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Operator Liability for Administrative "Gross Negligence"

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In the balancing of interests between operators and non-operators in co-owned Canadian oil and gas properties, the allocation of risk that has evolved under common industry agreements purports to hold an operator liable to its non-operators only in respect of those acts or omissions that rise to the level of "gross negligence or wilful misconduct". This narrow basis for operator liability is consistent with the underlying premise that a co-owner consents to undertake the role of operator on a mere cost-recovery basis, and not as a third party "for profit" asset manager or service provider. In the ordinary course, any one of several competent joint-owners could potentially fill the role of operator, and once appointed the operator is always subject to removal and replacement by the other non-operators.

A pair of Alberta Court decisions, when taken together, are giving a troubling texture to what constitutes "gross negligence" in the context of an operator's administrative duties (as distinguished from its operational/field duties) that may impact how, and perhaps by whom, those administrative duties are performed under existing operating procedures.

The *Adeco*[1] and *Trident*[2] Decisions

As reported by Professor Bankes on ABlawg.ca, broad interpretations by Alberta Courts of what constitutes "gross negligence" are putting operators at considerable risk when their administrative practices fail to meet standards applied in a courtroom *ex post facto*.[3,4] In a 2008 decision, the Alberta Court of Appeal held in *Adeco* that an operator's failure to appropriately submit a lease continuance was not merely negligent but was actually "grossly negligent". Recently, in the *Trident* decision an operator who agreed to take charge of responding to a Crown offset notice and who failed to timely do so, or inform the joint-operators that it was no longer intending to respond, was also found "grossly negligent". Both the *Adeco* and *Trident* decisions were interpreting the undefined term "gross negligence" in Clause 401 of the 1990 CAPL Operating Procedure.

The Way Forward – Renegotiate or Outsource

The reality is that Western Canada is a mature, natural gas prone basin where administrative overhead is and will continue to be a serious challenge to profitability. Asset administration departments have been historically under-resourced, and that will not change in the foreseeable future. Insofar as these decisions, in the words of Professor Bankes in his discussion of *Adeco*,

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[1] http://www2.albertacourts.ab.ca/jdb/2003-/ca/civil/2008/2008abca0214.pdf
[2] http://www.albertacourts.ab.ca/jdb/2003-/qb/civil/2012/2012abqb0242.pdf
[3] "*The legal implications of failing to continue a Crown oil and gas lease: the duty of the operator to its joint operators and to the holder of a royalty interest*" on June 16, 2008 http://ablawg.ca/wp-content/uploads/2009/09/blog_nb_adeco_abca_june2008.pdf
[4] "*More grist for the mill, another case of gross negligence under CAPL 1990*" on May 2, 2012 http://ablawg.ca/wp-content/uploads/2012/05/blog_nb_trident_may2012.pdf

"eviscerate the carefully constructed limitation on liability that the CAPL 1990 Operating Procedure has created for the operator", operators seeking to limit potential liability for administrative gross negligence claims are left with the difficult choice of either trying to negotiate amendments to existing operating agreements, or embarking down the road of outsourcing asset administration to a third party service provider with those additional costs shared by the joint account.

Defining Administrative Gross Negligence

On a go forward basis, when negotiating new operating agreements or amending existing ones, the oil and gas industry should make attempts to specifically address operator liability for "gross negligence" in administration by including a definition that takes into account the decisions in *Adeco* and *Trident*. Two examples of the language used are found in:

- the 2007 CAPL Operating Procedure[5] which defines the term "Gross Negligence or Wilful Misconduct" as "any act, omission or failure to act … by a person that was intended to cause, or was in reckless disregard or, or wanton indifference to, the harmful consequences to the safety or property of another person or to the environment which the person acting or failing to act knew (or should have known) would result from such act, omission or failure to act"; and

- the PJVA model form Unit Operating Agreement[6] which defines the term "Gross Negligence" as " a marked and flagrant departure from the standard of conduct of a reasonable Person acting in the circumstances at the time of the alleged misconduct, or such wanton and reckless conduct or omissions as constitutes in effect an utter disregard for harmful, foreseeable and avoidable consequences".

In our view, it still remains unclear whether either of these definitions do enough to limit an operator's ongoing risk of liability for administrative oversight. What may be missing is the explicit recognition in operating agreements of the conceptual distinction between negligence/gross negligence in the conduct of an operator's administrative duties, versus in the conduct of its operational/field duties. "Gross negligence" in the context of boots-on-the-ground field operations seems much more practical than in respect of, for example, the timely submission of notices to government agencies. A potential solution is to limit an operator's liability in respect of administrative duties to a maximum dollar amount per occurrence, while leaving its liability for operational duties open ended, and limit the standard of care to be imposed on an operator in administering jointly held properties to mirror the standard that it applies to its 100% owned properties. In other words, an operator would only be found to be grossly negligent if it takes a less diligent approach to its jointly held properties than it does to its 100% owned properties.

Third Party "For Profit" Asset Management

The idea of outsourcing oil and gas asset administration is not new and, when coupled with the rapid data management advances taking place, may be an idea whose time has come. An operator that enters into an arrangement with a third party asset manager and takes the additional step of having that outsourcing arrangement approved by the joint-operators would presumably insulate itself from liability. In this regard, we note the following from Clause 401 of the 1990 Operating Procedure: "… provided that an act or omission of the Operator or its Affiliates, directors, officers, servants, consultants, agents, contractors or employees shall be deemed not to be gross negligence or wilful misconduct, insofar as such act or omission was done or was omitted to be done in accordance with the instructions of or with the concurrence of the Joint-Operators."

It may also be that Alberta Courts are more inclined to accept liability limitations in third party "for profit" arrangements (see the Alberta Queen's Bench decision in *Horizon Resources* v. *Blaze Energy*[7]) than in the

[5] http://www.landman.ca/landman_tools/operating_procedure2007.php
[6] http://www.pjva.ca/index.php?page=agreements/descriptions.php
[7] http://www.albertacourts.ab.ca/jdb/2003-/qb/civil/2011/2011abqb0658.pdf

context of the quasi-fiduciary relationship that underscores that of the operator and its non-operators in the 1990 CAPL Operating Procedure. Unlike the "cost recovery" model contemplated by industry operating procedures that merely seeks to keep an operator whole for its efforts, the fees charged by third party "for profit" asset management providers could include the additional costs and/or risks associated with meeting the administrative standard of care imposed by the Alberta Courts.

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