amount.

[12] Trafigura points to various sections of the Prepayment Agreement to make the point that the right of set-off was central to the entire repayment arrangement, which is clearly accurate (Recital B, ss.2.1 and 5.3 of the Prepayment Agreement). It says that a debt is a debt, whether owing now or in the future; *North American Tungsten Corp. Ltd*, 2015 BCSC 1382 at para.10. However, acknowledging the existence of a debt is different than saying that debt is owing.

[13] There is a 1998 Ontario case, *Re 728835 Ontario Ltd*, in which the Court reasoned that any existing debt, regardless of when it was payable, was eligible for set-off. The decision was upheld by the Ontario Court of Appeal; 1998 CarswellOnt 2576. To the extent that my decision is contrary to that jurisprudence, I rely on subsequent cases which have delved more deeply into the distinction of debts owing pre-filing versus post-filing.

[14] In fact, *728835 Ontario Ltd* was cited by two of my colleagues, once in *Schendel Mechanical Contracting Ltd. (Re)*, 2021 ABQB 893 and once in *FAST Industries Ltd v Sparta Engineering Inc*, 2017 ABQB 240 (affirming Master Smart at 2016 ABQB 215. Both of those

decisions centred on what was owing at the date of the bankruptcy or filing. Justice Topolniski put it thus:

[Section 97\(3\) BIA](#) preserves legal set-off and equitable set-off where two persons are both debtors and creditors of the other: [Husky Oil Operations Ltd. v. Minister of National Revenue](#), 1995 CanLII 69, [1995] 3 S.C.R. 453 (S.C.C.). Indeed, as noted in that case at para 60:

...in the bankruptcy context, the law of set-off allows a debtor of a bankrupt who is also a creditor of the bankrupt to refrain from paying the full debt owing to the estate, since it may be that the estate will only fulfil a portion, if that, of the bankrupt's debt. Consequently, in this limited sense the party claiming set-off has Parliament's blessing for the "reordering" of his priority in bankruptcy by virtue of the operation of the law of set-off.

Because the effect of the set-off is to prefer one creditor over the general body of creditors, it is confined within narrow limits and the requirement of mutuality is rigorously enforced, *Bank of Credit & Commerce International S.A. (No. 8)*, [Re \(1995\), \[1996\] 2 W.L.R. 631](#) (Eng. C.A.). Accordingly, [s 69 of the BIA](#) stays all proceedings against a bankrupt or a person who has filed a NOI including set-off of *pre-bankruptcy and pre-NOI debts against post-bankruptcy and NOI debts: Vachon v. Canada (Employment & Immigration Commission)*, [\[1985\] 2 S.C.R. 417](#) (S.C.C.); *Sabey, Re*, [\[1996\] B.C.J. No. 2820](#) (B.C. S.C.) at para 16; *Jones, Re (2003)*, [66 O.R. \(3d\) 674](#) (Ont. C.A.) at para 14; *Cobourg Felt Hat Co., Re*, [\[1925\] 2 D.L.R. 997](#) (Ont. S.C.); *728835 Ontario Ltd., Re (1998)*, [3 C.B.R. \(4th\) 211](#) (Ont. Gen. Div. [Commercial List]), *aff'd 728835 Ontario Ltd., Re (1998)* [\[1998 CarswellOnt 2576](#) (Ont. C.A.)].

The longstanding policy reason for this limitation is that, notwithstanding [s 97\(3\)](#), the equitable rights of creditors cannot be undermined. As noted in *Cobourg Felt at* paras 9 -10, allowing set-off from a post NOI debt against a debtor's pre-NOI obligations is inconsistent with, and in effect, a fraud on the proposals contrary to equity and good conscience. In my view, the competing policy objective of fostering continued relationships between restructuring entities or persons and their trading partners is trumped by the need to protect the integrity of the bankruptcy system.

FAST Industries Ltd v Sparta Engineering Inc, 2017 ABQB 240 at paras.20-22

[15] Although Trafigura intimates that the maturity debt of the Loan is irrelevant for our purposes, it is not. While Cleo is meeting its obligations under the Prepayment Agreement, there is no contractual ability to accelerate the obligation in order to set off the balance against Trafigura's current obligations to Cleo. Without the ability to accelerate the amount owing, there can be no right to set-off an amount not yet due.

[16] Houlden & Morawetz, cited by Master Smart in *FAST Industries*, defines a debt existing at the time of filing as one capable of being enforced:

In order for legal set-off to apply, the debts must exist between the same parties and be capable of being ascertained with certainty at the relevant date:

Mutual debts are debts due from either party to the other for liquidated sums or money demands that can be ascertained with certainty at the date of bankruptcy. Each party must have the right to enforce its claim at the date of bankruptcy, and if one party cannot do so, there is no right of legal set off ...[emphasis added]

L.W. Houlden and Geoffrey B. Morawetz, *Houlden and Morawetz Bankruptcy and Insolvency Analysis*, WestlawNext Canada (Consulted on March 21, 2016) [Houlden] F§237 – Set-Off (1) – Generally Houlden, supra at F§237 – Set-Off (2) – Legal Set-Off

[17] In the alternative, Trafigura argues that Cleo was in breach of the Prepayment Agreement prior to filing its NOI on December 8, 2024 because it did not disclose the pending proceedings nor the material and adverse changes to its financial position that precipitated the BIA proceedings. Trafigura says that these pre-filing breaches entitle it to accelerate and set-off the remaining Loan balance.

[18] With respect, this argument cannot be accepted. To do so would undermine the entire mechanism and the objectives of the protections created under the BIA. Unless working with their secured creditors, debtors do not generally announce their intentions to file a NOI as that would obviate the statutory protections sought. Nor can I accept that there was an undisclosed material adverse change. Trafigura knew about Cleo's financial troubles – that is why it loaned the money in the first place. Like many creditors in insolvency proceedings, it did not call its loan prior to the NOI filing and cannot do so now.

Conclusion

[19] I appreciate the perception of unfairness to Trafigura in having extended a loan to Cleo, substituting a right of set-off in place of actual security (likely not an option at that point) and now being foreclosed from that contractual right. However, that is akin to the perceived unfairness visited on all unsecured creditors whose rights are suspended for the statutory objectives of BIA-sponsored reorganization.

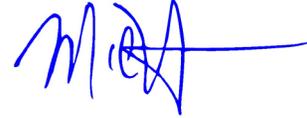
[20] Those objectives, as concerns Cleo, must in my view take precedence over the rights of one unsecured creditor, particularly where granting the relief sought by Trafigura would not only mean the end of the company but would prejudice the other creditors of Cleo, both in extinguishing the possibility of a proposal to all but also in paying one creditor in preference to the others.

[21] Cleo's application is granted and Trafigura's cross-application is dismissed. A filed copy, corrected for any typographical errors, will be provided to the parties as soon as possible. Costs

will be reserved and may be spoken to later if counsel cannot agree. The issue of ongoing monthly set-off, which was raised by both parties, is adjourned to the scheduled court appearance on January 6, 2025. The presiding Justice will be made aware of this Endorsement.

Heard on the 23rd day of December, 2024.

Dated at the City of Calgary, Alberta this 26th day of December, 2024.



M.H. Hollins
J.C.K.B.A.

Appearances:

Tom Cuming and Sam Gabor
for Cleo Energy Corp.

Karen Fellowes, KC and Archer Bell
for Trafigura Canada Ltd.