Canadian energy oil and gas: Top 20 of 2020 - Judicial decisions

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Part 1

Without question, the top story over the last year has been the COVID-19 pandemic and its tremendous ongoing effects felt across Canada and the world.

This time has had a significant impact on Canada's energy industry and many of the changes and developments that took place in 2020 will continue to influence trends, business decisions and the future growth of Canada's energy industry in 2021.

As we look back at 2020, we have highlighted the Top 20 industry developments and decisions made throughout the year in four key areas: Judicial decisions, regulatory decisions, legislative and policy developments, and transactions and trends.

In this article, we analyze the top five **judicial decisions** of the last year and how these decisions may affect your business in 2021.

The top five judicial decisions of 2020

Our list of the top five judicial decisions starts with a busy Supreme Court of Canada (SCC) considering issues of federal and provincial jurisdiction as well as the scope of the peace, order and good government federal power. The SCC started 2020 with its January ruling on BC's provincial jurisdiction to regulate heavy oil on an interprovincial pipeline, followed by the Saskatchewan, Ontario and Alberta Carbon tax challenges in September. The Federal Court of Appeal handed TMX a victory in one of its many legal challenges, while the difficult economic environment for Canadian oil and gas companies kept Alberta courts busy with numerous insolvency proceedings, including considering gross overriding royalties and eligible financial contracts. Finally, the SCC closes out our list with its decision to provide additional guidance and a caution to contracting parties on the scope of the duty of honest performance of contractual obligations in December 2020.

1. The Carbon Tax Challenge heads to the Supreme Court of Canada in *Reference Re Greenhouse Gas Pollution Pricing Act (Saskatchewan, Ontario, and Alberta)* [1]

In 2019 and 2020, the Saskatchewan Court of Appeal (SKCA), the Ontario Court of Appeal (ONCA) and the Alberta Court of Appeal (ABCA) released their reference decisions on the constitutionality of the federal *Greenhouse Gas Pollution Pricing Act* (the GGPPA). These decisions were appealed to the SCC, which is now tasked with resolving a critical division of powers issue between the federal and provincial governments over the regulation of GHG emissions.

The ONCA and SKCA majorities found that the GGPPA was a valid exercise of federal power under the national concern branch of the peace, order, and good government power (POGG) on the basis that without a concerted provincial effort to address GHG emissions, legislative action in Canada would be conducted in fragmented fashion and ultimately be ineffective.[2] The dissent in both decisions, foreshadowing aspects of the ABCA decision that followed, disputed this, finding that "[t]here are many things that individual provinces cannot establish, but it does not follow that those things are matters of national concern on that account.

The ABCA provided support for the dissenting opinions from the SKCA and ONCA, with its February 2020 decision, holding that the GGPPA represents an unconstitutional "Trojan Horse" that would "forever alter the constitutional balance" between the provinces and territories.[3] On the issue of POGG, the ABCA majority differed from the SKCA and ONCA majorities by: (1) interpreting its scope of application more narrowly, holding that "it is not a grand entrance hall into every head of provincial power";[4] and(2) holding that the provincial inability test does not relate to the *consequences* of provincial inaction but rather provinces' *jurisdictional ability* to enact a challenged scheme on their own. Accordingly, placing the GGPPA under POGG would allow it to "intrude deep into the provinces' exclusive jurisdiction over property and civil rights".[5]

The SCC heard the appeals in September of 2020 and has reserved judgement. Before it were two different articulations of the GGPPA's pith and substance and the proper scope of POGG. At it's core, the ABCA's decision represents a strong and robust articulation of provincial rights, interpreting the GGPPA broadly and the scope of POGG narrowly. Contrastingly, the ONCA and SKCA decisions interpret the GGPPA narrowly and invite a broader application of POGG. If the SCC adopts the ABCA's reasoning, it will significantly restrict federal ability to regulate GHG emissions, and potentially other environmental matters, under POGG. A more detailed analysis of the ABCA decision can be found here.

The lasting implications of the decision will be significant for future development of energy projects in Canada, as well as other reference decisions making their way through the courts, including the ABCA's upcoming reference hearing on the constitutionality of the recently enacted *Impact Assessment Act*. While the parties filed their materials with the ABCA in 2020, no date has been set for a hearing of the Reference.

2. The Supreme Court of Canada considers the scope of provincial jurisdiction in *Reference re Environmental Management Act (British Columbia)*

On January 16, 2020, the SCC dismissed British Columbia's attempt to regulate the transportation of heavy oil through the province. The nine-member panel delivered a rare oral decision from the bench, stating that it agreed with the British Columbia Court of Appeal's (BCCA) reasons.

As part of a larger response to the TransMountain Pipeline Expansion project (the TMX Project), which will considerably increase the flow of heavy oil from Alberta to BC's coast, the BC government proposed changes to the Environmental Management Act (the EMA) in April of 2018. The changes would have prohibited the possession, charge, or control of heavy oil in BC without a provincial permit. Premier Horgan referred the matter to the BCCA in response to political controversy and concerns over the constitutionality of the proposed amendments.

The BCCA unanimously held that the amendments were outside the scope of provincial jurisdiction as they primarily focused on a federal interprovincial undertaking and that their "default position" represented "an immediate and existential threat to a federal undertaking". The BCCA also noted that it would be impractical for "different laws and regulations to apply to an interprovincial pipeline every time it crosses a border", as it would obstruct its operation by forcing it to "comply with different conditions governing its route, construction, cargo, safety measures, spill prevention, and the aftermath of an accidental release of oil". Parliament received exclusive jurisdiction to regulate these matters, "allowing a single regulator to consider interests and concerns beyond those of individual provinces".

The SCC's affirmation of the BCCA's decision provides legal clarity on regulatory jurisdiction over federal undertakings. The decision aligned with project proponents. It agreed with the BCCA's decision that the proposed amendments should fall at the validity stage of the division of powers analysis, holding outright that provinces do not have constitutional authority to regulate interprovincial pipelines without having to apply complex doctrines including federal paramountcy. This decision potentially removed a major legal obstacle facing the TMX Project and other future projects. Read BLG's original blog on the decision here.[6].

3. The Federal Court of Appeal rules in favour of the TMX Project in *Coldwater Indian Band et al v Attorney General of Canada* [7]

On February 4, 2020, in another decision concerning the TMX Project, the Federal Court of Appeal (FCA) dismissed an application for judicial review by several parties that challenged the second approval of the TMX Project. The review related to whether the Crown had adequately addressed deficiencies in its consultation efforts with Indigenous groups prior to the second approval.

In November 2016, Canada approved the TMX Project as being in the public interest. However, several parties launched court challenges alleging that the Crown had failed to adequately discharge its duty to consult. In its 2018 decision, the FCA found that the TMX Project's environmental assessment was deficient and that the Crown had failed to fulfil its duty to consult.[8] Canada initiated a reconsideration hearing and continued the Indigenous consultations set out in the 2018 Federal Court decision. Again, Canada approved the TMX Project on June 22, 2019 and several parties sought judicial review on the same grounds as the initial Federal Court decision.

The FCA dismissed the appeal, finding no basis for interfering with Canada's second authorization of the TMX Project, which it deemed reasonable. In reaching this decision, the FCA commented that

> "The applicants' submissions are essentially that the Project cannot be approved until all of their concerns are resolved to their satisfaction. If we accepted those submissions, as a practical matter, there would be no end to consultation, the Project would never be approved, and the applicants would have a de facto veto right over it."[9]

This decision represented a major victory for the TMX Project, which has been the subject of litigation for many years, was confirmed when the SCC refused to hear an appeal of the decision in July 2020. The federal government has invested significant time and money to continue the TMX Project, which has now proceeded with construction. This decision also provides some clarity with respect to the Crown's consultation obligations by emphasizing that Indigenous groups do not have a veto power over projects. For further details, see our earlier comments here.

4. Provincial courts weigh in on insolvency and creditor protection issues

As energy producers continue to face challenges, including the ongoing low prices and market constraints, insolvency and creditor protection related proceedings continue keeping the Courts busy. Canadian Courts generally continued to wrestle with the fallout from the SCC decision in the *Redwater* case. Alberta Courts specifically considered the intersection between insolvency law and the energy industry, including in the context of gross-overriding royalties, irrevocable directions to pay, and eligible financial contracts.

a) BC Superior court hints at broad super-priority for environmental obligations

The decision in *British Columbia Attorney General (BC) v Quinsam Coal Corporation*[10] (Quinsam) was the latest 2020 case to consider the priority between a debtor's environmental liabilities and a secured creditor following the SCC's 2019-landmark decision in *Redwater*[11]. Though not determining the issue, *Quinsam* suggests that *Redwater* may have established a general rule in Canadian insolvency law that the 'polluter pays' principle effectively creates a 'super priority' for regulatory environmental obligations, which outranks the claims of all other creditors, including secured creditors.

The issue in *Quinsam* was whether the Province of British Columbia was entitled to the proceeds of sale of the coal inventory at a bankrupt mining company. Relying on *Redwater*, B.C. argued that the sale proceeds must fund the unfulfilled environmental obligations imposed under the *Mines Act*, in priority to such proceeds being distributed to a secured creditor. The creditor argued that *Redwater* should not be interpreted in such a broad manner, and in any event, was distinguishable due to the different legislative regimes in question.

Since the sale of the coal inventory closed prior to bankruptcy, the Court found that the creditor's entitlement to the sale proceeds crystalized prior, such that the proceeds never formed part of the bankrupt estate. As such, the priority over the sale proceeds in the bankruptcy proceedings did not need to be resolved, and was not definitively ruled on by the Court.

Despite resolving the matter on other grounds, the Court provided extensive commentary on *Redwater*. As part of this discussion, the Court suggested that the reasoning in *Redwater* is likely to be interpreted broadly, and extended to regulatory contexts beyond oil and gas development in Alberta. Beyond its immediate practical implications in this turbulent area of insolvency law, *Quinsam* stands as a reminder that parties lending to companies operating in industries with significant environmental liabilities will need to be proactive in developing their security package and monitoring performance to manage risk.

For a more detailed discussion of *Quinsam*, please refer to our prior article here. An analysis of *Redwater* is available here. In addition, BLG notes the Alberta Court of Appeal recently issued its decision in *PriceWaterhouse Coopers Inc. v. Perpetual Energy Inc.* case here, overturning the lower Court's interpretation of and application of *Redwater*. BLG will continue to follow this issue and make further comments on this decision in the coming days.

b) Alberta Court of Queen 's Bench clarifies the priority of property claims in oil and gas insolvencies

Three significant decisions arose out of the insolvency proceedings of Accel Energy Canada Limited and Accel Canada Holdings Limited (collectively, Accel),[12] concerning gross-overriding royalties (GORRs) and irrevocable directions to pay (IDPs). In all three cases, the Alberta Court of Queen's Bench found there was no priority rights granted. The GORRs and IDPs granted only ordinary contractual rights (respectively), resulting in an unsecured claim from the creditors. However, the decisions were fact dependent and may be distinguishable from other cases.

In the first decision, *Re Accel Canada Holdings Limited*[13],the Court considered applications to determine whether GORRs granted before the insolvency proceedings were "interests in land". If so, the Court would be limited in its ability to "vest" the GORRs off Accel's property in connection with a court-approved sale. Without being able to vest off the GORRs, the GORRs would survive the insolvency, bind a third-party purchaser, and effectively enjoy a super-priority status. Accel had granted one of the GORRs for an asset purchase transaction, in place of Accel paying the full purchase price in cash. The other GORR had been sold by Accel to an investment fund for cash. The Court looked to the parties' objective intentions when entering into the contracts creating the GORRs to determine if they were "interests in land." As the GORRs could be extinguished upon payment in full by Accel, the Court concluded they were mere "contracts for payment" (i.e., security interests), not interests in land, and thus capable of being vested off.[14]

The two subsequent proceedings, *Re Accel Canada Holdings Limited,*[15] and *Re Accel Energy Canada Limited*,[16] concerned applications by creditors in relation to IDPs granted by Accel before the insolvency proceedings. Specifically, Accel had given IDPs that "irrevocably authorized and directed" Accel's oil and gas marketer to pay a portion of Accel's net proceeds directly to each of the two creditors. Once the Accel insolvency proceedings began, the creditors sought declarations giving them proprietary entitlements to the production proceeds by the IPDs. The creditors argued that the IPD created a trust or constituted an "assignment" of Accel's property. The Court rejected both arguments finding there was no clear intention to create a trust[17] or assignment of

ownership over production proceeds to the creditor.[18] In short, the IDPs created "simple commercial arrangements" and not priority, proprietary rights.

Together, these decisions show a reluctance by Alberta's Courts to allow creditors to assert property claims in insolvency. In so doing, the Courts have favoured fairness and predictability amongst all creditors. However, in these three decisions the Court made clear that the results depended on the particular contracts and surrounding circumstances, thereby leaving the door open that that GORRs or IPDs may create property claims (and in effect priority claims) given the right facts.

c) Alberta courts consider the treatment of eligible financial contracts under the CCAA

In connection with the *CCAA* proceedings of Bellatrix Exploration Ltd., the Alberta Court of Queen's Bench had two opportunities to consider the treatment of eligible financial contracts (EFCs) under Canadian insolvency laws. Financial contracts are commonly used in commodities trading, including in the energy industry, and are afforded protections as EFCs under the *CCAA*, including that EFCs are outside the scope of a debtor's ability to disclaim contracts. In *Re Bellatrix Exploration Ltd*[19] (*Bellatrix 1*) the Court of Queen's Bench of Alberta was tasked with determining whether a financial contract must provide for a fixed price (as opposed to the typical spot-pricing with reference to the market) in order to constitute an EFC. In *Re Bellatrix Exploration Ltd*,[20] (*Bellatrix 2*) the Court then considered the scope of the statutory protection provided to EFCs. In light of these decisions, companies would be wise to revisit their risk assessment for financial contracts.

In *Bellatrix 1*, BP Canada Energy Group ULC (BP) had contracted to purchase natural gas from Bellatrix at a price based on natural gas spot prices for the applicable month in which the gas is delivered. In the event of default, BP had the option to terminate the contracts and net off the amounts owing based on market prices as of the date of default. Bellatrix sought to disclaim the contracts and BP objected, asserting the contracts were EFCs. Bellatrix claimed the contracts were not financial contracts because the price was not fixed, but rather fluctuated based on the spot pricing in the market. The Court disagreed with Bellatrix, finding that the contracts constituted EFCs because they served an important financial purpose, such as price diversification, and that the use of spot pricing constituted a "defined price" or "pricing mechanism" for forward commodity contracts. The Court emphasized that exceptions to EFCs are to be narrowly construed given Parliament's decision to provide protection to such contracts, and the *CCAA* cannot rewrite contracts that clearly fit within the definition of EFCs. Bellatrix has been granted leave to appeal this decision so it remains to be seen if the Court of Appeal will provide further guidance on the characterization of EFCs.

Bellatrix 2 concerned the priority of the first lien lenders *vis a vis* BP to sale proceeds from the debtor estate. Following delivery of its disclaimer notice of the at issue contracts, Bellatrix ceased performance under the agreement and stopped delivering natural gas to BP. Instead of terminating the contracts, BP demanded that Bellatrix resume performance. Following the sale of most of Bellatrix's assets (which excluded the impugned contracts), Bellatrix's first lien lenders asserted priority to the proceeds of sale and amounts held in trust on account of BP's last payment under the contracts. BP sought a return of its payment and distribution of the proceeds because of its damages claim for Bellatrix's breach of contract in priority over the secured creditors. The Court

found that the prohibition against disclaiming EFCs under the *CCAA* did not require the insolvent party to perform the contracts. Solvent counterparties could terminate EFCs to crystallize their losses as unsecured claims and to effect set-off if permitted by the contract. However, solvent counterparties cannot compel a debtor to continue to perform an uneconomic contract and, in the absence of a security interest, their damages claim would rank as an unsecured claim. Accordingly, the first lien lenders had priority to the sales proceeds and the funds held in trust.

As a result, it is clear that solvent counterparties cannot rely upon the EFC exception to disclaimers to require continued performance. Instead, counterparties are required to terminate an EFC to assert netting or set-off and must also carefully consider the application of netting off provisions with a view to the timing of commodity delivery and payment when dealing with insolvent or near insolvent counterparties.

5. Supreme Court of Canada clarifies scope of duty of honest contractual performance

In 2014, the SCC solidified the overarching principle of good faith and introduced the duty of honest contractual performance in Canadian contract law in *Bhasin v Hrynew*, 2014 SCC 71. In 2020, the SCC revisited and clarified the duty of honest performance *C. M. Callow Inc v Zollinger*.[21] The Court confirmed not only that parties must exercise their contractual rights in an honest manner, but also that they may be required to correct a counterparty's mistaken belief on the intention to exercise such rights. *Callow* may introduce uncertainty in commercial contracts, as compliance with express contractual obligations may not shield parties from claims for breach of the duty of honest performance.

The dispute in *Callow* arose from a winter maintenance contract between the plaintiff, Callow, and a number of condominium corporations. The contract provided for early termination by the condominium corporations on a ten-day notice. In the spring of 2013, the condominium corporations decided to terminate the winter contract for the upcoming season. The corporations did not inform Callow of their intended termination so its work during the summer season was not jeopardized. Callow was under the impression that the winter contract would likely be renewed, and performed free extra work to incentivize renewal. The condominium corporations provided their ten-day notice of early termination in September 2013. The issue before the SCC was whether the exercise of a unilateral contractual right can constitute a breach of the duty of honest performance notwithstanding compliance with express contractual requirements.

The SCC found that the condominium corporations acted dishonestly. The Court confirmed that a contractual right must be exercised in accordance with the duty of honest contractual performance, which means that a party cannot "lie or otherwise knowingly mislead" the other about "matters directly linked to the performance of the contract." Although this does not create a positive duty of disclosure, a contracting party has an obligation to correct misapprehensions occasioned by its conduct. Both active communication and omission/withholding of information may constitute deception in breach of the duty of honest performance.

From a practical perspective, commercial parties must exercise significant caution prior to exercising what appears to be an unfettered contractual right, in order to ensure that the circumstances of the parties' dealings cannot give rise to a breach of honest

contractual performance. We expect further judicial guidance will be required to clarify the scope and factual inquiry necessary in making such a determination.

[1] *Reference Re Greenhouse Gas Pollution Pricing Act (Saskatchewan, Ontario, and Alberta*), 2019 ONCA 544 [ONCA Reference]; 2019 SKCA 40 [SKCA Reference]; 2020 ABCA 74 [ABCA Reference]

[2] *SKCA Reference, supra* at paras 153-158.

[3] *ABCA Reference, supra* at para 22.

[4] *ABCA Reference, supra* at paras 166-182.

[5] *ABCA Reference, supra* at para 333.

[6] BLG Lawyers, Michael Marion, Alan Ross and Brett Carlson were counsel to the Canadian Energy Pipeline Association, an intervener in the proceeding.

[7] *Coldwater Indian Band et al v Attorney General of Canada*, 2020 FCA 34 [Coldwater].

[8] Tsleil-Waututh Nation v Canada (Attorney General), 2018 FCA 153.

[9] *Coldwater, supra* at para 86.

[10] 2020 BCSC 640

[11] 2019 SCC 5.

[12] In November 2019, Accel commenced restructuring proceedings under the Companies' Creditors Arrangement Act. In June 2020, the CCAA proceedings were converted into a receivership under the *Bankruptcy and Insolvency Act*. See generally: Alberta Court of Queen's Bench File Nos. 1901-16581 and 2001-06776.

[13] 2020 ABQB 182.

[14] 2020 ABQB 182, para. 93.

[15] 2020 ABQB 204

[16] 2020 ABQB 652

[17] Accel Canada Holdings Limited, Re, 2020 ABQB 204, paras. 42-51

[18] Accel Energy Canada Limited, Re, 2020 ABQB 652, paras. 28-31.

[19] [2020] AWLD 1317 (Bellatrix 1) and

[20] 2020 ABQB 809 (Bellatrix 2)

[21] 2020 SCC 45

By

Rick Williams, Jessica Cameron, Clay Jacobson, Garrett Finegan, Jack Maslen, Tiffany Bennett, Brett Carlson, Victoria Tulk

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BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749