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2017 Year in Review: Top 10 Judicial Decisions and Trends of Importance to the Canadian Energy Industry

In 2017, Canadian courts released an unusually large number of decisions affecting the energy industry directly.

The Alberta Court of Appeal rendered the much-awaited *Redwater* decision, confirming the right of a trustee in bankruptcy to disclaim uneconomic assets of a bankrupt debtor. The impact of this decision has been felt throughout the upstream and midstream oil and gas industry, as the Alberta Energy Regulator has required licensees to provide much more information and to be much more financially stable. An appeal to the Supreme Court of Canada was granted, and the industry is on tenterhooks awaiting the result.

Other crucial decisions of 2017 touched upon a wide variety of issues including:

- clarifying the Crown's duty to consult First Nations as part of the project approval process;
- the definition of 'Working Interest' under oil and gas contracts;
- the interaction among rights of first refusal, contractual language, and the duty of good faith under a contract;
- the application of intellectual property principles to oil and gas technology;
- ongoing disputes between oil and gas operators and their partners, especially in regards to set-off;
- an energy regulator's liability for damages under the *Canadian Charter of Rights and Freedoms*;
- liability for matters carried out by affiliates in other jurisdictions;
- personal liability of corporate directors for oppression; and
- the deference owed to arbitration panels, an increasingly important dispute resolution forum for the energy industry.

1. The Crown's Duty to Consult: *Clyde River (Hamlet)* and *Chippewas of the Thames First Nation.*

In the companion decisions of Clyde River (Hamlet) v Petroleum Geo-Services Inc., 2017 SCC 40 ("Clyde River"), and Chippewas of the Thames First Nation v Enbridge Pipelines Inc., 2017 SCC 41 ("Chippewas"), the Supreme Court of Canada clarified several features of the Crown's duty to consult with and accommodate indigenous people prior to project approvals being granted. For a detailed summary of these cases and their implications, see our previous post here.

These two cases were likely chosen by the Court for their stark contrast, in order to illustrate how to, and how not to, discharge the duty. The Court found generally that while the duty to consult First Nations should be viewed as a matter of first instance for each project, it also confirmed that one way to ensure that the duty to consult would be satisfied is through that project's regulatory approval process. Though the Crown owed the affected First Nation the duty to consult, practically speaking, the project proponents are responsible for discharging the duty.

The Court provided the following four step road map that proponents can use to satisfy the duty to consult:

1. determine when the duty to consult is triggered;
2. assess whether the tribunal has power to satisfy the Crown's duty to consult;
3. attempt to determine the scope of the duty to consult (i.e. from shallow consultation to deep consultation) by assessing the Aboriginal rights claims and the seriousness of the impact of the project on those rights; and
4. ensure that the Crown's obligation to consult is upheld in the specific tribunal process.

In *Clyde River*, Petroleum Geo-Services Inc. and others applied to the National Energy Board ("NEB") under the *Canada Oil and Gas Operations Act* to conduct offshore seismic testing off the northeast coast of Nunavut. The proposed project contemplated towing air-guns through a project area and to produce underwater sound waves annually between July and November for five years. Under the *Nunavut Land Claims Agreement* (1993), the Inuit of Clyde River ceded all Aboriginal claims, rights, title and interests in the Nunavut Settlement Area, including Clyde River, in exchange for defined treaty rights, including the right to harvest marine mammals.

The NEB launched an environmental assessment of the seismic testing, and the Inuit of Clyde River and others filed a petition against the project with the NEB. The NEB held meetings in surrounding communities to collect public comment, and representatives of the project proponents attended these meetings. At these meetings, the proponents of the project were unable to answer basic questions about the effects of the seismic survey on marine mammals, including which mammals would be affected by the testing. Instead of answering the personally asked questions, the proponents filed a 3,926 page document with the NEB and delivered it to the Clyde River offices. The document was not translated into Inuktitut (the Inuit language), and due to limited bandwidth on Baffin Island the document could not be downloaded. Subsequently, the NEB approved the project noting that marine mammals could be affected, but that the testing was unlikely to cause significant environmental effects, given the mitigation measures undertaken by the proponents.

The Supreme Court found that the Crown's duty to consult had not been discharged and quashed the approval. Following the roadmap outlined above, the Court found that the duty to consult was triggered in this case and the NEB had broad procedural powers to implement consultation; that the consultation required in this case was "deep" and on the higher end of the continuum; and that the process used by the NEB did not discharge the duty to consult because it failed to require oral hearings and formal participation when it could have done so. Further, the proponents did not answer basic questions by the Inuit of Clyde River that went to the heart of their treaty right – the right to harvest marine mammals.

In contrast, in *Chippewas*, Enbridge Pipelines applied to the NEB to increase the capacity of its Line 9 oil pipeline. The NEB held a public hearing and 19 Aboriginal groups, including the Chippewas of the Thames First Nation were informed of the proposed project and the NEB hearing process. The First Nation participated in the NEB process but thereafter wrote a letter to the Crown stating that no Crown consultation had taken place. The federal Minister of Natural Resources relied on the NEB's process to fulfil the duty to consult.

The NEB approved the project subject to conditions, some of which related to indigenous communities. It assessed the potential impact on Aboriginal rights as being limited and was satisfied that the potentially affected Aboriginal groups had the opportunity to share their views through the NEB process. The Chippewas appealed, stating that the approval could not be issued without the duty to consult and accommodate being met.

Going through the same process as it did in Clyde River, the Supreme Court of Canada held that the commencement of the NEB process triggered the duty to consult and since the NEB was the final decision-maker on this project, the NEB process was capable of satisfying the duty. It was further found that the duty was in fact discharged by the NEB in this case by providing an opportunity to Chippewas to participate in the hearings, issuing a written decision recognizing the treaty rights, and imposing suitable conditions.

These decisions effectively set out a list of "what-to-do/what-not-to-do" when project proponents are discharging the duty to consult. Effectively, the Supreme Court found that Enbridge did everything right, and Petroleum Geo-Services did not. Therefore, using the Enbridge model of discharging the duty is something that project proponents are likely to adopt going forward.

2. *Charter* Damages Claim Against Provincial Energy Regulator: *Ernst v Alberta Energy Regulator*

The plaintiff in Ernst v Alberta Energy Regulator, 2017 SCC 1, claimed that the Energy Resources Conservation Board (the "Board"), predecessor to the Alberta Energy Regulator, had violated her rights under the *Canadian Charter of Rights and Freedoms* (the "*Charter*") by (a) negligently administering a regulatory scheme; and (b) by violating her right to freedom of expression. The Plaintiff alleged that Encana Corporation's drilling program that used hydraulic fracturing caused her fresh water supply to become toxic. The Plaintiff sought damages in the amount of $33 million as a remedy for this loss pursuant to section 24 of the *Charter*.

The Alberta Court of Queen's Bench found that the Plaintiff's claims was barred by section 43 of the *Energy Resources Conservation Act* (the "*ERCA*" or the "Act"). Section 43 of *ERCA* provided immunity to the Board or a member of the Board from actions or proceedings in respect of any act or thing done by the Board or a Board member in pursuance of *ERCA*, or a decision or order made by the Board under the Act. Section 43 of *ERCA* is now section 27 of the *Responsible Energy Development Act*. The Plaintiff appealed the lower court's decision.

The Alberta Court of Appeal held that the Board did not owe the Plaintiff a duty of care and, in any event, her claim was barred by the *ERCA*. Further, the Court held that section 43 applied to bar her *Charter* claim as well.

The Plaintiff appealed to the Supreme Court of Canada on the constitutional issue, arguing that section 43 of the *ERCA* was unconstitutional (see BLG's post about Supreme Court's decision to hear the Plaintiff's claim here).

In a deeply divided decision, the Supreme Court of Canada upheld the lower court's decision opining that it was plain and obvious that section 43 of the *ERCA* barred the Plaintiff's claim for *Charter* damages. It was held that the Plaintiff failed to provide an adequate factual basis to permit the finding that the provision was unconstitutional. As the Plaintiff failed to meet this burden, her claim was held to have been properly struck.

However, in a dissenting opinion, four Justices would have set aside the order striking the Plaintiff's *Charter* damages claim and reverted the matter back to Alberta Court of Queen's Bench on the basis that it was not plain and obvious that the punitive conduct alleged by the Plaintiff would be caught by the language of section 43 of *ERCA*. As a result, in order to address the question of constitutionality of section 43, the dissenting justices would have granted the Plaintiff another opportunity to show that the Board's decision to avoid all contact with her was not protected by section 43.

In finding section 43 of *ERCA* a bar to the Plaintiff's claim, the majority of Supreme Court reasoned that the claim lacked factual basis to find the said section unconstitutional. This leaves open the possibility that given the right facts, such an action could succeed. In addition, the dissenting Justices' opinion, that the matter should be reverted back to the lower court, further adds to the uncertainty on the subject.

3. Right of Trustee in Bankruptcy to Disclaim Uneconomic Assets: *Orphan Well Association v Grant Thornton Limited*

In a much-awaited decision rendered in April, the Alberta Court of Appeal in Orphan Well Association v Grant Thornton Limited, 2017 ABCA 124 (aka "*Redwater*"), upheld the trial judge's ruling that a receiver can disclaim or renounce uneconomic assets, including those that are subject to environmental liabilities.

The decision confirmed the industry's view that a trustee in bankruptcy can choose those assets of the bankrupt debtor to be sold and disclaim the rest, effectively transferring the responsibility for those assets, including any cleanup, to Alberta's Orphan Well Association (the "OWA"). The Alberta Energy Regulator (the "AER") has already taken significant steps to address the implications from the trial decision. We expect further modifications to the AER's practice are yet forthcoming.

In *Redwater*, Grant Thornton was appointed as receiver for Redwater Energy Corporation ("Redwater"), a publicly listed oil and gas company. The receiver took possession of Redwater's most valuable assets for sale under the *Bankruptcy and Insolvency Act* (the "*BIA*"), and sought to disclaim the remaining Redwater assets, including those suspended and abandoned wells that would likely have environmental liabilities and obligations associated with them. The AER opposed this process, claiming that the receiver was required to sell all the assets of Redwater, not just those that had value, as the effect would be to leave the bad assets in the hands of the taxpayers. This argument would have the effect of preferring the AER's claims to those of Redwater's secured creditors.

The trial court confirmed that receivers and trustees in bankruptcy of holders of licences from the AER are permitted under the *BIA* to renounce such assets and that the AER and the OWA do not have priority over the other creditors of a bankrupt licencee.

The OWA and the AER appealed the trial decision. The central question on appeal was whether a receiver or a trustee in bankruptcy must address the liabilities inherent in the remediation of oil wells in priority to the claims of secured creditors. The majority held that the AER cannot mandate that the trustee satisfy environmental claims in priority to the claims of the secured creditors under the *BIA*. The Alberta Court of Appeal agreed with lower court's finding that there was an operational conflict between the provision of *BIA*, which is a federal legislation, and the provisions of the *Oil and Gas Conservation Act* and the *Pipeline Act*, both of which are provincial legislations. As a result, pursuant to the doctrine of federal paramountcy, the *BIA* prevailed. The majority rejected arguments by the Appellants and some intervenors that public policy and fairness considerations should factor into its decision, holding that bankruptcy court has no ability to create exceptions to the statute based on general considerations of fairness or public policy.

Redwater is headed to the Supreme Court of Canada as leave to appeal the Alberta Court of Appeal decision was granted in November.

4. Enforcement of Foreign Judgments: *Yaiguaje v Chevron Corporation*

The ongoing saga of the Ecuadorian plaintiffs' attempt to enforce judgment against Chevron Corporation and Chevron Canada continued in 2017.

The Ontario Court of Appeal in Yaiguaje v Chevron Corporation, 2017 ONCA 827, overturned a security for costs order by a motions judge holding that allowing such an order to stand in that case would be unjust and against the interests of justice (see our previous blog posts about the original decision and its appeal here and here).

After the Supreme Court of Canada confirmed in 2015 (that decision can be found here) that the Ecuadorian plaintiffs with a $9.5 billion judgment against Chevron Corporation were entitled to commence enforcement proceedings in Canada, Chevron and Chevron Canada brought motions for summary judgment to dismiss the claims against Chevron Canada on the basis that it was a separate corporate entity from Chevron Corporation, the original party to the lawsuit. This motion to dismiss was granted.

The Ecuadorian plaintiffs appealed this decision to the Ontario Court of Appeal but before the appeal was heard, the Chevron defendants brought a motion for security of costs for roughly $1,000,000 on the basis that the plaintiffs were not ordinarily resident in Ontario, had not established they had a good chance of success on the appeal, and had not provided evidence that they were impecunious. Chevron Canada's motion was granted and the plaintiffs were ordered to post $942,950 as security for costs. The Ecuadorian plaintiffs appealed the security for costs order.

The Ontario Court of Appeal found that the motions judge erred in principle in determining the justness of the order for security for costs. The Court opined that when considering justness of such an order, factors like merits of the claim, access to justice considerations, and the public importance of litigation are to be considered.

The Court held that the interests of justice required that no order for security for costs be made. The Court reached this conclusion based on the following factors:

1. the litigation was in public interest;
2. the profitability of the Chevron defendants mitigated against such an order; and
3. the appeal was not wholly devoid of merit.

As a result, the order for security for costs was set aside with costs to the plaintiffs.

5. Deference to Arbitration: *Teal Cedar Products Ltd. v British Columbia*

The Supreme Court of Canada in Teal Cedar Products Ltd. v British Columbia, 2017 SCC 32 endorsed the efficiency and finality objectives of commercial arbitration. This case serves as a reminder to parties entering into agreements with arbitration clauses that the scope of review of an arbitrator's decision in the commercial context is narrow. For a comprehensive summary of the case, see our previous blog here.

In *Teal Cedar*, the licenses owned by Teal Cedar Products Ltd. ("Teal Cedar") allowing it to harvest Crown timber were negatively affected after the province of British Columbia implemented the *Forestry Revitalization Act*. The Act contained a compensation scheme which provided for two types of compensation: (1) reduction to harvesting rights (the "Rights Compensation"); and (2) the value of improvements made to Crown land (the "Improvements Compensation").

Teal Cedar suffered significant losses as a result of enactment of the Act. The parties entered into negotiations but were unable to agree on the Improvements Compensation. In the meantime, to confirm their settlement, the parties entered into a Settlement Framework Agreement which provided that no interest would be payable under any compensation provided by BC to Teal Cedar. The negotiations failed and the parties submitted to arbitration for resolution of the dispute. Three issues were submitted to arbitration: which valuation method was consistent with the Act, whether BC was liable to pay interest regardless of the Settlement Framework Agreement, and whether Teal Cedar was entitled to improvements compensation for an unaffected license. The arbitrator accepted the depreciation replacement cost method, held that Teal Cedar was entitled to interest regardless of the Settlement Framework Agreement, and that Teal Cedar was not entitled to improvements compensation for the unaffected license.

On appeal from the arbitrator's decision, the British Columbia Supreme Court upheld the arbitrator's award except in connection with improvements compensation, which was remitted back to the arbitrator. A majority of British Columbia Court of Appeal allowed BC's appeal, finding that the arbitrator had erred on all three issues.

Reversing the British Columbia Court of Appeal decision, and pertaining to the province's *Arbitration Act*, the Supreme Court of Canada held that courts have no jurisdiction to review the contractual interpretation issue in this case, as the arbitrator was best situated to weigh the factual matrix in his interpretation of the parties' agreement regarding the payment of interest. Further, it was held that the court had no jurisdiction to review the improvements compensation issue, as it engaged the question of whether the arbitrator correctly applied the valuation methodology to a license — a mixed question of law and fact which is beyond appellate review.

The Court found that interpretation of the *Forest Revitalization Act* involved questions about the broad category of methods that are acceptable under the terms of the *Revitalization Act* and that these were questions of law. Opining that the standard of review on legal questions arising from an arbitrator's analysis of statutory interpretation issue is reasonableness, the Court found that this standard was not negated in this case in light of the nature of the question at issue and the arbitrator's presumed expertise. The Court found the arbitrator's decision on the question of law was reasonable, in that, it fell within a range of possible, acceptable outcomes which were defensible in respect of the facts and law, and the decision was justified, transparent and intelligible.

6. Personal Liability of Directors as Remedy for Oppression: *Wilson v Alharayeri*

In Wilson v Alharayeri, 2017 SCC 39, the Supreme Court of Canada upheld the finding of two corporate directors personally liable to compensate a minority shareholder for dilution of the value of his shares under section 241 of the *Canada Business Corporations Act* ("*CBCA*"). This decision confirms that directors of a corporation can be held personally liable in an oppression action.

Mr. Alharayeri was a significant minority shareholder of Wi2Wi Corporation (the "Corporation"). He held common shares and two classes of preferred shares – Class A and Class B. Mr. Wilson, a director of the Corporation and a member of its audit committee, was the beneficial owner of another class of preferred shares – Class C. All preferred shares were convertible into common shares if the Corporation met financial targets set for each class of preferred shares. In 2007, the Corporation decided to issue a private placement of common shares, the effect of which would be dilution of any shareholder's shares who did not participate. Prior to the private placement, the Board of the Corporation decided to accelerate the conversion of Class C shares into common shares, despite doubts as to whether the required financial target had been met. Upon Wilson's advocacy, the same was not done for Class A and Class B shares although they met the required criteria. As a result, Alharayeri's common shares were diluted and the value of his Class A and B shares was reduced. He filed an application for oppression under s. 241 of the *CBCA* against Wilson and three other directors.

The Supreme Court was asked to decide if the circumstances of this case warranted imposing personal liability on the Corporation's directors. The Court started by confirming the two-pronged test as set out in Budd v Gentra Inc., 1998 CanLII 5811 (Ont CA) ("*Budd*"), for deciding whether to impose personal liability on directors of corporations:

- the oppressive conduct is properly attributable to the director because he or she is implicated in the oppression; and
- the imposition of personal liability is fit in the circumstances.

In respect of the second criteria above, it was held that whether imposition of personal liability is "fit" is guided by four general principles: (1) the oppression remedy request must in itself be a fair way of dealing with the situation; (2) any order should go no further than necessary to rectify the oppression; (3) any order made may serve only to vindicate the reasonable expectations of security holders, creditors, directors or officers in their capacity as corporate stakeholders, and (4) a court should consider the general corporate law context in exercising its remedial discretion. This means that director liability cannot be a surrogate for other forms of statutory or common law relief, particularly where other relief is more fitting.

To determine whether oppression remedy would be a fair under the first principle outlined above, the Court identified five situations (non-exhaustive) where personal orders against directors are likely to be fair: (a) where directors obtain a personal benefit from their conduct; (b) where directors have increased their control of the corporation by the oppressive conduct; (c) where directors have breached a personal duty they have as directors; (d) where directors have misused a corporate power; and (e) where a remedy against the corporation would prejudice other security holders.

The Court opined that these four principles serve as "guideposts informing the flexible and discretionary approach" the courts have adopted under s. 241(3). It found that it was open to the trial judge to attribute oppressive conduct to Wilson and one other director because they played leading roles in Board discussions resulting in the non-conversion of Alharayeri's Class A and B shares. This satisfied the first criteria under the *Budd* test and the trial judge did not err in finding as such. Under the second part of the test, the Court found that Wilson had accrued personal benefit as a result of the oppressive conduct. The accelerated conversion of Wilson's Class C shares to common shares before the private placement benefitted him by increasing his control over the Corporation, to the detriment of Alharayeri. Further, considering the five indicia of fairness outlined above, the trial judge's order against Wilson was held to represent a fair way of rectifying the oppression and went no further than necessary to vindicate Alharayeri's reasonable expectations. The trial decision was upheld.

7. 'Working Interest' is a legal term of art: *IFP Technologies (Canada) Inc. v EnCana Midstream and Marketing*

The Alberta Court of Appeal in IFP Technologies (Canada) Inc. v EnCana Midstream and Marketing, 2017 ABCA 157, held that that the term "working interest", as it is used in the oil and gas industry, is a legal term of art. The Court also made important findings about the relevance of evidence surrounding the execution of a contract in interpreting such a term. Although this case provides some clarity as to what "working interest" means if used in an oil and gas contract, it also serves as a reminder to parties that if they intend the term to mean something else, they would have to be explicit about it both in the contract and in negotiations leading up to its execution.

Sometime in the late 1980s or early 1990s, IFP Technologies (Canada) Inc. ("IFP") and the predecessor company to PanCanadian Resources ("PCR") entered into a technology licencing agreement (the "TLA") granting IFP a 3% gross overriding royalty over certain lands (the "Eyehill Lands") owned by PCR in exchange for PCR's use of certain technology owned by IFP. At the time, both PCR and IFP were of the view that primary production of the Eyehill Lands was at an end, but further production could be obtained through a steam-assisted gravity drainage operation. Negotiations ensued and the parties entered into an agreement whereby PCR granted to IFP a 20% working interest in the Eyehill lands. Under the contract between IFP and PCR, PCR had both a right of first refusal over the Eyehill Lands and right to consent (or not) to any disposition by PCR of its interest, so long as such consent was not unreasonably withheld.

After some time, PCR negotiated a farmout of its remaining interests in the Eyehill Lands with Wiser Oil Company of Canada ("Wiser"). IFP did not exercise its ROFR rights and did not consent to PCR's transfer of its interest to Wiser, as Wiser intended to produce the Eyehill Lands in a way that would render SAGD production impossible. Notwithstanding IFP's lack of consent, PCR transferred its interest in the Eyehill Lands to Wiser but indemnified Wiser against any future claims made by IFP. Wiser proceeded with its plans to produce the Eyehill Lands by conventional methods. IFP sued PCR for breach of contract and claimed damages for same, an accounting of net revenue from the Eyehill Lands, or $45 million in damages.

The trial judge concluded that IFP retained its 20% working interest only in thermal and other enhanced recovery operations at Eyehill Lands. Further, it was held that IFP unreasonably withheld its consent to the disposition of PCR's interest in the said lands to Wiser. As a result, PCR did not breach the consent requirement found in the agreement between the parties. The trial judge declined to award any damages on the basis that doing so would be giving IFP better contractual rights than what it had negotiated. IFP appealed.

The Court of Appeal held that "working interest", as it was used in the agreement between IFP and PCR, is a legal term of art and has a specific meaning in the oil and gas industry and "constitutes the percentage of ownership that an owner has to explore, drill, and produce minerals from the lands in question." The industry meaning of the term can be relied upon when such term is used in a contract between the parties unless the meaning is changed by explicit agreement between them. It was held that the trial judge erred when he failed to apply the industry standard definition of "working interest" as it was used in the agreement between IFP and PCR, and that PCR clearly conveyed to IFP a 20% working interest in all minerals in the Eyehill Lands.

The Court of Appeal also found that it is an error of law for a trial judge to not consider evidence of the circumstances surrounding a contract's formation. Evidence of the surrounding circumstances is admissible even if there is no ambiguity in the contract. The presence of an "entire agreement" clause did not change this result.

This case provides some certainty regarding the meaning of working interest, but also adds potential for future uncertainty for industry participants as what constitutes "standard meaning" of a legal term of art may be debatable in future cases.

8. ROFRs in light of duty of good faith performance of contracts: *Northrock Resources v ExxonMobil Canada Energy*

In August, the Saskatchewan Court of Appeal in Northrock Resources v ExxonMobil Canada Energy, 2017 SKCA 60, dismissed an appeal by Northrock Resources ("Northrock") and provided much needed insight into the interaction between ROFR provisions and the duty of good faith to be exercised in contractual performance.

Northrock's claims against ExxonMobil Canada Energy ("Exxon") arose as a result of a transaction in which Exxon disposed of some of its Saskatchewan oil and gas interests in what are called busted-butterfly transactions. Exxon structured the transactions this way so that it could achieve favourable tax results.

The central issue in this case was whether Exxon breached ROFR obligations it owed to Northrock as part of the sale process. Northrock asserted that, regardless of how it was to occur, the purpose and effect of the sale transaction was disposition of its ROFR-tied interests and thus the transactions triggered its first-refusal rights.

The trial judge dismissed all of Northrock's claims, finding that on a plain reading of the ROFRs in their grammatical and ordinary sense, they did not apply to a busted-butterfly transaction at issue. The trial judge further found that Exxon had not breached its duty of good faith to Northrock because it did not lie, mislead, and did not use the busted-butterfly structure for the purpose of avoiding ROFRs.

The Saskatchewan Court of Appeal found that by their terms, the ROFRs only applied to the disposition of *interests*, not to change-of-control transactions. It held that the ROFRs at issue permitted, in general, the assignment of ROFR-tied interest to an affiliate of the assignor but were silent on the subsequent disposition of the shares of the assignee affiliate. On the other hand, the ROFRs specifically excluded certain transactions from their scope. It was unimportant that Exxon was selling all or substantially all of its interest to a third party, what was important was that it could do so without triggering the ROFRs. The ROFRs did not apply to all dispositions of ROFR-tied interests to third parties. Further, the Court of Appeal held that the trial judge's finding that the ROFRs did not apply to the busted-butterfly structured sale was to be afforded due deference because it was based on two critical findings of fact:

1. in negative terms, Exxon had not been motivated by a desire to avoid triggering the ROFR provisions; and
2. in positive terms, Exxon had preferred a busted-butterfly structure because it was motivated by tax considerations.

Exxon was found to not have breached its duty of good faith to Northrock and the trial decision was found to be consistent with principles established in *Bhasin v Hrynew* and earlier authorities. To the contrary, the Court of Appeal concluded that to accept Northrock's argument in this case would "imprudently broaden the duty of good faith in commercial relations."1.

Although *Northrock* does not stand for the proposition that ROFRs cannot apply to all transfers of interest to third parties, it emphasizes that the eventual result in such cases would depend on the bargain reached between parties, especially when they are sophisticated. The Court will not imply, or read into the agreement, a term that is not supported by the agreement as a whole.

9. Fracking Related Patent Declared Invalid: *Packers Plus Energy Services Inc. v Essential Energy Services Ltd.*

In this case Packers Plus Energy Services Inc. v Essential Energy Services Ltd., 2017 FC 1111, the Federal Court declared a fracking-related patent held by Packers Plus Energy Services Inc. ("Packers") to be invalid and dismissed its claim for patent infringement against several large oilfield services companies. The patent at issue covered a method of fracturing technology referred to as open-hole, multi-stage ball drop fracturing that has had widespread use.

The case is a significant patent decision and also provides important commentary with respect to confidentiality obligations in the oil and gas industry. Further, had Packers been successful in its claims, it would have resulted in widespread implications for the named defendants to the action as well as to a wide variety of actors in the oil patch. The methodology for calculating damages in the patent context would invariably have resulted in a significant damages award. In particular, as against Harvest Operations Corp. (the sole upstream producer that was a party to the action), Packers was seeking disgorgement of profits from what it claimed was enhanced hydrocarbon recovery from the use of the technology. Success in this action could have been precedent for Packers to pursue similar claims against other upstream producers.

The decision involved four separate patent infringement claims relating to its patent against Essential Energy Services ("Essential"), Baker Hughes Canada Company, Weatherford Canada Ltd. and Harvest Operations Corp., and Resource Well Completion Technologies Inc. (and various other related parties). The Federal Court consolidated part of the proceedings, hearing the claim for infringement against Essential and the counterclaims of all of the defendants that the patent was invalid in a trial in early 2017. Had Packers been successful, trials on the issue of patent infringement for the other defendants and the determination of damages were set to be heard in 2018. As there can be no infringement if there is no valid patent, the Court's decision is determinative of all issues, subject to any appeal by Packers.

The Federal Court considered two main issues as part of this decision: 1) did Essential infringe the patent; and 2) was the patent invalid?

The Court found no evidence of infringement, either directly by Essential, by inducement of Essential's customers (upstream producers) or through the combined role it played with other actors involved at a wellsite (for example an operator, or a drilling or fracturing company, etc.).

On the validity of the patent, the Court found that the patent was invalid for two reasons: 1) the subject matter of the patent had been previously disclosed by Packers; and 2) the subject matter of the patent was obvious and not capable of being patented.

A patent is only valid if it covers an invention that is truly new, useful and unobvious. If a party makes a public disclosure of a patent prior to a year before filing the patent, or the patent is so obvious it is not truly novel, then it is invalid.

Packers admitted that it had made public disclosures by, among other things, presenting the technology to various customers prior to patenting the technology. However, it asserted that any such disclosures were made confidentially (an exception to the one year rule). Packers argued that duties of confidentiality arose through an industry standard regarding confidentiality, oral representations it made to recipients of the information and by stamping documents as confidential.

The Court found that there was no explicit and binding oral or written agreement in place that the information was to be kept confidential. The Court also noted that standard industry practice in the oil and gas industry was in fact to commit obligations of confidentiality to written agreements given the highly competitive environment that exists. It noted that boilerplate "Confidential" labels on documents are not legally binding obligations of confidentiality.

Lastly, the Court held that the invention was obvious and not capable of being patented because the method of fracturing would have been obvious to a skilled person at the time the patent was filed. On review of evidence relating to the state of the industry at the time, the Court held it did not represent an advance on the state of the art and was obvious to try.

We expect an appeal of this matter to be forthcoming. BLG was counsel to the Defendants Weatherford Canada Ltd. and Harvest Operations Corp. at trial.

10. Set-off: *Spyglass Resources Corp v Bonavista Energy Corporation*

In Spyglass Resources Corp v Bonavista Energy Corporation, 2017 ABQB 504, the Alberta Court of Queen's Bench appears to have expanded the scope of set-off in oil and gas contracts, approving an operator's set-off of joint royalty credits against the non-operator's share of abandonment and decommissioning costs.

In *Spyglass*, Bonavista Energy Corporation ("Bonavista") was the operator of a number of wells, compressors and pipelines in Alberta for itself and the non-operator, Spyglass Resources Corp. ("Spyglass"). In accordance with its practice, Bonavista used one joint account to administer all the revenues and costs for the project notwithstanding that the land and facilities were governed by different operating and accounting procedures. The main project agreements were a Construction, Ownership and Operating Agreement for the plant ("CO&O") and a Joint Operating Agreement ("JOA") for the wells that incorporated a 1990 CAPL Operating Procedure ("1990 CAPL"). As part of its original regulatory approval for the project from the Alberta Energy Regulator (the "AER"), Bonavista was required to prepare a Decommissioning and Land Reclamation Plan ("Decommissioning Plan") in case the plant stopped operating.

In late 2011, the AER issued a permanent shut-in order of the wells, and as a result Bonavista and Spyglass were entitled to gas-over-bitumen royalty credits ("GOB Credits"). Sometime later, the plant ceased production and Bonavista began decommissioning the plant and abandoning the pipelines, in accordance with the Decommissioning Plan. The CO&O required the Operator to clean up and restore the site, even without the approval of the operating committee. Each month, Bonavista issued Spyglass one joint interest bill ("JIB") for the joint account, detailing each cost borne by the project and the GOB Credit, and netted the GOB Credit against Spyglass's share of costs. Spyglass disputed the costs and did not pay the balance owing.

Subsequently, Spyglass entered receivership in November 2015 and Ernst & Young was appointed its receiver (the "Receiver"). The receiver demanded the return of Spyglass's interest in the GOB Credits that had been netted against Spyglass's share of costs. The receiver sought a declaration, *inter alia*, that Bonavista was not entitled to exercise set-off rights against Spyglass.

The Court found that the facts of this case supported each of the three types of set-off, i.e. contractual, legal, and equitable set-off. The Court found that although the CO&O and JOA created different set-off rights with GOB Credits arising under the JOA and decommissioning costs under the CO&O, the agreements in the aggregate should be interpreted as permitting netting of costs against credits to promote business efficacy.

Further, the amounts owing by Spyglass were ascertainable through the delivery of the monthly JIBs by Bonavista and such amounts crystallized when the time period for them to be paid expired. As a result, the circumstances in this case also warranted legal set-off.

In addition, the Court agreed with Bonavista that the costs were a direct result of the shut-in order, and the shut-in order led directly to the GOB Credits. Thus, the same order gave rise to the requirements to incur the costs and the GOB Credits, warranting application of equitable set-off in the circumstances.

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1 *Northrock* at para 44.

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