

# Top Energy Issues in Canada in 2022 with implications for 2023 and beyond

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BLG's energy lawyers continuously review the policies, issues, cases and developments affecting the Canadian energy industry. The following is our list of the top 10 energy issues of 2022 that will influence trends, business decisions and the future growth of Canada's energy industry in 2023 and beyond.

## Key takeaways

The Canadian energy sector continues to encounter structural change. The major themes and energy issues in Canada that BLG noted involve government energy transition policy, jurisdictional disputes and geopolitical disruption within the context of a generally supportive commodity price environment and recovering petroleum demand. We also noted the apparent dichotomy between the substantial investments made in the transition away from traditional fossil fuels and the essential role such fossil fuels play in economic recovery and energy independence.

## Transactions, Developments and Projects

### Footnotes

<sup>1</sup> Strathcona Resources to buy Serafina Energy for \$2.3 billion: sources | Financial Post

<sup>2</sup> *Rieger* at para 47.

<sup>3</sup> *Peace River Hydro Partners v Petrowest Corp*, 2022 SCC 41

## Significant M&A Transactions

There were several significant M&A Transactions in 2022, which thematically highlighted the role of private equity in the energy space, the importance of Canadian

natural gas in energy transition, and the consolidation of upstream production in an increased commodity price environment. These transactions also continued a trend in 2022 of acquisition of production (or share buybacks and dividend increases) rather than investment in the drill bit.

## **Pembina and KKR**

On March 1, 2022, Pembina Pipeline Corporation (Pembina) announced that it had entered into an agreement with leading global investment firm KKR & Co. Inc. (KKR) to form a [joint venture entity](#), later named Pembina Gas Infrastructure (PGI), which combined their respective western Canadian natural gas processing assets. PGI would be 60 per cent owned by Pembina and 40 per cent owned by KKR, with Pembina serving as operator and manager. The value of the transaction totalled \$11.4 billion and formally closed on [Aug. 15, 2022](#).<sup>1</sup>

This transaction aimed to create a competitive gas processing entity with the ability to serve customers throughout the Montney and Duvernay formations from north central Alberta to northeast B.C., through cost reductions and enhanced customer service offerings. This transaction reaffirms the investors' faith in the role that Canadian natural gas will continue to play within the global energy transition trend.

Subsequent to the closing of the transaction, PGI announced on Dec. 12, 2022 that it had entered into an agreement with Stonepeak Partners LP (Stonepeak) to sell its 50 per cent non-operated interest in the Key Access condensate and liquids Pipeline System (KAPS) [for \\$662.5 million](#). This transaction further highlighted the increasing role that private equity firms are playing in the Canadian energy space. Anthony Borreca, Senior Managing Director at Stonepeak stated, "We believe that North American hydrocarbons, particularly natural gas, will continue to be an important component of the global energy mix for the foreseeable future, especially as efforts to decarbonize East Asia continue – natural gas production growth in Western Canada will play a critical role in those efforts." Closing of this transaction is expected to occur in the first quarter of 2023.

## **Strathcona Resources and Serafina Energy**

On Aug. 29, 2022, Strathcona Resources Ltd. (Strathcona), owned by private equity firm Waterous Energy Fund, announced the completion of [the acquisition](#) of private equity-backed Saskatchewan heavy oil company Serafina Energy Ltd. (Serafina) for [\\$2.3 billion](#). Serafina produces approximately 40,000 BOEs/d which will be combined with Strathcona's existing production capacity of 100,000 to 115,000 BOEs/d.

This transaction is consistent with the trend of well capitalized, often private equity, buyers acquiring upstream assets in order to take advantage of the increased oil price environment (near \$100 per barrel around the closing date of this transaction).

## **Whitecap Resources and XTO Energy Canada**

On June 28, 2022, Whitecap Resources Inc. (Whitecap) announced that it had entered into an agreement to acquire XTO Energy Canada (XTO) in a cash deal for [\\$1.9](#)

[billion](#). The transaction closed on Aug. 31, 2022, and was funded through existing credit facilities and a new \$705 million 4-year term loan.

The acquired XTO assets produce approximately 32,000 BOEs/d from the Duvernay and Montney formations in Northwestern Alberta. [Whitecap summarized](#) the underlying strategic direction stating that this acquisition “adds top tier Montney inventory by expanding and consolidating certain working interests in Whitecap’s current Montney assets in the greater Kakwa, Alberta region, and represents an entry into the prolific liquids-rich Duvernay play at Kaybob.”

## **Tamarack and Clearwater**

On Sept. 12, 2022, Tamarack Valley Energy Ltd. (Tamarack) announced that it had entered [into an agreement](#) to acquire Deltastream Energy Corporation (Deltastream), a privately held pure-play Clearwater oil producer for a total of [\\$1.425 billion](#). [This deal](#) consisting of \$825 million in cash, \$300 million in a deferred acquisition payment, and \$300 million in Tamarack equity.

Deltastream produces 19,500 BOEs/d and this deal represents an expansion of Tamarack’s leading position in the Clearwater heavy oil play in north-central Alberta. Tamarack expects its total production from the Clearwater play to be in the range of 68,000 BOEs/d to 72,000 BOEs/d in 2023.

## **Emissions Reduction**

In 2022, the Government of Canada (the Federal Government) continued to push forward with new policies and regulatory measures to meet its greenhouse gas (GHG) reduction targets. In March, the Federal Government released its [2030 Emissions Reduction Plan](#) (the Plan), which sets out the emissions reduction policies the Federal Government has in place and laid out new policies it is pursuing.

[A summary of the Plan can be read here.](#)

Two major components of the Plan which were implemented into law in 2022, the Federal GHG offset system and the Clean Fuels Regulations, are discussed in more detail below:

### **The Canadian greenhouse gas offset system**

In the wake of the Supreme Court of Canada’s 2021 decision upholding the constitutionality of the *Greenhouse Gas Pollution Pricing Act*, S.C. 2018, c. 12 (GGPPA), the Federal Government set out to fortify the carbon pricing system in Canada and implemented the Canadian Greenhouse Gas Offset Credit System in June. This system, outlined in the Canadian Greenhouse Gas Offset Credit System Regulations, SOR/2022-111, consists of a credit and tracking system to register certified federal GHG offsets, and protocols to establish the activities which will be eligible to generate federal offsets and to quantify pollution reductions for those activities.

The Federal Government has published one protocol to date under the Federal Offsets system: the Landfill Methane Recovery and Destruction protocol. Five further offset protocols are currently in development, with the Direct Air Carbon Dioxide Capture and Sequestration protocol of particular interest to oil & gas corporations that are assessing the viability of carbon capture and storage projects.

## Clean fuels regulations

The Clean Fuel Regulations, SOR/2022-140 came into effect on June 21, 2022, creating a requirement for liquid fossil fuel suppliers to reduce the carbon intensity of the fuels they supply in Canada. The Clean Fuel Regulations set 2016 as the baseline point for carbon intensity reduction and outlined July 1, 2023 as the first benchmark point by which suppliers must meet the carbon intensity reduction standards.

The Clean Fuel Regulations also implemented a credit trading system, giving suppliers the opportunity to meet their carbon intensity reduction requirements by generating compliance credits through three primary categories of activities:

- Compliance Category 1: GHG emission reduction projects which reduce the carbon intensity of a liquid fossil fuel over the course of its lifecycle;
- Compliance Category 2: supplying low carbon intensity fuels such as ethanol by producing or importing them into Canada; or
- Compliance Category 3: supplying fuel or energy to advanced vehicle technology projects aimed at changing or retrofitting fossil fuel combustion devices to be powered by alternate energy sources (e.g. electric vehicles).

## Clean Energy Tax Credits

To incentivize the adoption of clean energy technology, the Federal Government announced the [2022 Fall Economic Statement](#) (2022 FES) on November 3, 2022. On Dec. 1, 2022, the Department of Finance launched consultations on the tax credits proposed under the 2022 FES:

- **Clean Hydrogen Investment Tax Credit** - this refundable tax credit for clean hydrogen production investments based on the lifecycle carbon intensity of hydrogen will focus on the appropriate carbon intensity-based system for the Canadian context and the level of support needed for different production pathways in Canada. Thresholds with respect to what these lifecycle carbon emissions tiers will look like were not indicated in the 2022 FES, however the lowest carbon intensity tier that meets all eligibility requirements is proposed to receive an investment tax credit of at least 40 per cent.
- **Clean Technology Investment Tax Credit** – this is a refundable tax credit of 30 per cent for clean technology investments in electricity generation systems, stationary electricity storage systems, low-carbon heat equipment and industrial zero-emission vehicles and related charging or refueling equipment.

Both proposed tax credits will be available for investments made as of the day of Budget 2023, with the credits being phased out after 2030.

In addition, to incentivize job creation, both proposed tax credits will be reduced by 10 percentage points if a company does not meet certain labour conditions. Part of Department of Finance's consultations will focus on these labour conditions including prevailing wages based on local labour market conditions and apprenticeship training opportunities.

## Geopolitical Events Affecting Energy Issues in 2022

The world's attention focused on energy in 2022, in part due to the sharp dose of reality dispensed by Russia's invasion of Ukraine. Historic underinvestment in energy infrastructure meant that when a stiff test of easy energy availability arrived in 2022, countries found themselves scrambling, and anxious about their energy independence. In addition, inflation arrived in North America and the central banks responded with consistent rate hikes. This meant higher prices throughout the energy chain, most of which land in the laps of consumers.

### Price volatility

In 2022, the world saw extreme oil and natural gas price volatility, due in part to the war in the Ukraine. While the price of oil entered and exited the year at approximately \$80/bbl for West Texas Intermediate, during the year the price ballooned to \$120/bbl before retreating. Similarly, natural gas at Henry Hub was around \$4/Mcf at the start of the year and \$3.75/Mcf at the end of the year, but rose to \$9/Mcf in August.

The volatility appears to have been due to three main factors:

- Russia's invasion of Ukraine in February 2022, coupled with Russia's threat to drastically reduce natural gas supply to Western Europe.
- Post-COVID pent-up consumer demand in North America.
- Zero-COVID restrictions in China leading to supply chain failures in the face of increased demand.

### Ukraine and energy

The Ukraine war has had global energy consequences that were unthinkable even a year ago. Germany was forced to reactivate coal-fired electrical generation, as it had decommissioned its nuclear power stations in reaction to the Fukushima nuclear disaster in 2011. Doing so had unwittingly left it at the mercy of Russian gas imports, highlighting once again the importance of a broad energy mix. The Biden administration also eased restrictions on the import of Venezuelan oil, offering an olive branch to the Maduro regime that US governments had previously rejected outright.

More broadly, the Ukraine war catalyzed discussions between the United States and Europe with respect to LNG imports, given the relatively easy access from the U.S. Gulf Coast to LNG import facilities in Western Europe. Canada's contribution to European gas demand will be, as usual, mainly be in the form of supply of raw gas to LNG

liquefaction facilities in the U.S. LNG export at scale from Canada is still some years away.

## **Inflation and energy**

The Bank of Canada pursued an inflation-fighting strategy relentlessly in 2022, hiking its target rate from 0.5 per cent in March to 4.2 per cent in Dec. Inflation has been affecting operating costs of oil and gas producers, but their netbacks were not materially affected due to high commodity prices.

The use of interest rates as an inflation-fighting mechanism is not necessarily effective when inflation is due to lack of supply, or to high commodity prices. For example, Canada's transportation infrastructure runs almost entirely on diesel fuel and the high cost of diesel is passed on to consumers, who themselves are facing a cash crunch due to higher interest rates for consumer lending.

Higher interest rates, as well as the unpopularity of oil and gas producers generally among conventional banks and some high-profile investors, meant that investment in exploration was relatively modest. High price environments usually lead to more oil and gas investment, as companies can finance drilling through debt or equity, not just through cash flow.

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The consensus appears to be that 2023 will be a calmer year than 2022, with the possibility of a return to relatively stable commodity prices and lower interest rates. However, if 2022 shows us anything, when the energy mix is threatened, seismic changes can occur in the world economy. A return to investment in energy infrastructure while times are good is likely warranted – whether that arrives remains to be seen.

## **The Faith (and Financing) of Innovation on the Path to Net Zero**

Leading up to and following the COP 26 conference in Glasgow in November 2021, Canada made numerous commitments to reduce greenhouse gas (GHG) emissions. Like other countries and jurisdictions (at COP 26 over 40 countries committed to accelerating clean technology innovation and deployment) Canada's plan for achieving these GHG reductions relies heavily on innovations and emerging technologies. The Canadian government has itself noted that 50 per cent of the global GHG emissions reductions required by 2050 will need to come from commercially available clean technologies that are still in early stages of development. The identification, support and ultimately funding of these technologies was a significant trend in Canadian energy policy, investment and public interest in 2022.

In advance of COP 26, Canada announced its Nationally Determined Contributions (NDC) which are its general GHG reduction targets under the Paris Agreement. These NDC included commitments to cut emissions by 40 per cent to 45 per cent below 2005

levels by 2030 (approximately 406.5 to 443.4 Mt CO<sub>2</sub>e) and to achieve net zero emissions by 2050. In March 2022, the Federal Government delivered its 2030 Emissions Reduction Plan (the Plan), which sets out the more specific tactics for Canada to meet the 2030 reduction commitments set out in its NDC. While the Plan outlines policies and strategies affecting a range of sectors including buildings, transportation, oil and gas, and electricity, and proposes numerous measures including carbon pricing and clean fuel standards, there is a strong reliance on emerging technologies and innovations to achieve the objectives of the Plan. The following innovations and technologies garnered significant attention and funding in 2022:

**Carbon capture use and storage (CCUS)** - CCUS is a crucial component of most plans to achieve net zero by 2050, including plans of the UN Intergovernmental Panel on Climate Change and the International Energy Agency. The capture of CO<sub>2</sub> from industrial or power applications and its use in products such as concrete and low carbon synthetic fuels, or its storage in underground geological formations, is not only considered a means of reducing emissions, it is also a cornerstone of the blue hydrogen strategies previously rolled out by [Canada](#), Alberta, [Ontario](#) and [British Columbia](#).

Significant investments and advancements in CCUS were made in 2022. In March and October 2022, the Alberta government requested, evaluated, and selected for further evaluation, 25 proposals to develop carbon sequestration hubs in the province. During 2022, the Federal Government solicited input on, and outlined details of, an investment tax credit (the CCUS Tax Credit), which will apply to investments in equipment for CCUS projects that permanently store captured CO<sub>2</sub> (the CCUS Tax Credit is expected to cost approximately \$1.5 Billion annually and may be expanded to cover additional costs and investments). Numerous other investments and tax incentives, including funds for studies and projects provided by entities such as Emissions Reduction Alberta and Alberta Innovates, were also announced in 2022. Governments were also keenly aware of the competing incentives and credits available in the U.S. through the *Inflation Reduction Act*.

**Direct air capture (DAC)** Direct Air Capture technology captures and uses carbon dioxide from the atmosphere using industrial-sized fans to remove carbon for subsequent storage under ground or for alternative use. To be economically viable it must be close to renewable energy sources. In 2022, the Federal Government incentivized DAC by including it as an eligible investment for the CCUS Tax Credit. Funding was also available from entities such as Emission Reduction Alberta and Alberta Innovates. Leading Canadian DAC companies such as Carbon Engineering Ltd also benefitted from investments from Air Canada, BMO and others in 2022.

**Hydrogen** – In 2022, Federal and provincial governments built on their respective previously announced hydrogen strategic plans by making significant investments in hydrogen production projects (including \$475 million of public funding to support the [Air Products Alberta Hydrogen Energy Complex](#)), and in hydrogen blending projects (notably [Enbridge](#) in Ontario and [ATCO](#) in Alberta). In August 2022, Canada and Germany signed a [joint declaration](#) of intent to establish a hydrogen alliance. The Federal Government also proposed to establish a Clean Hydrogen tax credit (Clean Hydrogen Credit) for investments starting in 2023, although many details of the Clean Hydrogen Credit remain to be determined.

**Small Modular Reactors (SMR)** – SMRs have a lower capital costs than large nuclear reactors, but need to demonstrate scalability. Building on its December 2020 SMR Action Plan to set next steps to develop and deploy this technology, the Federal Government announced in October 2022 that it will, through the Canada Infrastructure Bank, provide \$970 million in financing to Ontario Power Generation towards development of a 300 MW commercial grid scale SMR. Similarly, in March 2022, the governments of Ontario, Alberta, Saskatchewan and New Brunswick announced a joint strategic plan for the development and use of SMR.

**Fusion** - Fusion, which creates energy by combining two atoms (usually hydrogen isotopes), is dispatchable which means it does not rely on environmental variables like the sun or wind, and creates no carbon emissions or long term waste. However, so far, fusion machines have not been viable as a technological path to net zero since the energy input to power the reaction has exceeded the energy produced. However, in December 2022, the National Ignition Facility in California announced that they had produced for the first time more energy in a fusion reaction than was used to ignite it. This remarkable breakthrough is a tremendous milestone in producing clean energy. Work still remains in order to repeat and perfect the process, nurture the supply chain, develop scaled prototypes, establish a regulatory framework and solicit financing. Nevertheless, prudent energy leaders and policy makers will need to consider fusion as a new potential pathway to achieve net zero targets in the mid to longer term.

## Alberta Court of Appeal finds *Federal Impact Assessment Act* unconstitutional

In June 2019, the [Federal Government introduced the \*Impact Assessment Act\*](#) (IAA). Shortly thereafter, the government of Alberta launched a constitutional reference that asked the Alberta Court of Appeal to determine whether the IAA and its corresponding *Physical Activities Regulations* were unconstitutional, in whole or in part.

In the May 2022 decision *Reference re Impact Assessment Act*, 2022 ABCA 165, the Alberta Court of Appeal concluded that the main thrust of the IAA was the establishment of a federal impact assessment regime that enables the federal executive to designate, review, and regulate projects based on their effects, including greenhouse gas emissions. Based on this characterization, [the court found](#) that the IAA intrudes fatally into provincial jurisdiction and does not fall under any federal head of power, including the national concern branch of the peace, order, and good government power.

This case represents another key development in the ongoing constitutional saga sketching out the jurisdictional boundaries between the federal and provincial governments with respect to modern environmental legislation. As a result, the Supreme Court of Canada's disposition of the constitutional questions in this case will have far-reaching implications for project proponents, resource market participants, and provincial natural resource development.

## Alberta Sovereignty within a United Canada Act

True to her central campaign promise to shield Alberta from federal incursions, newly-elected Premier of Alberta Danielle Smith tabled the *Alberta Sovereignty Within a United Canada Act* (the Sovereignty Act), which was granted Royal Assent on December 15, 2022.

The Sovereignty Act permits the Legislative Assembly of Alberta to approve resolutions authorizing the Lieutenant Governor in Council to take certain measures on the basis that a federal initiative causes, or is anticipated to cause, harm to Albertans on account of interference with provincial constitutional jurisdiction or interference with Charter rights. Significantly, these measures include the ability to “issue directives to a provincial entity and its members, officers and agents, and the Crown and its Ministers and agents, in respect of the federal initiative”.

The effects of the Sovereignty Act are potentially broad and significant, but cannot be known with certainty until measures are taken under the Sovereignty Act, or the courts rule on the constitutionality of the Sovereignty Act itself. Implementation measures are likely to impact the energy industry as the Premier has asked provincial ministers to review federal policies that seek to “regulate and control Alberta’s natural resources and economic development and “penalize” the provinces energy and agricultural sectors.

## Court of Appeal refuses to certify property owner’s class action for oil spill

In *Rieger v Plains Midstream Canada ULC*, 2022 ABCA 28, the Court of Appeal of Alberta rejected an application to certify a class action brought by property owners near Gleniffer Lake for a claim against a company responsible for an oil spill contaminating the lake.

The Plaintiff sought to certify a class action on the basis that the class members suffered damages for (1) the loss of use of the lake and its facilities; and (2) diminution of the property values of properties that were physically unaffected by the spill.

Applying the analysis set out by Supreme Court of Canada in *1688782 Ontario Inc v Maple Leaf Foods Inc*, 2020 SCC 35, the Court held that there is no general right protecting against the negligent or intentional infliction of pure economic loss. To recover for pure economic loss, the plaintiffs would need to prove all of the elements of the test for negligence and further establish that the plaintiff suffered damages as a result of an interference with a legally cognizable right. The Court found that the Plaintiff’s had “not pled interference with any legally cognizable right. Their loss of use of Gleniffer Lake was the loss of use of a public place, and their property was not physically damaged by the oil spill.”<sup>2</sup> Moreover, the Court held that the Plaintiff’s failed to establish a proximate relationship which warranted imposing a duty of care on Plains Midstream. The application to certify the class was accordingly dismissed.

In *Rieger*, Alberta's top court placed an important limit on the pool of potential claimants seeking damages in the event of an oil spill. Claims by owners of neighbouring property not directly damaged by the spill will face significant challenges following this decision.

## Court of Appeal further clarifies nature of end-of-life obligations

In the latest instalment of the *PricewaterhouseCoopers Inc v Perpetual Energy Inc., 2022 ABCA 111* (Perpetual Energy) saga, the Alberta Court of Appeal further clarified the nature of asset retirement obligations (ARO) or the now preferred "end-of-life obligations".

The Trustee in bankruptcy filed a statement of claim alleging that the acquisition of certain petroleum assets by Perpetual Energy Operating Corp. (PEOC), prior to its change of name to Sequoia Resources Corp. and assignment into bankruptcy, was void under s.96 of the *Bankruptcy and Insolvency Act*, RSC 1985, c.B-3 on the basis that PEOC was insolvent when the assets were transferred at undervalue, or rendered insolvent by the transfer at undervalue.

The Court of Appeal found that the chambers Justice had erred in determining that ARO obligations are not an "obligation due or accruing due" and that their value is therefore nil for the purpose of a Balance Sheet Solvency Test. While the Supreme Court of Canada confirmed in *Orphan Well Association v. Grant Thornton Ltd., 2019 SCC 5 (Redwater)* that ARO obligations cannot be a "claim provable in bankruptcy", and the Alberta Energy Regulator is not a "creditor" with respect to end-of-life obligations, these conclusions do not mean that end-of-life obligations are nonexistent, mere assumptions or speculations, or of nil value. Rather, end-of-life obligations are "real and omnipresent", forming a "fundamental part of the value of licensed assets", and before they are fully performed "the only thing they cannot be is nil". Noting that the Trustee's valuation of end-of-life obligations far exceeded the net asset value, the Court of Appeal allowed the appeal and directed that the s.96 issue proceed to trial.

Following this decision, parties engaged in the sale or acquisition of petroleum assets must consider that the present value of ARO obligations will be taken into account in the event that a bankruptcy trustee should subsequently seek to have the transaction declared void as a transfer at undervalue.

For more information about the Court of Appeal's decision, please see [Alberta Court of Appeal vindicates trustee in the latest Perpetual Energy decision.](#)

## Supreme Court of Canada permits receiver's court proceedings despite arbitration clause

The Supreme Court of Canada's recent decision in *Peace River Hydro Partners v Petrowest Corp.* considers the interaction between arbitration and receivership, and

provides guidance on the application of the doctrine of separability in the insolvency context.

In this case, Peace River Hydro Partners (Peace River) subcontracted Petrowest Corporation (Petrowest) to perform certain construction work. The contracts contained mandatory arbitration clauses. Petrowest subsequently entered court-ordered receivership proceedings. The Receiver commenced court proceedings against Peace River for monies allegedly owing to Petrowest under the contracts. Peace River sought a stay of proceedings on the basis that the claim was subject to mandatory arbitration under the terms of the contracts.

The Supreme Court noted that a party seeking to enforce an arbitration clause, and thus stay court proceedings, must establish the technical prerequisites for a mandatory stay of proceedings. This typically includes establishing that an arbitration agreement exists, court proceedings have been commenced, the court proceedings are in respect of a matter that the parties agree to submit to arbitration and the party applying for a stay has not taken a step in the court proceedings. Once these are established, the Court may nonetheless refuse to grant a stay of proceedings if a statutory exception applies.

The Court held that although the technical requirements for a stay of proceedings were made out, the arbitration agreements were inoperative on the basis that they contemplated multiple arbitral processes that would compromise the orderly and efficient resolution of the receivership, contrary to the *Bankruptcy and Insolvency Act*.

The Peace River decision is an important reminder that despite the inclusion of clear arbitration clauses in commercial agreements, parties may nonetheless find themselves litigating their disputes before the courts in certain circumstances, including where a counterparty initiates insolvency proceedings and it is held that arbitration would compromise the orderly and efficient resolution of those proceedings.

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