Court rules party cannot rely on exculpatory clause to avoid liability for deceit

May 04, 2021

In *NEP Canada ULC v MEC OP LLC*, 2021 ABQB 180 (*NEP*), the Alberta Court of Queen's Bench rendered an important judgment ruling on the interplay between an action for a deceitful contractual representation and an exclusionary clause contained within that same contract. In short, a party will not be able to escape liability through reliance on a contractual limitation of liability clause where the party has made fraudulent misrepresentations in that very contract. In this case, the consequences of this finding were significant, as the Court ultimately awarded the Plaintiff approximately $185,000,000 in damages, which included a $120,750,000 award for loss of opportunity, despite a limitation of liability clause which barred liability for consequential and indirect damages, including loss of profits.

What you need to know

- The duty of good faith and honest contractual performance does not just preclude actively misleading conduct, it also precludes half-truths, omissions and silence, which mislead the other party. Accordingly, a party cannot rely on opaque language in a disclosure schedule, or obfuscate disclosures with half-truths, in order to escape liability.
- A party who makes a fraudulent misrepresentation to induce another to enter into a contract may not rely upon exculpatory or limitation of liability clauses in that very contract to absolve them of liability. The consequences of this, particularly where the transaction value is high, can be significant and result in substantial damage awards.

Discussion

A. Background

NEP arose out of a share purchase transaction through which NEP Canada ULC (NEP) acquired the shares of MEC Operating Company ULC (MEP), a wholly owned subsidiary of Merit ULC (Merit). MEP's assets included wells, pipelines and facilities in various producing fields in Alberta (the Transaction Assets). The share purchase agreement (SPA) included a "Schedule D" which purported to disclose all regulatory

non-compliance issues. The vendors made several contractual representations and warranties in relation to Schedule D, including that Schedule D disclosed all material violations or defaults of any applicable laws or regulations.

A few months after closing, NEP discovered that numerous regulatory non-compliance issues plagued the Transaction Assets. NEP promptly moved to disclose these issues to the Alberta Energy Regulator (AER) through a formal "self-disclosure" process. NEP came to discover that employees of the Defendants had been aware of the non-compliance issues for years, and all of the regulatory non-compliance issues that NEP had to self-disclose to the AER had been brought to the attention of Merit's management prior to, and during the process of, drafting Schedule D.

Accordingly, NEP commenced the Action, alleging that the Defendants did not truthfully disclose what they knew about the Transaction Assets, particularly with respect to regulatory compliance issues. NEP sued for breach of contractual representation and warranty, deceit, conspiracy and breach of the duty of good faith and honest performance.

B. The Court found that the Defendants breached the SPA, their duty of good faith and honest contractual performance and were deceitful

Schedule D to the SPA disclosed "potential instances" of various non-compliance issues. Merit argued that the word "potential" encompassed instances of non-compliance that actually existed, as well as unknown, possible instances of non-compliance, and was purposefully general and broad. It therefore argued that it had disclosed the regulatory non-compliance issues.

The Court did not accept these arguments. The Court interpreted "potential" to mean possible, but not yet extant, instances of non-compliance, which did not include known and existing instances of non-compliance. The Court further found that Merit and MEC were fully aware that a significant number of non-compliance issues existed and the "opaque language" used by Merit did not constitute proper disclosure and particularization of these non-compliance issues. Given these findings, the Court held that the Defendants breached the representations and warranties in the SPA.

NEP further claimed that the conduct of Merit amounted to the tort of deceit. The Court agreed, finding that while a party negotiating a contract has no general duty of disclosure, if a party elects to make a disclosure, then it must ensure the representation is accurate. If the disclosing party allows the other party to proceed on the basis of incomplete information or a half-truth, an actionable fraudulent misrepresentation arises. The Court held that rather than being honest and direct in Schedule D, Merit chose "word weasel terminology" to hide what it knew. The Court found deceit by Merit through both half-truths and positive misrepresentations.

With respect to the duty of good faith and honest contractual performance, the Court reiterated the Supreme Court's comments in *Callow*[1] that what constitutes the notion of knowingly misleading a party to a contract is a highly fact-driven determination, and under appropriate circumstances, may include half-truths, omissions and silence. The Court again found Merit in breach, holding that Merit framed the contents of Schedule D with half-truths, which were true only with qualifications or additions known to, but withheld, by Merit.

C. The Court held that the Defendants could not rely on the limitation of liability clause

Given these findings of liability, the Court moved to assessing NEP's damages. The SPA contained a limitation of liability clause which provided that no party would be liable for consequential, indirect or punitive damages, including loss of anticipated profits, business interruption or any special or incidental loss of any kind. However, the Court applied the tripartite test from *Tercon*[2] to determine whether the limitation of liability clause was applicable in the circumstances. The *Tercon* test asks: (1) As a matter of ordinary contractual interpretation, does the limitation of liability clause apply to the circumstances established in the evidence?; (2) If yes, was the limitation of liability clause unconscionable at the time the contract was made?; and (3) If no, should the court decline to enforce the limitation of liability because of an overriding public policy concern which outweighs the very strong public interest in the enforcement of contracts?

The Court found that the limitation of liability clause applied and was not unconscionable. However, regarding the third aspect of the test, the Court held that where a party, such as the Defendants in this case, makes fraudulent misrepresentations to induce another to enter a contract, they may not rely upon exculpatory or limitation clauses in that very contract to protect themselves from their wrongful conduct. The Court stated:

> In my view, similar policy concerns emerge out of Merit's conduct. Merit knowingly misled NEP by failing to disclose important regulatory non-compliance issues, even when expressly asked about them. It seems contrary to equity to allow a party to escape liability for the false remarks simply because the same party, while withholding crucial truths or actively making mendacious comments, inserted into the contract a clause that shields it from legal ramifications.[3]

Given its findings with respect to deceit, the Court concluded that the limitation of liability clause in the SPA was unenforceable, and Merit was liable for consequential damages flowing from its wrongdoing.

The Court ultimately assessed damages at $184,570,200, which was comprised of:

i) Remediation costs ($9,937,608);
ii) Loss of opportunity ($120,750,000);
iii) Shut-in production ($3,273,000); and
iv) Borrowing costs ($20,609,592).

Regarding loss of opportunity, NEP's original plan was to sell the Transaction Assets in 2014. However, the Court accepted that as a result of Merit's deceit and misrepresentations, it was not in a position to monetize the Transaction Assets until 2016 at the earliest, by which time the commodity prices had dropped dramatically and the market for oil and gas assets was drastically different. NEP ultimately did sell its interest in the Transaction Assets in 2018. Accordingly, the Court assessed loss of opportunity damages as the difference between what NEP recovered in 2018 and the fair market value it could have obtained in 2014. Based on expert evidence, this difference in value ranged from $274,000,000 and $416,000,000, or a midpoint of $345,000,000. After taking into account certain contingencies that would have affected

the probability of NEP securing the $350,000,000 value, the Court assessed the final award for loss of opportunity at $120,750,000, which was 35 per cent of the midpoint figure of $345,000,000.

Regarding borrowing costs, the Court accepted NEP's evidence that it was forced to seek additional financing and incur borrowing costs as a direct result of Merit's conduct. Particularly, Merit's conduct caused NEP to suffer reduced cash flows from shut-in wells, costs related to remediation, and delay in bringing on revenue from new wells, which together forced NEP to rely on credit facilities to finance its activities. The Court therefore awarded over $20 million in borrowing costs.

Takeaways

This case exemplifies that parties, even extremely sophisticated parties, cannot contract out of liability for deceitful or fraudulent conduct. Parties can carefully construct and agree to exclusion clauses to try to do so, but the exclusion clause will not likely operate to exclude liability in the face of an explicit fraudulent representation which induced the making of the contract. It also underscores the significant consequences that can arise from that finding, given the $185,000,000 damages award in this case. In short, while a party negotiating a contract has no general duty of disclosure, a party who elects to make a disclosure in a transaction must be careful to ensure that the representation is both accurate and complete, or otherwise risk facing extensive damages arising from claims of breach of contract, deceit and breach of the duty of good faith and honest performance.

Further, while the Court did not explicitly discuss the principle of caveat emptor, or "buyer beware", it seems that this case is an example where caveat emptor was overridden by the deceitful conduct. Certain "potential" issues of non-compliance were disclosed in Schedule D, but the Court did not find that NEP ought to have done more fulsome due diligence as to the extent of these non-compliance issues. This may have been the result of the Court's findings that the non-compliance issues were not potential at all. Instead, they were known and existing at the time, and certain key employees of the Defendants admitted at trial to actively deceiving NEP. For instance, when a key employee of the Defendant was asked by NEP whether she had anything to add to Schedule D, she said "no" despite testifying at trial that Schedule D was full of "garbage" as there were hundreds of non-compliance issues that were not "potential", but known and existing for years.

[1] *CM Callow Inc v Zollinger*, 2020 SCC 45.

[2] *Tercon Contractors Ltd. v British Columbia (Transportation and Highways)*, 2010 SCC 4.

[3] *NEP Canada ULC v MEC OP LLC*, 2021 ABQB 180 at para 1076.

By

Michael A Marion, Miles F. Pittman, Laura Poppel

Expertise

Corporate Commercial, Disputes, Environmental, Energy - Oil & Gas

---

BLG | Canada's Law Firm

As the largest, truly full-service Canadian law firm, Borden Ladner Gervais LLP (BLG) delivers practical legal advice for domestic and international clients across more practices and industries than any Canadian firm. With over 800 lawyers, intellectual property agents and other professionals, BLG serves the legal needs of businesses and institutions across Canada and beyond – from M&A and capital markets, to disputes, financing, and trademark & patent registration.

blg.com

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

The information contained herein is of a general nature and is not intended to constitute legal advice, a complete statement of the law, or an opinion on any subject. No one should act upon it or refrain from acting without a thorough examination of the law after the facts of a specific situation are considered. You are urged to consult your legal adviser in cases of specific questions or concerns. BLG does not warrant or guarantee the accuracy, currency or completeness of this publication. No part of this publication may be reproduced without prior written permission of Borden Ladner Gervais LLP. If this publication was sent to you by BLG and you do not wish to receive further publications from BLG, you may ask to remove your contact information from our mailing lists by emailing unsubscribe@blg.com or manage your subscription preferences at blg.com/MyPreferences. If you feel you have received this message in error please contact communications@blg.com. BLG's privacy policy for publications may be found at blg.com/en/privacy.

© 2026 Borden Ladner Gervais LLP. Borden Ladner Gervais LLP is an Ontario Limited Liability Partnership.