

# Oil and Gas: Top Trends and Transactions of 2018

January 31, 2019

2018 was a rollercoaster year for the Canadian oil and gas industry. Below is a summary of our top trends and transactions for 2018:

## **Trans Mountain Acquisition by the Federal Government**

With the cancellation of Northern Gateway and Energy East, and continued uncertainty around Keystone XL, the industry turned to the expansion of the Trans Mountain pipeline as its best hope to establish access to tidewater for the growing Canadian oil production. **Trans Mountain was a lightning rod in the Lower Mainland, inspiring pro- and anti-pipeline protests and strong statements from First Nations both supporting and opposing the expansion. In the face of heavy BC Government opposition, the project proponent, Kinder Morgan, announced that it would cease work on the project; prompting the Government of Canada to step in and acquire the entire Trans Mountain project for \$4.5 billion. In an unexpected twist, a day before the closing of the acquisition the Federal Court of Appeal overturned the National Energy Board ("NEB") approval of the project, and required that additional work be undertaken with respect to First Nations consultation and marine effects of the proposed expansion. The NEB is required to complete its reconsideration process and issue its new resulting report no later than February 22, 2019.**

## **Alberta Oil Curtailment**

As a result of the combination of weakening global energy prices, continued pipeline uncertainties, untimely facility and refinery turnarounds, and perhaps just some bad luck, Canadian oil prices went into freefall near the end of 2018 with the benchmark Canadian Western Canadian Select ("WCS") heavy oil price dropping to unheard of lows of USD\$11/bbl, down from recent peaks achieved in 2018 of USD\$53/bbl (WCS). Citing the unprecedented price disaster and an estimated loss of C\$80 million suffered per day by the sector and the Province of Alberta, Premier Notley imposed a temporary 325,000 bbl/d curtailment on larger producers in a bid to bring Canadian heavy oil **supply and demand in line and to clear the buildup of oil inventory stuck behind pipe.** This action was taken after a commitment by the Government of Alberta to acquire as many as 7,000 rail cars to assist in easing the medium term glut while pipelines are built. **The curtailment had immediate results with differentials in Alberta returning to**

more historically normal levels. The effect of the curtailment on inventory and long-term prices remains to be seen.

## LNG Canada

In October 2018, after years of delays and after the withdrawal and cancellation of numerous other export projects, LNG Canada finally announced that its joint venture partners, Shell, PETRONAS, PetroChina, Mitsubishi and KOGAS had made a positive Final Investment Decision to build a \$40 billion LNG Canada export facility in Kitimat, **British Columbia and an associated natural gas pipeline. Gas prices experienced similar pressures to oil prices in the Western Canadian Sedimentary Basin ("WCSB") as expanding liquids-rich producers in Canada's Montney play continue to expand natural gas liquids production irrespective of low gas prices and reduced gas takeaway capacity. The completion of the LNG Canada project would be a major artery for Western Canadian gas to reach markets in Asia where prices remained high.**

## Continued Rise of Hostile Takeovers

2018 brought a continued increase of hostile take-over activity and contested proxy **fight**s in the oil and gas sector— a sector historically characterized by friendly deals. These include notable deals such as the (now withdrawn) hostile bid by Husky Energy Inc. for MEG Energy for \$6.4 billion (a 44% premium to market just as WCS prices began their downward slide) and Ensign Energy Services Inc.'s successful \$1.03 billion hostile bid for Trinidad Drilling Ltd. (despite the arrival of a white knight bidder, Precision Drilling Corporation, offering a 25% premium in Precision stock. Smaller hostile bids also succeeded, including Velvet Energy Ltd.'s (hostile turned friendly) bid for **Iron Bridge Resources Inc. (formerly RMP Energy Inc.) for \$120 million. Along with hostile deals, 2018 saw more shareholder activism including the unsuccessful proxy fight for Crescent Point Energy Corp. by activist investor, Cation Capital Inc. With continued weakness in public company energy sector stocks and divergence of buyer and seller expectations, we anticipate 2019 will continue to be a growth year for hostile bids and shareholder activism.**

## Increased Well Liabilities and Redwater Decision

Faced with a continued low price deck and lower future price expectations, 2018 saw more and more companies "throw in the towel" and seek insolvency or restructuring **protection. As a result, there was a substantial increase in the number of orphan wells** (being wells and wellsites which have not been abandoned, reclaimed and restored to their previous pre-exploitation state, as required pursuant to regulator directives and which do not have owners to fund these end of life operations). The obligation to reclaim these wells and wellsites now falls on both Western Canadian provincial governments **(and hence taxpayers) and industry, through the Orphan Well Fund. In late 2018,** Energy Minister Margaret McCuaig-Boyd announced that she had instructed the Alberta Energy Regulator ("AER") to increase oversight of energy companies' financial health **and to impose cleanup timelines on energy companies.**

In the background bubbling was the highly anticipated Supreme Court of Canada's decision in the Orphan Well Association v Grant Thornton Ltd. (the "Redwater" case). In that decision, released this morning, the Supreme Court reversed the Court of Appeal's ruling in a 5-2 decision that makes it clear that upon bankruptcy, an operator's

environmental obligations will take priority over creditor claims. A more detailed analysis on this decision is to follow.

### **Continued Withdrawal of International Majors**

2017 witnessed a significant withdrawal of international major producers and financial investors from Canada through sales to primarily larger Canadian entities, including ConocoPhillips' sale of its deep basin assets to Cenovus Energy Inc. in March of 2017 for \$17.7 billion, and Canadian Natural Resource Limited's ("CNRL") acquisition of Shell Canada Limited's interests in the Athabasca Oil Sands Project for \$11.1 billion in cash and stock. 2018 continued this trend with a smaller number of marquee transactions, including Mocal Energy Ltd.'s sale of its stake in Syncrude's northern Alberta oilsands mining operations to Suncor Energy for \$920 million and Shell's sale of its entire interest holdings in CNRL for \$4.3 billion. 2019 may bring a continued trend towards less "major international ponies" in the Canadian oil and gas race.

### **No Public Equity Market and Continued Consolidation**

2018 was the lowest year on recent record for public financings into the upstream space, with \$245 million of deals occurring, compared to \$10.0 billion in 2016 and \$4.7 billion in 2017. **The universe of public companies has also continued to shrink dramatically. In 2014 there were 75 public exploration and production companies,** compared to 53 at the end of 2018, and down more dramatically from 140 public issuers in 2006. **A few of the notable consolidations and go-private transaction in 2018 include** Baytex Energy Corp.'s merger with Raging River Exploration Inc. at \$1.4 billion of Baytex paper, Vermillion Energy's acquisition of Spartan Energy Corp. for \$1.2 billion of Vermillion paper, and Cona Resources Ltd.'s go-private transaction at approximately \$250 million in cash.

### **Canada's East Coast**

In 2018, Canada's East coast continued to be of interest to international explorers. Equinor ASA (formerly Statoil ASA), BHP Billiton Ltd., Husky Energy Inc. and Suncor Energy all were part of successful bids for large exploration licences for the East coast. In other notable East coast news, 1,570 barrels of crude leaked into the Atlantic Ocean during a production restart in November of 2018, as a result of a violent storm at Husky's South White Rose Extension. This spill was the largest spill to date in Newfoundland and was widely covered in the media, adding to the list of negative news stories that dominated the oil and gas media discourse in 2018.

### **Changes at the Top**

With oil and gas companies facing turbulent times in 2018, some large oil and gas producers underwent notable and newsworthy management changes of longstanding leadership. After 15 years as the President and CEO at Crescent Point Energy Corp., Scott Saxberg stepped down after a proxy fight with dissident shareholders in May of 2018. Craig Bryska, formerly a vice-president of energy at Crescent Point, was named the new President and CEO. In November of 2018, Steve Williams announced that he would be stepping down from leadership of Suncor Energy after 16 years with the company and Mark Little, the former Chief Operating Officer would be appointed the

new CEO. It is expected that notable management changes may continue into 2019 as companies determine who is best to lead in an era of oil and gas adversity.

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