

**SOBER SECOND THOUGHTS: LITIGATING PURCHASE AND SALE AGREEMENTS
IN THE ENERGY INDUSTRY**

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INTRODUCTION

The purchase and sale of energy assets is generally a complex, expensive and risky transaction. Transactions often involve real and personal property, transfer potential liabilities that can have enormous financial and reputational impacts for both the vendor and purchaser, and are often required to be closed within tight deadlines. When disputes relating to transactions arise, they often involve difficult legal issues that can complicate the successful recovery of losses. In the current economic environment, as deal flow increases as industry participants refresh their business strategies in Canada, now is the perfect time to take stock of some of the legal issues involved in litigating purchase and sale agreements (“PSAs”) of energy assets.

This paper identifies issues that commonly impact disputes relating to PSAs in the energy context. Part I provides a general overview of how courts analyze PSAs, including discussion of principles of contractual interpretation. Part II canvasses disputes occurring prior to closing that can compromise or frustrate finalizing a sale, including when the actions of a third party (such as a holder of a right of first refusal (“ROFR”) or a regulator) threaten to compromise closing. Part III provides an overview of frequently litigated issues that can arise post-closing, including disputes relating to the definition of the “Assets” conveyed, breaches of representations and warranties and the mechanics of indemnities. Part IV addresses other issues that may impact how, when and where parties bring claims, including limitation of liability clauses and limitation periods.

I. INTERPRETING THE PSA

PSAs in the energy context are generally drafted, negotiated and executed by sophisticated commercial entities, often with assistance of both external and internal legal counsel. PSAs are usually in writing and are comprehensive in outlining the rights and obligations of the contracting

parties. Further, the industry has attempted to standardize simple transactions through the development of the Canadian Association of Petroleum Landmen Property Transfer Procedure (the “CAPL PTP”).² However, notwithstanding the careful attention paid at the drafting stage of agreements, unpacking the meaning of a PSA before a court can involve piecing together a puzzle of complicated facts, legal principles and evidentiary rules.

Courts will generally try to hold parties to their bargains and will assume that parties are aware of the legal consequences of the terms agreed to.³ However, energy-related PSAs often have peculiar characteristics that can complicate their interpretation. Among other things: PSAs often involve legacy agreements underlying the assets being transferred that may have been entered into decades ago and which may not reflect the modern understanding of legal principles; PSAs may contradict or operate in tandem with other agreements; and PSAs often contain a web of complicated and referential provisions and defined terms.⁴

The purpose of contractual interpretation is to “ascertain the objective intent of the parties.”⁵ The “objective intent” is not what one party subjectively understood the contract to mean, but rather

² The Canadian Association of Petroleum Landmen, 2017 Property Transfer Procedure (Calgary: CAPL, 2017), online: <<http://landman.ca/wp/wp-content/uploads/2017/12/2017-CAPL-PTP-Unannotated-Text-Final-Clean.pdf>> [CAPL PTP] is a standard form document that can be used for simple transactions. The CAPL PTP contains a number of elections that parties can make to modify the terms of a transaction and expressly contemplates inclusion of a “Head Agreement” laying out specific negotiated terms relevant to the particular deal at hand.

³ See for example *Guarantee Co of North America v Gordon Capital Corp*, [1999] 3 SCR 423, [1999] SCJ No 60 where the Supreme Court of Canada, at para 46, noted a “general reluctance to disturb the choice of terms by sophisticated commercial parties” and stated at para 45 that a sophisticated party “can be expected to know the meaning of fundamental legal terms [...] and it is appropriate to give effect to their intent as expressed in the plain words of the contract”. In the oil and gas context see for example, *NOV Enerflow ULC v Enerflow Industries Inc*, 2015 ABQB 759, [2015] AJ No 1343 at para 14 [*NOV Enerflow*].

⁴ An exhaustive overview of the principles of contractual interpretation is beyond the scope of this paper. This Part provides specific commentary on how contractual interpretation impacts the litigation of disputes relating to PSAs in energy disputes.

⁵ *Sattva Capital Corp v Creston Moly Corp*, 2014 SCC 53, [2014] 2 SCR 633 at para 49 [*Sattva*]; *IFP Technologies (Canada) Inc v EnCana Midstream and Marketing*, 2017 ABCA 157, 53 Alta LR (6th) 96 at para 79 [*IFP Technologies*].

what a reasonable person would have objectively understood from the words of the agreement in the factual matrix in which the agreement was made.⁶

Courts determine objective intent by looking at the actual words the parties have negotiated, having regard to the surrounding context. The words used must be given their “ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract.”⁷ It is not just what the parties knew at the time, but also “what the parties using those words against the relevant background would reasonably have been understood to mean.”⁸ This opens up a broad range of factors that can inform a court’s analysis into objective intent.

A. Analyzing the Words

The starting place for a court’s analysis of a contract is an assessment of the ordinary and grammatical meaning of the written words. However, the ordinary and technical usage of a particular word is not necessarily determinative of a word’s meaning because “[t]he meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean.”⁹ Courts will adopt the meaning of words that parties have defined themselves in agreements;¹⁰ however the words of the contract, and the entire contract itself, must be read in context.¹¹

⁶ *IFP Technologies*, *supra* note 5 at para 79, citing Geoff R Hall, *Canadian Contractual Interpretation Law*, 2nd ed (Markham: LexisNexis, 2012) at 33; see also *Sattva*, *supra* note 5 at para 59.

⁷ *Sattva*, *supra* note 5 at para 47.

⁸ *Sattva*, *supra* note 5 at para 48 citing *Investors Compensation Scheme Ltd v West Bromwich Building Society* (1997), [1998] 1 All ER 98 (UK HL) at 115 [*Investors*].

⁹ *Sattva*, *supra* note 5 at para 48 citing *Investors*, *supra* note 8.

¹⁰ *NOV Enerflow*, *supra* note 3 at para 17.

¹¹ *IFP Technologies*, *supra* note 5 at para 83, citing *Sattva*, *supra* note 5 at para 85.

Further, even where the literal meaning of words is apparent, they will not be relied upon where to do so would “bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere” in which the contract was entered into.¹² However, while commercial common sense can be a factor in interpretation, it cannot supersede the actual language used in a contract.¹³

PSAs often involve very comprehensive defined terms. Where such definitions exist, courts will adopt that meaning in their analysis, even if the express definition conflicts with the ordinary or technical usage of the word.¹⁴ As lawyers are often involved in drafting PSAs, an assessment of commercial reasonableness is more limited given that it is presumed parties intended the natural legal consequences of the language used.¹⁵ There are a number of cases where the courts have interpreted words commonly used in energy-related PSAs, some examples of which include: “working interest”;¹⁶ “wells producing to a Facility”;¹⁷ “Assets” (which included an analysis of related terms including “Tangibles”, “Miscellaneous Interests” and “Petroleum and Natural Gas

¹² *Consolidated Bathurst Export Ltd v Mutual Boiler & Machinery Insurance Co*, [1980] 1 SCR 888, [1980] 1 RCS 888 at 10 [*Consolidated Bathurst*].

¹³ *Valard Construction Ltd v Bird Construction Co*, 2016 ABCA 249, 42 Alta LR (6th) 223 at para 184.

¹⁴ *Lake Louise Limited Partnership v Canad Corp of Manitoba Ltd et al*, 2014 MBCA 61, [2014] MJ No 171 at para 144, leave to appeal denied, [2014] SCCA No 374, [2014] CSCR No 374 [*Lake Louise*].

¹⁵ *Eli Lilly & Co v Novapharm Ltd*, [1998] 2 SCR 129, [1998] SCJ No 59 at para 56; *NOV Enerflow*, *supra* note 3 at para 14. The rule of *contra proferentum* generally will not apply where there are sophisticated commercial entities involved in a transaction. See for example, *Royal Bank of Canada v Swartout*, 2011 ABCA 362, 56 Alta LR (5th) 25 where the Court stated “the *contra proferentum* rule should not be invoked where there are sophisticated parties, represented by lawyers and each had a meaningful opportunity to participate in the negotiation of the instrument”: at para 48, citing *Ironside v Smith*, 1998 ABCA 366, 223 AR 379 at paras 66-67. PSAs also can expressly exclude the operation of the *contra proferentum* rule, see for example the CAPL PTP, *supra* note 2 at clause 1.14.

¹⁶ In *IFP Technologies*, *supra* note 5 at para 98 the Court stated that “working interest” is a “legal term of art” in the oil and gas context, holding that it “constitutes the *percentage of ownership* that an owner has to explore, drill and produce minerals from the lands in question”.

¹⁷ The Court in *Canlin Resources Partnership v Husky Oil Operations Limited*, 2018 ABQB 24, [2018] AJ No 26 [*Canlin*] held that the words “‘wells producing to a facility’, given their ordinary and grammatical sense, mean wells that are being processed by the dehydrator and inlet separation and flow splitter units of the Facility”: at para 41. *Canlin* is currently under appeal to the Alberta Court of Appeal.

Rights”),¹⁸ “ordinary course of business”;¹⁹ “indemnified losses”;²⁰ “carried interest”;²¹ “best efforts”;²² and “commercially reasonable efforts”.²³

B. Factual Matrix

Courts will usually look beyond the four corners of the agreement when analyzing a contract in order to consider the context in which it was entered. Such an assessment “ensure[s] the written words of the contract are not looked at in isolation or divorced from the background context against

¹⁸ See for example *Talisman Energy v Esprit Exploration Ltd*, 2013 ABQB 132, 75 Alta LR (5th) 219 [*Talisman v Esprit*]; *Anadarko Canada Corporation v Canadian Natural Resources Limited*, 2006 ABQB 590, [2006] AJ No 959 [*Anadarko*] and *Nexxtep Resources Ltd v Talisman Energy Inc*, 2013 ABCA 40, 82 Alta LR (5th) 273 [*Nexxtep*]. Further discussion of these cases and disputes as to the “assets” transferred pursuant to a PSA are included in Part III of this paper.

¹⁹ In *Gauntlet Energy Corporation (Companies' Creditors Arrangement Act)*, 2005 ABQB 605, [2005] AJ No 1108 the Court was tasked with considering the meaning of the words “ordinary course of business” as part of a review regarding the allocation of Gas Cost Allowance Credits. The Court stated at para 51 that “it is unwise to attempt to give a comprehensive definition of the term but rather that it is best to consider the circumstances of each case”. See also *NOV Enerflow*, *supra* note 3 where the Court stated at para 32 “Whether something is or is not done in the ordinary course of business is a contextual, fact-specific determination to be made on a case-by-case basis in light of all circumstances known to the parties at the time”.

²⁰ In *NOV Enerflow*, *supra* note 3, “Indemnified Losses” was expressly defined in the agreement. The decision provides that while “the parties’ definitions may stretch the conventional understanding of indemnified losses, their deliberate decision to capitalize and define that term” was sufficient evidence of their intention: at para 20.

²¹ *United Canso Oil & Gas Ltd v Washoe Northern, Inc*, [1991] AJ No 1029, 121 AR 1 (ABQB) cites a number of definitions of “carried interest” at 20. However, note that in *Pine Pass Oil & Gas Ltd et al v Pacific Petroleum Ltd et al* [1968] BCJ No 20270, DLR (2d) 196, the Court held that there was “no such thing as a “standard” carried interest agreement, and the rights and obligations of the parties in every case depend specifically upon the nature of the bargain as reduced to writing between them”: para 11.

²² In *Telsec Developments Ltd v Abstak Holdings Inc*, 2017 ABQB 801, [2018] AWLD 562 [*Telsec*] the Court outlined the following principles for satisfying “best efforts”: 1. “Best efforts” imposes a higher obligation than a “reasonable effort”; 2. “Best efforts” means taking, in good faith, all reasonable steps to achieve the objective, carrying the process to its logical conclusion and leaving no stone unturned; 3. “Best efforts” includes doing everything known to be usual, necessary and proper for ensuring the success of the endeavor; 4. The meaning of “best efforts” is, however, not boundless. It must be approached in the light of the particular contract, the parties to it and the contract’s overall purpose as reflected in its language; 5. While “best efforts” of the defendant must be subject to such overriding obligations as honesty and fair dealing, it is not necessary for the plaintiff to prove that the defendant acted in bad faith; 6. Evidence of “inevitable failure” is relevant to the issue of causation of damage but not to the issue of liability. The onus to show that failure was inevitable regardless of whether the defendant made “best efforts” rests on the defendant; 7. Evidence that the defendant, had it acted diligently, could have satisfied the “best efforts” test, is relevant evidence that the defendant did not use its best efforts (citing *Atmospheric Diving Systems Inc v International Hard Suites Inc*, (1994), 89 BCLR (2d) 356, 53 CPR (3d) 459 (BCSC) at para 71).

²³ There is little case law on the meaning of “commercially reasonable efforts”, however the limited case law that does exist suggests that it is a lower standard than “best efforts” and recognizes a commercial and reasonable aspect that allows a party to have regard for its own economic interests and place those interests above the interests of the other party: Geoff R Hall, *Canadian Contractual Interpretation Law*, 1st ed (LexisNexis: Markham Ontario), at 2087.

which the words were chosen”.²⁴ In recent years, courts have finally disposed of tired arguments that the use of factual matrix offends the parol evidence rule²⁵ or is inapplicable where there is an entire agreement clause.²⁶

The scope of the factual matrix is broad and the surrounding circumstances can include “absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable [person].”²⁷ It can include the genesis, aim or purpose of the contract; the nature of the relationship created by the contract; and the nature or custom of the market or industry in which the contract was executed.²⁸ However, the factual matrix cannot overwhelm or contradict the words in the contract, add new terms to the contract or create an ambiguity that otherwise does not exist.²⁹

In the transactional context, the evidence litigants will likely have at their disposal to support arguments on the proper interpretation of PSAs includes: the agreement itself; documents referenced in the agreement; ancillary or related agreements or documents (for example letters of intent, memorandums of understanding or technical reports); evidence of negotiations generally; evidence from individuals actually involved in the negotiation of the transaction (including their memories of events, emails or other records); previous drafts of the agreement; and evidence of how the parties conducted themselves before and after the transaction was closed.

²⁴ *IFP Technologies*, *supra* note 5 at para 81; see also *Starrcoll Inc v 2281927 Ontario Ltd*, 2016 ONCA 275, [2016] OJ No 2029 at para 17.

²⁵ *Sattva*, *supra* note 5 at para 60.

²⁶ *IFP Technologies*, *supra* note 5 at para 124.

²⁷ *IFP Technologies*, *supra* note 5 at para 83, citing *Sattva*, *supra* note 5 at para 58.

²⁸ *IFP Technologies*, *supra* note 5 at para 83.

²⁹ *IFP Technologies*, *supra* note 5 at para 124.

However, there are limitations on the use of such evidence as part of establishing the factual matrix and the application of the corresponding legal principles can be difficult in practice. As outlined in greater detail below, there is no bright line as to what evidence properly forms part of the factual matrix, and there is ample room in the law for litigants to argue as to the admission and weight of particular evidence where it helps their case. In practice, attempts to completely exclude potential factual matrix evidence at trial are often ill-founded and time wasting. Courts are uniquely equipped to allow evidence to be entered at trial and then deal with its admissibility on weight in rendering the decision.³⁰ Further, breach of contract cases often involve alternate pleadings that a contract is ambiguous or should be rectified, both of which arguably allow a wider scope of evidence to be admitted – courts are able to sort through the evidence and decide which evidence can be used for which purposes.

1. Fact Witnesses

The most general limitation on the scope of the factual matrix is that the evidence of the factual matrix must go to the objective and not subjective intent of the parties.³¹ One party's subjective understanding of what it thought the deal entailed, or what it subjectively intended, is not permissible evidence of the factual matrix. For example, a key negotiator intimately involved in the transaction may not prove useful as a fact witness if that individual's testimony only relates to his or her own understanding of the deal.³²

³⁰ See for example *Qualico Developments Ltd v Calgary (City)*, 53 Alta LR (2d) 129, 81 AR 161 (ABQB) at para 7.

³¹ *Sattva*, *supra* note 5 at para 59.

³² An example in the context of a PSA is *Minto Metropia v Neighbourhoods of Windfields*, 2014 ONSC 3846, [2014] OJ No 3222 where the Ontario Superior Court held at para 38 that affidavit evidence as to the principals of a business' understanding as to the availability of a post-closing purchase price adjustment through a re-calculation of a "net developable area" was subjective evidence of intention and did not form part of the factual matrix.

Accordingly, the use of fact witnesses is generally restricted to setting out any objective evidence regarding the background to the transaction. Such evidence might include, for example, a memorandum of understanding³³ or letter of intent³⁴ that is drafted and approved by both parties providing context for the commercial purpose of the transaction. Evidence as to the conduct of the parties after the transaction is generally not relevant to the interpretation of the agreement, unless the contract is held to be ambiguous.³⁵

Another issue impacting fact witnesses relates to privilege. Given the involvement of legal counsel in the negotiation and drafting of PSAs, often key documents relevant to a dispute will include communications between transaction counsel and their clients. Parties can choose to waive privilege over these types of communications; however, if privilege is not waived and a party wishes to maintain it, it can result in limitations on the scope of questioning of witnesses. The problem of privilege becomes particularly acute where the external or internal legal counsel is a relevant witness.³⁶

³³ See for example, *IFP Technologies*, *supra* note 5 at para 114 where the Alberta Court of Appeal stated: “Evidence of the negotiations between the parties and the MOU leading up to the conclusion of the AEA and related documentation are critical to understanding the genesis and aim of the Contract.”

³⁴ See for example, *Talisman v Esprit*, *supra* note 18 at para 170.

³⁵ *Weyerhaeuser Co v Ontario (Attorney General)*, 2017 ONCA 1007, [2017] OJ No 6654 at para 116 [*Weyerhaeuser*]; *Shewchuk v Blackmont Capital Inc*, 2016 ONCA 912, 404 DLR (4th) 512 at para 56. A contract is generally held to be ambiguous if the provision in issue can reasonably bear two different interpretations; see *Consolidated Bathurst*, *supra* note 12 at 10. In *CNR v CP Ltd*, 95 DLR (3d) 242, [1979] 1 WWR 358 (BCCA) the Court stated: “In the case of evidence of subsequent conduct, the evidence is likely to be most cogent where the parties to the agreement are individuals, the acts considered are the acts of both parties, the acts can relate only to the agreement, the acts are intentional and the acts are consistent only with one of the alternative interpretations. Where the parties to the agreement are corporations and the acts are the acts of employees of the corporations, then evidence of subsequent conduct is much less likely to carry weight”: para 51.

³⁶ For this reason, it is often inappropriate or impractical for the external counsel firm that was involved in the transaction to also act in respect of the litigation of a dispute under the contract. At a minimum, alternative counsel may need to be retained to present the evidence of the external counsel because the lawyer and his/her firm cannot be both witness and advocate. For example, the Alberta Code of Conduct provides “The lawyer who is a necessary witness should testify and entrust the conduct of the case to another lawyer” (5.2-1). In *Northrock Resources v ExxonMobil Canada Energy*, 2017 SKCA 60, 416 DLR (4th) 321 [*Northrock*] ExxonMobil relied on two external legal memorandums in defending itself in the dispute, presumably having chosen to waive privilege over them (see for example para 29).

2. Evidence of Negotiations

Another limitation to the admissibility of evidence relevant to the transactional context is the general rule that evidence of the negotiation of specific provisions does not form part of the factual matrix.³⁷ However, there are some exceptions where evidence of negotiations can be admissible, where “that evidence shows the factual matrix, for example by helping to explain the genesis and aim of the contract.”³⁸

There is no bright line rule as to when negotiations are obviously admissible and navigating the use of evidence as to negotiations can prove difficult in practice. In one case, for example, the very fact that parties were involved in negotiations and the reason for those negotiations was found to form part of the factual matrix informing the objective commercial objectives of the parties.³⁹ In the energy context, in *Nexxtep*⁴⁰ (discussed in greater detail in Part III of this paper), evidence of “prior proposed transactions” was considered to form part of the factual matrix.⁴¹ To the extent evidence of negotiations is allowed, documentary evidence of negotiations is preferable to any witness’ personal recollection of oral statements made.⁴²

³⁷ See *Orbus Pharma Inc v Kung Man Lee Properties Inc*, 2008 ABQB 754, 463 AR 351 at paras 31, 43-44 [*Orbus*]; *Nexxtep*, *supra* note 18 at para 21-22; *Prenn v Simmonds*, [1971] 1 WLR 1381, [1971] 3 All ER 237 (HL) at para 7; *King v Operating Engineers Training Institute of Manitoba Inc*, 2011 MBCA 80, 270 Man R(2d) 63 at para 70; *Remington Energy Ltd v British Columbia Hydro & Power Authority*, 2004 BCSC 1352, [2004] BCJ No 2169 at para 40.

³⁸ *IFP Technologies*, *supra* note 5 at para 85.

³⁹ *Langley Lo-Cost Builders Ltd v 474835 BC*, 2000 BCCA 365, [2000] BCJ No 1187 at para 29.

⁴⁰ *Nexxtep*, *supra* note 18.

⁴¹ *Nexxtep*, *supra* note 18 at paras 30-32.

⁴² *IFP Technologies*, *supra* note 5 at para 85 where the Court stated “written evidence of those negotiations is far more objective evidence of the parties’ intentions than after-the-fact evidence from opposing parties about oral statements made during negotiations.”

3. “Expert” Evidence

As a general rule, parties can use expert and regulatory evidence to show the commercial context in which contracts are made and to explain technical terms of art.⁴³ However, the usefulness of expert testimony in a dispute relating to the interpretation of PSAs can be limited as it will be rejected or given little weight if it purports to interpret the contract, or if it is not necessary or helpful to a court’s analysis.⁴⁴

Courts will not accept expert evidence on contractual interpretation,⁴⁵ as that is the role of the courts.⁴⁶ For example, in *Lake Louise*,⁴⁷ the court held it was not appropriate for an accounting expert to opine on whether GAAP was expressly excluded from an agreement.⁴⁸

There are also examples in the energy PSA context where courts have accepted expert evidence but given it little weight because the expert’s analysis on general transaction practice was seen to be unhelpful to the court’s assessment of the specific facts at issue.⁴⁹ For example, expert testimony on the “industry custom and practice in interpretation of the CAPL Operating Procedure” has been given little weight.⁵⁰ An expert on the lexical meaning of the verb “produce”

⁴³ *Lake Louise*, *supra* note 14 at para 38.

⁴⁴ *IFP Technologies (Canada) v Encana Midstream and Marketing*, 2014 ABQB 470, 591 AR 202 at para 151 [*IFP Technologies Trial Decision*].

⁴⁵ In practice, in PSA disputes, so-called expert or opinion evidence often walks a very fine line, and many experts cannot resist providing their views on the proper contract interpretation.

⁴⁶ See for example *Lake Louise*, *supra* note 14 at para 38. See also *Dow Chemical Canada Inc v Shell Chemicals Canada Ltd*, 2010 ABCA 126, 25 Alta LR (5th) 221 at para 16.

⁴⁷ *Lake Louise*, *supra* note 14.

⁴⁸ *Lake Louise*, *supra* note 14 at para 38.

⁴⁹ See for example *Talisman v Esprit*, *supra* note 18 at paras 145 -146 where the Court admitted experts on the custom, norm and practice of the oil and gas industry in the context of acquisitions and divestitures but ultimately held that the “experts were not really helpful” because at the end of the day the court’s determination “depends on what the PSA says”. See also the decision in *Hunt Oil Company of Canada, Inc v Shell Canada Limited*, 2009 ABQB 627, 15 Alta LR (5th) 108 at para 37, 39 where the Court did not accept the evidence of an experienced landman on his experience regarding area of mutual interest clauses.

⁵⁰ *IFP Technologies Trial Decision*, *supra* note 44 at para 151. See also *Canlin*, *supra* note 17 where the Court found that expert evidence on the annotations of the Petroleum Joint Venture Association Model CO&O Agreement were of little assistance in interpreting the agreement at issue stating: “[t]he theory that the words “wells producing to the

was similarly given no weight in a recent decision as the Court held the “information was not technical in nature.”⁵¹

Expert evidence can be more useful in the transactional context where it can show the regulatory environment under which an agreement was made. For example, in *Nexxtep*⁵² the Court of Appeal expressly stated that expert evidence relating to licensing practices in Alberta at the relevant time was helpful evidence regarding the objective intent of the deal.⁵³

Given the limitations on these types of evidence, there are cases involving interpretation of PSAs where no witnesses have been tendered and the parties have proceeded by way of summary trial based on an agreed statement of facts.⁵⁴

II. PRE-CLOSING DISPUTES

The transfer of the risk and title to assets (referred to as the “Closing”) does not usually occur on the date a PSA is signed. Instead, PSAs prescribe a set date for the closing of a transaction to take place after signing (the “Closing Date”). The period between signing and the Closing Date is referred to in this paper as the “Interim Period”.

Facility” in the CO&O Agreement should be read as “wells associated with the Facility” on the basis of the language in the Annotations to the Model Agreement is backwards: the language of the Annotations does not prevail over the language of the contract”: para 33.

⁵¹ *Canlin*, *supra* note 17 paras 55-56. In *Erehwon Exploration Ltd v Northstar Energy Corp* (1993), 15 Alta LR (3d) 200, [1994] 3 WWR 488 (AB QB), the Court gave some weight to the testimony of a prominent energy lawyer who presented expert evidence on the history and practice of the petroleum industry in Alberta regarding marketing of petroleum and natural gas under the 1981 CAPL (see paras 108 and 109).

⁵² *Nexxtep*, *supra* note 18.

⁵³ *Nexxtep*, *supra* note 18 at para 33.

⁵⁴ See for example, *Anadarko*, *supra* note 18 and *Blaze Energy Ltd v Imperial Oil Resources*, 2014 ABQB 326, 28 BLR (5th) 111 [*Blaze*].

In the Interim Period, the vendor and the purchaser have conditions to satisfy and covenants to perform (or negative covenants not to undertake) before Closing can occur.⁵⁵ The Interim Period often gives rise to uncertainty and litigation because of unforeseen events, or because one party proposes to structure the transaction in a particular way and that structure has effects on strangers to the transaction. These issues can derail or force renegotiation of the transaction and, if litigation ensues, things often move quickly and decisions taken in the heat of the moment can affect the closing of the transaction.

Below, we review several types of issues that can arise in the Interim Period, including disputes over the duties owing between the parties that must be met to finalize a transaction (in particular the duty of honest performance), disputes relating to the satisfaction of contractual obligations in the Interim Period (including issues relating to the occurrence of a material adverse change) and disputes regarding the exercising of preferential rights.

A. The Duty of Honest Performance

In *Bhasin v Hrynew*,⁵⁶ the Supreme Court of Canada established that parties to an agreement have a duty to act honestly in contract performance.⁵⁷ Parties to a transaction do not have a duty to

⁵⁵ For example, in the CAPL PTP, *supra* note 2, the conditions to close include, among other things, obtaining the required approvals, issuance of ROFR notices, compliance with obligations under the agreement, delivery of conveyance documents and discharge of security interests: clauses 10.01 and 10.02.

⁵⁶ *Bhasin v Hrynew*, 2014 SCC 71, [2014] 3 SCR 494 [*Bhasin*].

⁵⁷ Note that the principles in *Bhasin*, *supra* note 56 only relate to the performance of a contract. As such, there is no duty of honest performance that relates to any pre-contractual relationship between parties. See for example *Styles v Alberta Investment Management Corporation*, 2017 ABCA 1, 44 Alta LR (6th) 214 at para 51 where the Alberta Court of Appeal stated “the *Bhasin* principle relates to the performance of the contract. It does not relate to the negotiation or terms of the contract”.

proactively disclose information to one another,⁵⁸ do not owe each other a duty of care,⁵⁹ but do have an obligation not to lie or knowingly lie or mislead one another.⁶⁰ A breach of the duty of honest performance may give rise to damages or other remedies.⁶¹ *Bhasin* also confirms that contracting parties cannot avoid the duty of honest performance through the use of limitation of liability clauses.⁶²

One example of how the duty of honest performance can arise during the Interim Period relates to communications between the parties about the assets being sold.⁶³ PSAs usually limit the scope of the vendor's factual statements about the characteristics or quality of the assets to those set out in the PSA specifically. A typical clause provides "the Purchaser is not relying upon any representation or warranty of the Vendor as to the condition, environmental or otherwise, of the Assets, except as is specifically made in Section ... [of this PSA]."⁶⁴ However, this limitation in scope does not (and cannot) extend to breaches of the duty of honest performance.⁶⁵

⁵⁸ See for example *Bhasin*, *supra* note 56 at para 73 where Justice Cromwell clarified that the duty "does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract." But see *Xerex Exploration Ltd v Petro-Canada*, 2005 ABCA 224, 367 AR 201 at paras 56-58 which confirms that a duty may exist where silence effectively renders a representation, already made, inaccurate.

⁵⁹ *Martel Building Ltd v Canada*, 2000 SCC 60, [2000] 2 SCR 860 at para 72.

⁶⁰ *Bhasin*, *supra* note 56 at para 73. For an example of where a breach of the duty of good faith has been found in the transactional context, see *Telsec*, *supra* note 22 where an agreement for the purchase of land was conditional on a development permit. The permit was never obtained. At issue was whether one party made sufficient efforts to obtain the permit. The Court of Queen's Bench held that the defendant misled the plaintiff about its efforts in obtaining the permit and in doing so breached the duty established by the Supreme Court in *Bhasin*, *supra* note 56 at para 33. Note that fraud "unravels all" (*Farah v Barki*, [1955] SCR 107, [1955] 2 DLR 657) and so a finding of fraudulent conduct "vitiates every contract and every clause in it": *Ballard v Gaskill*, [1955] BCJ No 110, [1955] 2 DLR 219 (BCCA) at 221.

⁶¹ In *Telsec*, *supra* note 22 the Alberta Court of Queen's Bench determined that the appropriate award of damages for a failed transaction was the difference in value of the land at issue at the time of the breach of the agreement and the price set out in the agreement (see para 39).

⁶² *Bhasin*, *supra* note 56 at para 75.

⁶³ An example of a case where communications during the Interim Period gave rise to claims relating to the duties in *Bhasin*, *supra* note 56 is *Empire Communities Ltd et al v HMQ et al*, 2015 ONSC 4355, 46 BLR (5th) 235 [*Empire*]. In this case the Court rejected the plaintiff's claim that the defendant had failed to disclose a lawsuit relating to the assets that were sold. The Ontario Superior Court held that the agreement itself contained no positive obligation to disclose the information and that there was no evidence of actual dishonesty or fraud.

⁶⁴ CAPL PTP, *supra* note 2, clause 13.04A.

⁶⁵ As noted above, contracting parties cannot contract out of the duty to act honestly.

Therefore, during the Interim Period, if the purchaser makes an inquiry relating to the assets being sold and is provided with false information in response by the vendor, or the vendor dishonestly withholds information that a purchaser may need to make its assessment, there may be a possible claim in damages based on the duty of honest performance, even if there is no express breach of the representations set out in the PSA.⁶⁶ However, Canadian courts have generally not been sympathetic to parties that fail to do proper due diligence and have held that evidence of dishonesty or fraud is required to support a claim.⁶⁷ Therefore, vendors should be mindful of the potential liability associated with the duty of honest performance, and purchasers need to be careful in their due diligence to protect their interests. Parties can mitigate this risk somewhat by ensuring that a strict communication protocol is observed during the Interim Period.

B. Failure to Satisfy Obligations During the Interim Period

1. Breach

PSAs often include certain obligations that must be satisfied by the parties during the Interim Period. Disputes can arise if a party is unable or unwilling to satisfy those obligations. The legal recourse available to the innocent party depends on the nature of the breach and the express terms

⁶⁶ For example, such an issue arose in *Transamerica Life Canada Inc v ING Canada Inc*, 68 OR (3d) 457, [2003] OJ No 4656 (ON CA). In that case the defendant alleged that the plaintiff breached a duty of good faith owing to it by being aware and “wilfully blind” of errors during the due diligence period and interim period and failed to identify those errors to the defendant prior to closing (see para 22). While the decision pre-dates *Bhasin*, *supra* note 56 and the Ontario Court of Appeal found there had been no breach of the duty of good faith) it is included as an example of a fact pattern where such an issue has arisen. Further, given the change in the law due to *Bhasin*, *supra* note 56, the result may have been different if the decision was heard at a later date.

⁶⁷ For example in *Empire*, *supra* note 63 the plaintiffs claimed that the defendant had failed to disclose a lawsuit relating to the assets that were sold. The Ontario Superior Court noted that it was the plaintiff’s obligation to conduct due diligence to satisfy itself on the issue and that the agreement itself contained no positive obligation to disclose the information and that there was no evidence of actual dishonesty or fraud. See also *Macera v Abcon Media Canada Inc*, [2017] OJ No 3740, 2017 CanLII 45939 (ON SCSM) where the Ontario Superior Court rejected a claim on the duty of honest performance relating to a transaction, expressly noting that the plaintiff had opportunity to conduct its own due diligence and failed and that there was no evidence of dishonesty on the part of the defendant.

of the PSA. Where there has been a “fundamental breach” of a contract⁶⁸ the innocent party has two options: it may elect to treat the contract as terminated or it may elect to affirm the contract by waiving the other party’s obligation to perform and sue for damages as a result of the breach.⁶⁹ If a breach is not “fundamental” it is treated as an ordinary breach of contract entitling the innocent party to sue for damages.

2. Failure to Satisfy Condition

PSAs in the energy context will often expressly set out the contractual terms that must be met in order for Closing to occur and the remedies available to the parties as a result of any failure to satisfy those obligations. For example, the CAPL PTP sets out express conditions precedent⁷⁰ that must be satisfied for Closing to occur and the remedies available to the parties if a condition precedent has not been satisfied.⁷¹ If non-compliance is discovered prior to Closing, the CAPL

⁶⁸ A fundamental breach of a contract occurs where the failure of one of the contracting parties to perform a primary obligation under the contract has the effect of depriving the other party of substantially the whole benefit which the parties intended that party to receive: *Mantar Holdings Ltd v 0858370 BC Ltd*, 2014 BCCA 361, [2014] BLR (5th) 49 at para 11.

⁶⁹ See for example *Peterson v 446690 BC Ltd (Seymour Arm Hotel & Restaurant)*, 2017 BCCA 394, 5 BCLR (6th) 12 at para 18. Waiver will only be found if there is evidence the party waiving had (1) a full knowledge of the deficiency that might be relied on and (2) an unequivocal and conscious intention to abandon the right to rely on it: *Technicore Underground Inc v Toronto (City)*, 2012 ONCA 597, 354 DLR (4th) 516 at para 63. If the innocent party becomes aware that the other party is not able or willing to satisfy the obligation prior to closing, it can accept that repudiation on the basis of anticipatory breach. Note however, that “[w]here a condition is inserted in an agreement for the benefit of one party, that party cannot take advantage of the condition unless it satisfies the court that it took all reasonable steps or used its best efforts to fulfill the condition. The law implies a duty on the part of the person for whose benefit the condition was inserted to take such steps”: *3081169 Nova Scotia Ltd v Lunar Fishing (New Brunswick) Inc*, 2010 NSSC 147, 290 NSR (2d) 260 at para 57.

⁷⁰ Note that at common law only a breach of a “true conditions precedent” will prevent the formation of a contract. A “true condition precedent” is one where “[t]he obligations under the contract, on both sides, depend upon a future uncertain event, the happening of which depends entirely on the will of a third party”: *Turney v Zhilka*, [1959] SCR 578, 18 DLR (2d) 447 at 583-584. If a contract does not expressly set out that a breach of a condition entitles the innocent party to treat the PSA as terminated, a breach of a condition will not entitle a party to such relief at common law unless the condition precedent is also a fundamental term.

⁷¹ For example, clause 10.01 provides for conditions for the benefit of both parties which include that required approvals have been obtained, that all ROFRs have been dealt with, that the parties will have complied in all material respects with their obligations under the PSA, that the representations and warranties are true, that the parties have addressed issues with required regulatory deposits and that there are no third party claims that would materially and adversely affect the Assets pending. Clause 10.02 sets out conditions for the benefit of the purchaser which include that there is no substantial unrepaired damage or physical alteration of the Tangibles (as defined in the CAPL PTP) occurring after the Effective Date, that conveyance documents have been delivered and that security interests have

PTP provides that the innocent party has a right to terminate the agreement on notice to the other party if it does not waive compliance with the condition precedent. After Closing, the only remedy for failure to satisfy a condition is limited to damages.⁷²

The CAPL PTP also includes other terms relating to other obligations in the Interim Period (including for example the obligation to provide an interim statement of adjustments or to provide the purchaser with copies of AFEs, notices and mail ballots received in the Interim Period).⁷³ These are not expressly defined as conditions precedent to Closing. Whether or not a term is “fundamental” is a question of fact; however, it is likely that a breach of one of these terms would not entitle the innocent party to treat the agreement as being terminated and would only warrant a remedy in damages. For example, in *2068895 Ontario Inc v Snyder*,⁷⁴ the Ontario Court of Appeal held that an error on a statement of adjustments prior to Closing did not justify a refusal to close the transaction.⁷⁵

3. Frustration

Where it becomes impossible to perform obligations as a result of factors outside of either party’s control, a party can also resort to reliance on the doctrine of frustration to avoid obligations under a contract.⁷⁶ In order to succeed in arguing that the contract has been frustrated, a party must

been discharged. Clause 10.03 sets out conditions for the benefit of the vendor which include that payments have been tendered to the purchaser and that conveyance documents have been delivered.

⁷² CAPL PTP, *supra* note 2, clause 10.05(A) and (B).

⁷³ CAPL PTP, *supra* note 2, clause 5.03(A).

⁷⁴ *2068895 Ontario Inc v Snyder*, 2012 ONCA 757, 23 RPR (5th) 169 [*Snyder*].

⁷⁵ *Snyder*, *supra* note 74 at para 4; see also *Lakeshore Landmark Development Corp v Mondelez Canada Inc*, 2016 ONSC 2313, 265 ACWS (3d) 256 at para 42. In the oil and gas context, the decision in *Lateral Resources Ltd v Karon Resources Inc* (1994), 22 Alta LR (3d) 265, [1994] AWLD 791 (AB QB) deals with a claim relating to a payout account.

⁷⁶ See for example *Royal West Homes Inc v Webster*, 2010 ABQB 446, 30 Alta LR (5th) 1 where the vendors failed to obtain an environmental assessment report and permit for a property subject to a sale. The Alberta Court of Queen’s Bench found that the obligation was incapable of being satisfied, through no fault of the vendor and therefore found there was no legally enforceable contract.

demonstrate that, due to a supervening event that fundamentally changes the obligations to be performed, it has become impossible to perform the contract.⁷⁷ A change in legislation has also been held in the energy context to amount to frustration in certain circumstances.⁷⁸

4. Material Adverse Change

A common purchaser's condition in a PSA is that the assets have not undergone a Material Adverse Change (or "MAC") in the Interim Period.⁷⁹ A MAC condition offers protection to the purchaser as it provides for an ability to terminate the PSA if a transaction looks materially different from the one it thought it signed. The vendor for its part usually resists a broad MAC to lower the risk it faces for a failed transaction. Two recent examples of energy industry transaction parties looking to MAC clauses are in *Stetson*⁸⁰ and in the recent changes to the Liability Management Rating ("LMR") program.

In *Stetson*, the defendant investment bank wished to rely on a "material adverse change-out clause" set forth in an engagement letter for a bought deal financing that was not ultimately reduced to a formal underwriting agreement.⁸¹ The bank refused to close on the financing, in part because between the time of the engagement letter and three weeks later, commodity prices had begun to

⁷⁷ See for example, *Jones v 2341464 Ontario Inc*, 2018 ONSC 717, [2018] OJ No 504.

⁷⁸ For example, in *Petrogas Processing Ltd v Westcoast Transmission Co* (1988), 59 Alta LR (2d) 118, 89 AR 321 where it was held that a change in law relating to the regulation of gas prices amounted to frustration of a gas purchase contract.

⁷⁹ For example the CAPL PTP *supra* note 2, provides: "Except as consented to in writing by the Purchaser, no substantial unrepaired damage or physical alteration of the Tangibles will have occurred between the earlier of the Effective Date or the date of the Agreement, as applicable, and the Closing Time which would materially and adversely affect the value of the Assets": CAPL PTP, *supra* note 2, clause 10.02. See for example *Brent Petroleum*, *supra* note 152 where there was a "material adverse change" provision that stipulated that material adverse changes out of the ordinary course of business would result in termination of the agreement. The Alberta Court of Queen's Bench found there was a material adverse change but that it was in the ordinary course of business: see paras 46-48. Other cases including consideration of material adverse change provisions include: *Marathon Canada Limited v Enron Canada Corp*, 2009 ABCA 31, 448 AR 245; *Mull v Dynacare Inc* (1998), 44 BLR (2d) 211, 83 ACWS (3d) 48 (ONSC).

⁸⁰ *Stetson Oil & Gas Ltd v Stifel Nicolaus Canada Inc*, 2013 ONSC 1300, 226 ACWS (3d) 732.

⁸¹ *Stetson*, *supra* note 80 at para 1.

free-fall.⁸² The Court found that the bank had improperly refused to close, and held it liable for damages in the amount of the difference between the amount of the failed financing, and a subsequently entered financing at half the price: \$16 Million.⁸³ The case illustrates the risk of refusing to close - if a purchaser does claim that a MAC has occurred and refuses to close, and is wrong, significant damages can result.

A current example of a situation where parties may be looking for a MAC arose when the AER made changes to the LMR program.⁸⁴ With no notice to industry, the AER required license transferees to have a significantly greater LMR before licenses would be transferred.⁸⁵ Anecdotally we understand this change caused transaction parties to consider whether this would constitute a MAC under their PSAs, though we are aware of no reported decisions to that effect.

C. ROFRs

The requirement to issue ROFRs pursuant to agreements relating to a transaction is a frequent cause of Interim Period disputes. Much has been written elsewhere on ROFRs in the energy space.⁸⁶ ROFR litigation usually occurs in the Interim Period and below we analyze several recent

⁸² *Stetson, supra* note 80 at para 78.

⁸³ *Stetson, supra* note 80 at para 175.

⁸⁴ In Alberta this is governed by the Alberta Energy Regulator Directive 006. Similar legislation exists in British Columbia and Saskatchewan.

⁸⁵ For further information on the LMR program see for example: Chidinma Thompson and Alan Ross, "Back to the Basics: The Alberta Energy Regulator Tightens License and Approval Eligibility Requirements to Eliminate Unreasonable Risk" (18 December 2017), online: < <http://blog.blg.com/energy/Pages/Post.aspx?PID=352>>.

⁸⁶ See for example: Donald G MacDiarmid, Sean J Korney, Melanie Teetaert, Julie JM Taylor, Robert Martz, & Randon E Slaney, "The Oil And Gas ROFR: Understanding Current ROFR Issues From The Point Of View Of The Transactional Lawyer, The Litigator, And In-House Counsel" (2017) 55:2 *Alta L Rev* 253; Gordon L Tarnowsky, Miles F Pittman, & Carolyn Wilton, "Restriction on Disposition in the Oil and Gas Industry: The Extinction of the Species?" (2007) 44:3 *Alta L Rev* 477; Keith T Smith & Shawn HT Denstedt, "Preemptive Rights and the Sale of Resource Properties: Practical Problems and Solutions" (1992) 30:1 *Alta L Rev* 57 [*Smith et al Paper*]; Clifford D Johnson & David J Stanford, "Rights of First Refusal in Oil and Gas Transaction: A Progressive Analysis" (1999) 37:2 *Alta L Rev* 316 [*Clifford et al Paper*].

cases to identify litigation strategies or issues that are beneficial to parties in navigating these types of disputes.

A ROFR is “a commitment by the grantor to give the grantee the first chance to purchase should the grantor decide to sell.”⁸⁷ Typically, a vendor will agree to sell an interest in a jointly held asset to a purchaser, and any co-owner of that asset may have the first right to acquire the interest on the same terms as agreed with the purchaser.⁸⁸ In a sale of a package of assets, the purchaser will usually provide the value it allocates in good faith to the assets subject to the ROFR to the vendor, and will indemnify the vendor against any damages it suffers from the third party disputing the ROFR value.⁸⁹ The vendor and the purchaser will require that, before Closing occurs, the third party either exercises its right to acquire the asset, or waives or is deemed to waive its right to acquire the asset.

Disputes arise in the Interim Period because the third party either: (a) believes it is entitled to a ROFR where the vendor and purchaser do not;⁹⁰ or (b) believes that the value ascribed to the assets subject to the ROFR is inflated.⁹¹ If a vendor fails to issue a ROFR notice to a third party or misstates the value of the lands in the ROFR notice to the third party, the third party can seek

⁸⁷ *Mitsui & Co (Canada) Ltd v Royal Bank of Canada*, [1995] 2 SCR 187, [1995] SCJ No 37 at 199-200.

⁸⁸ In *Canadian Natural Resources Ltd v Encana Oil & Gas Partnership*, 2008 ABCA 267, 440 AR 338 the Alberta Court of Appeal stated “a right of first refusal is an important contractual right, one purpose of which is ‘to prevent a party from being forced into an undesired partnership’: para 28.

⁸⁹ In contrast to what we believe to be industry practice, CAPL PTP, *supra* note 2, clause 7.01B provides that the values are to be “in good faith and on a reasonable basis”, and requires the parties to “consult with respect to the value as appropriate”. This seems to require that the parties actually agree to the ROFR values. It also provides that any disputes about the value between the parties are to be arbitrated, which, given the fact that this arbitration would have to occur before ROFR notices were sent out, seems unlikely to be undertaken.

⁹⁰ See for example *Calcrude Oils Limited v Langevin Resources*, 2003 ABQB 1051, 349 AR 353; *Blaze*, *supra* note 54.

⁹¹ For example, disputes relating to the value of the assets subject to the ROFR include: *Best Pacific Resources Ltd v Eravista Energy Corp*, 2002 ABCA 286, 317 AR 308; *Chase Manhattan Bank of Canada v Sunoma Energy Corp*, 2001 ABQB 142, 283 AR 260 [*Chase*]; *Apex Corp v Ceco Developments Ltd*, 2008 ABCA 125, 429 AR 110 [*Apex*]. There has also been a number of journal articles discussing valuation of lands subject to a ROFR which include: Robert Flannigan, “The Legal Construction of Rights of First Refusal” (1997) 76:1&2 Can Bar Review 1, *Clifford et al Paper*, *supra* note 86 and *Smith et al Paper*, *supra* note 86.

remedies including: injunctive relief to halt the sale to the purchaser;⁹² specific performance to unwind a closed transaction;⁹³ and/ or damages suffered as a result of the failure of the vendor to comply with its ROFR obligations.⁹⁴ Below we discuss cases where a third party claims it is entitled to a ROFR and the vendor and the purchaser claim that a ROFR does not apply either because of an exception or because of the specific language of the contract. These cases exemplify several key issues relating to litigation process and strategy.

1. **Blaze Energy Ltd v Imperial Oil Resources**

*Blaze*⁹⁵ provides a good example of some of the procedural and strategic issues that can impact the outcome of ROFR-related litigation. It involved ROFRs relating to two separate but related transactions. For both transactions, Blaze Energy Ltd. (“Blaze”) claimed it was entitled to ROFRs and that it had not been properly provided with ROFR notices.

Blaze and Imperial Oil Resources (“IOR”) were parties to two agreements covering certain lands (the “Lands”) and facilities: a 1960 operating agreement covering certain lands (the “Lands Agreement”); and a 1988 Construction, Ownership and Operating Agreement (the “CO&O”) governing a gas plant (the “Plant”).⁹⁶ IOR agreed to dispose of its interests in the Lands and the Plant to Whitecap Oil Resources Inc. (“Whitecap”) as part of a large divestiture program, and

⁹² See for example *Alim Holdings Ltd v Tom Howe Holdings Ltd*, 2016 BCCA 84 where the decision notes that the plaintiff obtained an injunction to restrain the transaction from proceeding pending resolution of the ROFR dispute (at para 27).

⁹³ See for example *Paragon Capital Corporation Ltd v Starke Dominion Ltd*, 2018 ABQB 351, [2018] AJ No 606. The remedy of specific performance is quite limited for disputes relating to real estate transactions. The Supreme Court of Canada has held that specific performance should not be granted absent evidence that (1) the property is unique to the extent that its substitute would not be readily available; (2) The remedy of damages is inadequate to do justice; and (3) The plaintiff has established a fair, real and substantial justification for the claim of specific performance: *Semelhago v Paramadeva*, [1996] 2 SCR 415, [1996] SCJ No 71 at para 22.

⁹⁴ See for example *Apex*, *supra* note 91 where the Court of Appeal upheld the trial judge’s finding that the plaintiff breached the defendants ROFR rights and was liable for damages.

⁹⁵ *Blaze*, *supra* note 54.

⁹⁶ *Blaze*, *supra* note 54 at paras 2 and 3.

Whitecap in turn agreed to dispose the Lands and the Plant to Keyera Partnership (“Keyera”).⁹⁷ The ROFR provisions applicable to both transactions were contained in the Lands Agreement and the CO&O. The Lands Agreement contained a 10-day ROFR.⁹⁸ The CO&O contained a 30-day ROFR, with the following exception:

Any Owner may, without restriction, dispose of an interest in the Plant in conjunction with the disposal of the Owner’s corresponding working interest in the lands in the West Pembina Area from which Gas is being produced into the Plant.⁹⁹

IOR issued a ROFR notice to Blaze with respect to the Lands, pursuant to the Lands Agreement (the “IOR ROFR Notice”), and concurrently advised Blaze and the other owners of the Plant that it was not issuing a ROFR Notice for the Plant.¹⁰⁰ IOR’s position was that no ROFR notice was required for the Plant because the proposed disposition fit within the CO&O exception set out above, as the disposition was in conjunction with a lands disposition.¹⁰¹

IOR’s position had the effect of severing the Lands from the Plant, such that if Blaze elected to exercise on the IOR ROFR Notice, it would not be able to acquire IOR’s interest in the Plant. For Blaze, this result was potentially disastrous, as Blaze would not have been able to claim owners’ priority at the Plant for that portion of the throughput allocable to the interest in the Lands it acquired, and would be required to pay a Plant processing fee instead of paying operating and maintenance capital costs as a Plant owner.

⁹⁷ *Blaze*, *supra* note 54 at paras 5 and 6.

⁹⁸ *Blaze*, *supra* note 54 at paras 30-31.

⁹⁹ *Blaze*, *supra* note 54 at para 37. Note – this restriction on a disposition’s genesis may come from a standard form Unit Operating Agreement, which states that “A Disposing Unit Owner may not dispose of an interest in the Unit Lands without also disposing of a corresponding interest in Unit Facilities, and vice versa.” Most unit owners interpret this language as requiring the lands and the facilities to be disposed of together – potentially a mistaken assumption?

¹⁰⁰ *Blaze*, *supra* note 54 at paras 50, 52.

¹⁰¹ *Blaze*, *supra* note 54 at para 52. Note that Blaze had acquired its interest in the Plant without ROFR notices being issued in 2012.

Blaze claimed that the IOR ROFR Notice was invalid, as Blaze could not properly evaluate the assets being sold because Blaze assumed (wrongly) that the corresponding working interest in the Plant was also being sold. Therefore, Blaze believed that if it exercised on the IOR ROFR Notice, the ROFR exception in the CO&O would not apply.¹⁰² Blaze did not exercise on the IOR ROFR Notice or take any steps to contest its validity until the filing of the Statement of Claim.¹⁰³

Subsequently, Whitecap proceeded with its planned sale of the Lands and Plant to Keyera and issued a ROFR notice to Blaze under the Lands Agreement but not under the CO&O (the “Whitecap ROFR Notice”).¹⁰⁴ Blaze purported to exercise on the Whitecap ROFR Notice, and, at the same time, also demanded a ROFR notice be issued for the Plant. Whitecap refused.¹⁰⁵

Blaze filed a Statement of Claim and the matter proceeded to an expedited trial on three issues: whether Blaze had ROFRs in relation to the IOL transaction; whether Blaze had ROFRs with respect to the Whitecap transaction; and whether, if Blaze did have those ROFRs, it was entitled to specific performance.¹⁰⁶

All the parties agreed to an accelerated dispute resolution process, based on an agreed statement of facts, affidavit evidence and no questioning or *viva voce* evidence.¹⁰⁷ This case is notable in part because of how quickly it was determined: Blaze filed the Statement of Claim on April 24, 2014 and the decision was issued on May 30, 2014.

¹⁰² *Blaze, supra* note 54 at para 122.

¹⁰³ *Blaze, supra* note 54 at para 122.

¹⁰⁴ *Blaze, supra* note 54 at para 131.

¹⁰⁵ *Blaze, supra* note 54 at paras 64-56.

¹⁰⁶ *Blaze, supra* note 54 at para 16.

¹⁰⁷ *Blaze, supra* note 54 at paras 17-19.

The Court held that, on a strict reading of the CO&O, the exception to the ROFR requirement applied and Blaze did not have any valid ROFR on the Plant.¹⁰⁸ As the IOR ROFR Notice was valid, Blaze's failure to strictly comply with the time limits for exercising was fatal to its ROFR claim.¹⁰⁹ The Court also held that Blaze had no valid claim to a ROFR on the Plant for the second transaction.¹¹⁰ Blaze's request for specific performance was rejected, and the Court noted that the contracts did not support any entitlement to specific performance. Further, Blaze had not sought relief with "clean hands" as Blaze was in default of the CO&O.¹¹¹

This case is instructive because of how the litigation proceeded. The parties agreed by consent to limit the evidence to affidavits from principals in order to proceed with an expedited trial. One wonders if further evidence of the factual matrix and the commercial context of the CO&O being entered would have had an impact on the outcome, which might have been available in a full trial. When the CO&O was entered into, the Plant likely existed to serve the Lands – they were constructed by owners of mineral rights that needed to process their gas. It stands to reason, therefore, that if a sale of the Lands was being undertaken, the mineral owners would assume that a corresponding interest in the Plant would also be sold, as the Plant existed only to serve the Lands. However, if a Plant owner wished to sell its Plant interest without a corresponding interest in the Lands, the other Plant owners (also being owners of the Lands producing the throughput) would be entitled to acquire that interest to ensure that the owners of the Lands maintained control of the Plant. At the time of entry into the CO&O, the Plant owners likely did not conceive that a proposed purchaser of the Lands would proceed with a purchase of the Plant without completing

¹⁰⁸ *Blaze*, *supra* note 54 at paras 169-171.

¹⁰⁹ *Blaze*, *supra* note 54 at para 123.

¹¹⁰ *Blaze*, *supra* note 54 at para 148.

¹¹¹ *Blaze*, *supra* note 54 at paras 77-78.

a purchase of the Lands – but this is what Whitecap plainly proposed to do. Therefore, *quaere* whether expert or other factual matrix evidence demonstrating that, in 1988, industry practice would generally be that owners of mineral lands wanted to build and own facilities and did not want non-mineral owners to have a piece of facilities, would have had an impact on the interpretation.

Further, the remedy sought by Blaze was limited to the three questions it posed to the Court. It may have had alternate remedies it could have pursued, including seeking injunctive relief to prevent the sale, suing for damages to recover losses suffered as a result of the sale, or to seek specific performance to try to unwind the sale after Closing. However, an injunction would have required an undertaking as to damages (which Blaze may or may not have been able to provide). The Court stated that Blaze should have brought any application to assert an entitlement to exercise the ROFR during the ROFR notice period (consistent with the *Chase* decision that the notice period “expiry operates like a limitation”).¹¹² A pragmatic ROFR holder should commence a claim prior to expiry of the ROFR notice period in order to ensure that there is no possibility of it losing its right to enforce its ROFR.

2. Northrock Resources v ExxonMobil Canada Energy

Another ROFR decision that highlights the importance of litigation strategy is *Northrock*.¹¹³ Northrock Resources (“Northrock”) alleged that ExxonMobil Canada Energy (“ExxonMobil”) had structured a transaction to intentionally deprive Northrock of a ROFR in an alleged breach of the duty of good faith.¹¹⁴ ExxonMobil defended the claim on the basis that it had chosen to structure

¹¹² *Chase*, *supra* note 91 at para 42.

¹¹³ *Northrock*, *supra* note 36.

¹¹⁴ This duty of good faith in the context of ROFRs was first set out in *GATX Corp v Hawker Siddeley Canada Inc* (1996), 27 BLR (2d) 251, [1996] OJ No 1462 (Ont Ct J (Gen Div)).

the transaction for tax reasons. ExxonMobil was painstaking in its record keeping and was able to show that it had thought about the ROFR issues but that it had been prepared to proceed with the structure because of the enormous potential tax savings (amounting to roughly \$29 million).¹¹⁵ ExxonMobil relied on evidence that demonstrated it was aware that its actions would ultimately deprive Northrock of its ROFR and risk Northrock bringing legal action against it, but that reducing tax was the main driver for structuring the transaction.¹¹⁶ The Saskatchewan Court of Appeal held that ExxonMobil's awareness of the impact to Northrock, and acceptance of the risk that Northrock might challenge the structure of the transaction was not evidence of a breach of the duty of good faith, noting that businesspeople take risks all the time and it was clear that reducing tax was the main reason for structuring the transaction this way.¹¹⁷

This case is instructive because ExxonMobil knew that there was a good possibility that it would be sued by Northrock. The properties being disposed of were valuable and Northrock would have exercised in the circumstances – in fact, it was the runner-up in the auction preceding the sale. Therefore, ExxonMobil diligently showed that the potential tax savings were the main reason for undertaking the structure; and disclosed general legal opinions obtained with respect to the structure to Northrock.¹¹⁸ This had the effect of bolstering ExxonMobil's claim that it had nothing to hide, and it had taken absolutely every step to ensure that it could use the ROFR exception to accomplish its tax goal. It was accordingly very difficult for Northrock to argue that ExxonMobil had been acting in bad faith. This case is an example of how properly papering the purpose of a transaction structure can be vital in order to assert or defend a claim.

¹¹⁵ See the facts outlined in the trial decision, *Northrock Resources v Exxonmobil Canada Energy*, 2016 SKQB 188, [2017] 2 WWR 559 at para 81 [*Northrock Trial Decision*].

¹¹⁶ *Northrock Trial Decision*, *supra* note 115 at para 86.

¹¹⁷ *Northrock Trial Decision*, *supra* note 115 at paras 86 and 88.

¹¹⁸ *Northrock Trial Decision*, *supra* note 115 at paras 72 and 76.

III. POST-CLOSING DISPUTES

Generally speaking, all claims arising post-Closing will involve an interpretation of the PSA at issue, in accordance with the principles of contractual interpretation set out in Part I. One reason for this, pursuant to the doctrine of *caveat emptor*, is the common law presumption that, absent contractual protections providing otherwise, a purchaser of real property acquires it “as is.”¹¹⁹ Therefore, absent specific contractual protections, parties have limited recourse to commence claims after Closing has occurred.

This Part focuses on a few common areas where disputes arise in the energy transaction context post-Closing, in particular: (1) disputes relating to the definition of the “Assets” conveyed; (2) claims relating to the operation of indemnity provisions; and (3) claims involving alleged breaches of representations and warranties.

A. Disputes over the Subject-Matter of the Transaction

One area frequently litigated is the subject-matter of a purchase and sale transaction.¹²⁰ Determining the subject of a sale is complicated in energy transactions where real and personal property is often described through the use of land schedules or by “white map sales” (where companies choose to divest all of their interests in wells and facilities in a given area). Often years after Closing, disputes can arise as to whether or not a particular asset was included in the

¹¹⁹ There are several exceptions to the application of *caveat emptor*, including: (1) fraud; (2) a mutual mistake; (3) a contractual condition; or (4) a warranty collateral to the contract which survives closing. A detailed overview of these exceptions is beyond the scope of this paper. For further information see *Motkoski Holdings Ltd v Yellowhead (County)*, 2010 ABCA 72, 474 AR 367 at para 112.

¹²⁰ For example, purchasers may argue that certain assets (and their associated liabilities) were not conveyed on the basis of the express words of the agreement, on the basis that there has been a common, mutual or unilateral mistake in describing the assets that supports damages or rectification (see for example *Performance Industries Ltd v Sylvan Lake Golf & Tennis Club Ltd*, 2002 SCC 19, [2002] 1 SCR 678 at para 31 and *Ghitter (Ron) Property Consultants Ltd v Beaver Lumber Co*, 2003 ABCA 221, 330 AR 353 at para 12), or on the basis that the vendor is estopped from taking the position that the purchaser is responsible for liabilities associated with the asset (see for example *Monarch Construction Ltd v Axidata Inc* (2007), 27 CELR (3d) 258 (Ont Sup Ct J) where a former owner of a business was unsuccessful in relying on estoppel to avoid liability for Environmental Costs).

transaction, and more importantly, which party is responsible for any liabilities (in particular for abandonment and reclamation) associated with that asset.¹²¹

One might think that the practice in the energy context of using broad definitions for terms such as “Petroleum and Natural Gas Rights”, “Miscellaneous Interests” and “Tangibles” would create a catch-all to include any assets inadvertently excluded from express reference in the PSA. However, in practice, such terms have sometimes been defined more narrowly. In *Anadarko*,¹²² for example, notwithstanding the existence of a broad definition of “Tangibles” in the PSA at issue, the Court held that the “common sense view of the definition of Tangibles is something that exists and can be used in the exploitation of the petroleum and natural gas”, and therefore concluded an abandoned battery did not fit within the broad definition.¹²³ The Court further found that the abandoned battery was not a “Miscellaneous Interest”. That term was defined to include property, assets and rights “pertaining or ancillary to either the Petroleum and Natural Gas Rights or Tangibles” and, because the Petroleum and Natural Gas Rights and Tangibles were seen to have been “defined as having an operational purpose”, the Court then concluded “it follows that the Miscellaneous Interests must also have such a purpose.”¹²⁴

The resolution of these types of disputes relies heavily on determining the proper interpretation of the defined terms in the PSA and in objectively determining what the parties reasonably understood they were buying and selling. The key determination for the court will be whether it is

¹²¹ Cases concerning asset sales and environmental liabilities include for example: *Talisman v Esprit*, *supra* note 18 and *Anadarko*, *supra* note 18. See for example: Michael A Marion, Michael G Massicotte & Jessica L Duhn, “Canada’s Aging Oil and Gas Infrastructure: Who Will Pay? The Public and Private Cost Recovery Frameworks” (2014) 52:2 Alta L Rev 331.

¹²² *Anadarko*, *supra* note 18.

¹²³ *Anadarko*, *supra* note 18 at para 25.

¹²⁴ *Anadarko*, *supra* note 18 at para 36.

clear from the definition of the “Assets” that a particular asset or liability was intended to be included as part of a sale.

In *Talisman v Esprit*,¹²⁵ the issue was whether Talisman Energy Inc. (“Talisman”) purchased certain sulphur stockpiles from Esprit Exploration Ltd. (“Esprit”). The Court determined ownership of the sulphur stockpiles based whether, on a proper interpretation of the contract, the sulphur stockpiles were included in the definition of the “Assets” conveyed.

As per industry practice, “Assets” was defined in the PSA to include “the Petroleum and Natural Gas Rights, the Miscellaneous Interests and the Tangibles...”¹²⁶ At issue was whether the sulphur stockpiles fit within the definitions of “Miscellaneous Interests” or “Tangibles”.¹²⁷ The Court held that the sulphur stockpiles did not expressly fit within those definitions. The Court then considered whether the factual matrix evidenced an objective intent by the parties to include the sulphur stockpiles as part of the sale. This raised a number of interesting evidentiary issues.

One particularly contentious issue was whether a draft PSA that had been included as part of the data room was properly admissible as factual matrix evidence. In the draft PSA sulphur was explicitly included in the definition of “Miscellaneous Interests”. The Court referred to the existence of the draft PSA as being the “Elephant in the Room”, noting that if the language from the draft PSA had been included in the final, executed version of the PSA “there is little doubt in my mind that Talisman would now be the proud owner of the Disputed Interest”.¹²⁸ The Court considered whether such evidence was properly admissible as part of the factual matrix. As explored further in Part I of this paper, generally drafts of agreements or the negotiation of specific

¹²⁵ *Talisman v Esprit*, *supra* note 18.

¹²⁶ *Talisman v Esprit*, *supra* note 18 at para 67.

¹²⁷ *Talisman v Esprit*, *supra* note 18 at para 70.

¹²⁸ *Talisman v Esprit*, *supra* note 18 at para 159.

provisions do not form part of the factual matrix. However, in this case, the Court held it was properly admissible context evidence.¹²⁹

The Court relied on other evidence when considering the factual matrix, including fact evidence from a Talisman employee, a Letter of Intent executed by the parties which explicitly referenced sulphur being part of the sale, and an appraisal report prepared for Talisman which also referenced sulphur as part of the valuation of the assets.¹³⁰ Given the parties' familiarity with sales involving Sulphur and the fact that the executed agreement contained no reference to sulphur, the Court held there was sufficient evidence to conclude the parties did not objectively intend it to form part of the transaction.

In *Nexxtep*¹³¹, the Alberta Court of Appeal upheld a trial decision which considered a dispute relating to the extent of the sale of certain assets by Talisman to Nexxtep. The issue was whether the sale included the "Petroleum and Natural Gas Rights" associated with a specific producing zone for a particular vertical well. The PSA's land schedule included the rights "below the base of the Mannville" formation and at the time of the sale, the parties understood, and the Energy Resources Conservation Board had designated, that the vertical well was producing sweet gas from the zone above the Mannville formation and that sour gas was being produced through a horizontal well from the zone below. However, after the PSA closed it was determined by the regulation that this was an error and that in fact the vertical well was producing sweet gas, at least in part, from the zone below the base of the Mannville.

¹²⁹ However, the Court noted that it did not change the Court's conclusion.

¹³⁰ *Talisman v Esprit*, *supra* note 18 at para 167.

¹³¹ *Nexxtep*, *supra* note 18.

Nexxtep sued Talisman in trespass and conversion, arguing that by virtue of the terms of the PSA where Talisman had sold Nexxtep the rights below the lease of the Mannville formation, Talisman's vertical well was producing from Nexxtep's acquired rights. The Court held that Nexxtep had purchased Talisman's entire interest in the lands below the base of the Mannville but excluding the pool from which the vertical well was producing.

In considering the factual matrix, the Court of Appeal upheld the trial judge's decision, and expressly approved the trial judge's reliance on evidence as to the factual matrix, which included, among other things: documents expressly referenced in the purchase and sale agreement;¹³² evidence about a prior proposed transaction;¹³³ and expert evidence as to customary industry practice, including evidence from the former chairman of the Alberta Natural Resources Conservation Board on licensing practices.¹³⁴

B. Indemnity Disputes

Most PSAs will contain indemnities which allocate future risk between the parties. Often energy-related PSAs contain multiple indemnities including a general indemnity, an abandonment and reclamation indemnity, and an indemnity specific to environmental claims.¹³⁵ The scope of indemnity coverage is determined on the basis of an ordinary contractual interpretation exercise.¹³⁶ Clearly setting out the scope of the indemnity, the triggering event and the targeted losses specific to the transaction at issue is imperative to avoiding disputes.

There is no established definition of indemnity, but generally indemnity clauses in PSAs provide

¹³² *Nexxtep*, *supra* note 18 at para 29.

¹³³ *Nexxtep*, *supra* note 18 at para 30.

¹³⁴ *Nexxtep*, *supra* note 18 at para 33.

¹³⁵ See for example the CAPL PTP, *supra* note 2.

¹³⁶ *Weyerhaeuser*, *supra* note 35 at para 101; *Sinclair v South Trail Shell* (1987), 2002 ABQB 378, 1 Alta LR (4th) 135 at para 28.

that one party protects the other from specified damages or losses that arise as a consequence of the ownership of the property.¹³⁷ Recovery under an indemnity differs from recovery for breach of contract. An indemnity does not necessarily require a breach of its terms or any other contractual terms to be triggered. Indemnity provisions “oust any common law cause of action, instead providing a contractually agreed-upon code, including rights and remedies, to make good the damage – the “claim” as contractually defined – caused by the breach.”¹³⁸ The scope of an indemnity needs to be set out expressly. Parties can expand or limit the scope of liability that would ordinarily exist at common law through express language.¹³⁹

Indemnities are strictly interpreted and are “untrammelled by any special rule.”¹⁴⁰ Indemnities can be drafted in a number of ways, including using a fault-based structure (whereby one party agrees to indemnify the other for losses suffered by the other as a result of a breach of representation or warranty or other contractual term) or a no-fault-based structure (whereby one party agrees to indemnify the other on the occurrence of a certain type of loss).¹⁴¹

Indemnities will generally have a “triggering event” which stipulates when it will operate. Often indemnities are drafted so that the indemnity is only triggered when there has been a breach of a representation or warranty in the agreement.¹⁴² An indemnity can also be triggered as of a set date

¹³⁷ Martin G Abbott, “Fundamental Issues and Practical Requirements Affecting the Purchase and Sale of Producing Resource Properties” (1991) 29:1 Alta L Rev 85; Nick Kangles, R Ben Rogers, Zahra Allidina & Chris Harris, “Risk Allocation Provisions in Energy Industry Agreements: Are We Getting it Right?” (2011) 49:2 Alta L Rev 339 at para 5 [*Kangles et al Paper*]. Black’s Law Dictionary defines an indemnity contract as one between “two parties whereby the one undertakes and agrees to indemnify the other against loss or damage arising from some contemplated act on the part of the indemnitor, or from some responsibility assumed by the indemnitee, or from the claim or demand of a third person, that is, to make good to him some pecuniary damage as he may suffer.” *Blacks Law Dictionary*, 7th ed, *sub verbo* “indemnity”.

¹³⁸ *CIT Financial Ltd v Canadian Imperial Bank of Commerce et al*, 2017 ONSC 38, [2017] OJ No 33 at para 52.

¹³⁹ *Kangles et al Paper*, *supra* note 137 at para 38.

¹⁴⁰ *EnCana Oil & Gas Partnership v Ardco Services Ltd*, 2017 ABCA 401, 61 Alta LR (6th) 102 at para 17 citing *Shaw GMC Pontiac Buick Hummer Ltd v Polaris Explorer Ltd*, 2009 ABCA 390, 469 AR 156 at para 26.

¹⁴¹ *Kangles et al Paper*, *supra* note 137.

¹⁴² See for example the CAPL PTP, *supra* note 2, clause 13.01(A).

(for example with the indemnity providing that liability will accrue for breaches occurring before or after a set date).¹⁴³

In addition, the remoteness principles that apply to a breach of contract and the foreseeability of loss required to recover for a tort claim do not apply to an indemnity and damage that was not contemplated by the parties at the time an agreement was entered into may be recoverable under an indemnity depending on the wording of the indemnity. The term of an indemnity is also critical. An overly broad indemnity could be interpreted such that the vendor has a liability that “goes on forever, except to the extent that it might be limited by statutory limitations.”¹⁴⁴ In the paper “Environmental Risk Allocation in the Asset Rationalization Process” the authors stated:

In every case, broad indemnities of unlimited term are inappropriate for both the vendor and purchaser as they often conflict with the vendor's intentions as expressed in the representations and warranties and often provide the purchaser with a false sense of security, thereby inhibiting his due diligence efforts.¹⁴⁵

PSA disputes often arise over whether a particular claimed loss is in fact covered by the indemnity. For example, in *Anadarko*,¹⁴⁶ the Court relied on ordinary principles of contractual interpretation to determine if a contractual indemnity applied to losses associated with a particular asset. The PSA contained a general indemnity that provided that the purchaser was required to indemnify the vendor for losses it sustained “by reason of any matter arising out of, resulting from, attributable to or connected with the Assets and occurring or accruing after the Effective Date,” an environmental indemnity covering “any matter or thing arising out of, resulting from, attributable to or connected with any environmental damage or contamination or environmental problems

¹⁴³ See for example the CAPL PTP, *supra* note 2, clause 13.01.

¹⁴⁴ *TransCanada Pipelines Ltd v Potter Station Power Ltd Partnership*, (2002), 22 BLR (3d) 210, [2002] OJ No 429 (Ont Sup Ct) at para 36 [*Potter*].

¹⁴⁵ Scott R Miller and Kevin S MacFarlane, “Environmental Risk Allocation in the Asset Rationalization Process” (1992) 30 *Alta L Rev* 94.

¹⁴⁶ *Anadarko*, *supra* note 18.

pertaining to the Assets or to any well located on the Lands, or any of them” and a separate indemnity specific to abandonment and reclamation which required the purchaser “to see to the timely performance of all abandonment and reclamation obligations pertaining to the Assets which in the absence of this agreement would be the responsibility of Vendor.”¹⁴⁷ All of the indemnities tied coverage to the “Assets” or to matters or things “pertaining to” the Assets. As noted earlier, the Court found that the abandoned battery did not fit within the definition of “Assets”. Therefore, the liabilities associated with it did not “pertain to the Assets” and the Court found that the claimed losses did not fit within the scope of the indemnity. This case illustrates how drafting the indemnity, particularly in relation to expressly defined terms, can operate to narrow the scope of an indemnity that otherwise uses very broad language.

Another issue that can arise in the interpretation of the scope of indemnities is whether the indemnity only covers damages incurred by third parties. While indemnities often only cover third party claims,¹⁴⁸ there is no general principle that indemnities only cover third party claims and a contractual interpretation exercise is required to determine whether the indemnity extends to losses suffered by an indemnitee directly.¹⁴⁹ If parties intend to limit the scope of an indemnity to third party claims, they must do so through clear and express language to that effect.¹⁵⁰

C. Representations and Warranties

Often disputes occurring post-Closing relate to alleged breaches of representations and warranties in the PSA. The most litigated scenario is where a purchaser alleges that a vendor has made a false

¹⁴⁷ *Anadarko*, *supra* note 18 at paras 41-42.

¹⁴⁸ *Weyerhaeuser*, *supra* note 35 at para 208 (note this paragraph is part of the dissenting opinion of Laskin J).

¹⁴⁹ *Potter*, *supra* note 144 at paras 35-36; *Weyerhaeuser*, *supra* note 35 at para 101.

¹⁵⁰ See *Potter*, *supra* note 144 and *Herron v Chase Manufacturing Inc*, 2003 ABCA 219, 16 Alta LR (4th) 225 at para 34 where the Court held that the indemnification obligation at issue applied to non-third party losses resulting from breaches of covenants (at para 36).

representation and warranty in the PSA and claims damages as a result of the untrue representation and warranty.¹⁵¹ While the terms “representation” and “warranty” are often used interchangeably or in conjunction with one another in oil and gas PSAs, there is some inconsistency in Canadian law as to whether representations and warranties should be treated as distinct legal concepts (with the difference being whether a representation imports tortious liability with damages for breach measured on the tort standard versus a warranty being a contractual breach with damages for breach measured on the contract law standard).¹⁵²

While a detailed review of this issue is outside the scope of this paper, one practical effect of this distinction is the question of whether a party is required to prove reliance on a representation and warranty in order to recover damages for a breach. Reliance is not a necessary element to prove a breach of contract – all that is required is for a term of a contract to be breached to entitle a party to seek damages.¹⁵³ However, reliance is a necessary element of a claim for misrepresentation in tort (as “a representee who knows the truth is not deceived”).¹⁵⁴ If a purchaser knows that a representation and warranty given by the vendor is untrue at Closing, but closes anyway, the issue

¹⁵¹ See for example *Brent Petroleum*, *supra* note 152; *Quinney v 1075398 Alberta Ltd*, 2015 ABQB 452, [2015] AJ No 790.

¹⁵² For example in some cases representations and warranties have been treated as contractual warranties (see *Brent Petroleum Industries Ltd v Caine Enterprises Limited*, 59 AR 78, [1984] AJ No 959 [*Brent Petroleum*] where the Alberta Court of Queen’s Bench stated “what was stated in it was a “representation and warranty”. I treat it as a term of the contract, the breach of which would, all other relevant points being in the plaintiff’s favour, entitle the plaintiff to recover damages”: at para 67. In other cases, Courts have required reliance on representations and warranties. For example, in *Caddick v Francis*, 2011 CarswellOnt 5170, 215 ACWS (3d) 513 (Ont SCJ) the contract at issue contained a clause that read “The seller represents and warrants, to the best of the Seller’s knowledge and belief, that, during the Seller’s occupancy of the building, the sewage system has been and will be in good working order on closing.”¹⁵² The Ontario Superior Court held that the purchaser “would only have a remedy if they had relied upon the representations in deciding to purchase the home”.¹⁵² For an overview of the issue in the United Kingdom and the United States see for example, “Eliminating The Phrase Represents and Warrants from Contract”, *Transactions: The Tennessee Journal of Business Law*, Vol 16, at 215.

¹⁵³ *French Family Funeral Home Limited v William Player, Joanne Harpell and Bruce Holtom, and 1564714 Ontario Ltd and 1872864 Ontario Inc*, 2015 ONSC 182, 51 RPR (5th) 33 at para 61 [*French Family*].

¹⁵⁴ *French Family*, *supra* note 153 at para 57 citing *Waxman v Yeandle*, [1953] 2 DLR 475, [1953] OR 367 at para 7.

becomes whether that knowledge precludes it from successfully recovering damages for that breach.

Parties often attempt to address this issue expressly in a contract through use of sandbagging clauses. A pro-sandbagging clause stipulates that knowledge of the purchaser of any breach of a warranty or representation prior to Closing does not impact any right to indemnification or other remedy post-Closing. An anti-sandbagging clause stipulates that the purchaser waives any right to claim for a breach of a representation or warranty if it had knowledge of the breach prior to Closing.¹⁵⁵ If reliance is not necessary to form the basis for a breach of a representation and warranty, then sandbagging clauses would seem unnecessary.

A review of cases considering breaches of representations and warranties demonstrates that the issue of reliance has been dealt with somewhat inconsistently. For example, in *Eagle Resources*¹⁵⁶ the Court of Appeal found that there was a breach of a representation and warranty which provided that there was no undisclosed fact materially adverse to any asset because the vendor had knowledge that the reserves information provided to the purchaser was inaccurate despite the fact that the purchaser had knowledge of the error.¹⁵⁷ The Alberta Court of Appeal stated “The argument of counsel for the respondent is that the purchaser knew the facts. But clause 3.3(g) does

¹⁵⁵ For discussion of sandbagging clauses in Canada, see for example: Borden Ladner Gervais LLP, “Good Tactics or Bad Faith: The Divisive Issue of Sandbagging in M&A (19 January 2017), online: <http://blg.com/en/News-And-Publications/Publication_4799>; Stikeman Elliot, “Sandbagging Clauses in Acquisition Agreements: A Little Knowledge Can Be A Dangerous Thing” (29 October 2012), Canadian M&A Law (blog), online: <https://www.stikeman.com/en-ca/kh/canadian-ma-law/sandbagging-clauses-in-acquisition-agreements-a-little-knowledge-can-be-a-dangerous-thing>; Sarah Josselyn, “Seller Beware: Sandbagging in Canadian Private M&A” (8 August 2017), Deal Law Wire (blog), online: <<https://www.deallawwire.com/2017/08/08/seller-beware-sandbagging-in-canadian-private-ma/>>; Benjamin Layton, Geoff R Hall, Mathew V Harris & Jeremy Busch-Howell, “Sandbagging in Good Faith: How Bhasin v Hrynew Can Impact Indemnification for Known Breaches” (28 November 2016), Canadian M&A Perspectives (blog), online: <<https://www.mccarthy.ca/en/insights/blogs/canadian-ma-perspectives/sandbagging-good-faith-how-bhasin-v-hrynew-can-impact-indemnification-known-breaches>>.

¹⁵⁶ *Eagle Resources v MacDonald*, 2001 ABCA 264, 96 Alta LR (3d) 3 [*Eagle Resources*].

¹⁵⁷ *Eagle Resources*, *supra* note 156 at para 17.

not speak of that. It warrants that all facts reports etc. are in the contract, not that the purchaser has been told about them.”¹⁵⁸

If reliance is necessary for a claim for a breach of a contractual representation, the plaintiff has the burden to prove it relied on the representation and warranty and did not have knowledge of the defect. The purchaser must therefore prove a negative – that it had no knowledge that the representation and warranty was not true (and therefore relied on it to close). A pro-sandbagging clause would provide greater protections to a purchaser (if reliance is in fact required). Purchasers should be cognizant of the difficult position that an anti-sandbagging clause can potentially put them in. For example, if the vendor provides volumes of materials for the purchaser to review as part of the due diligence process, information received by any employee of the purchaser could constitute “knowledge of the defect” and preclude any claim for a breach of a representation and warranty. Such a scenario could effectively make the carefully negotiated representations and warranties of no practical protection for the purchaser.

IV. LIMITATIONS ON RECOVERY

If a party has a viable claim arising out of a PSA, there are still a number of issues that can impact the successful recovery of damages. This Part discusses two common limitations that often impact how a claim can be commenced or whether it can be commenced at all: 1) limitation periods that bar bringing claims in their entirety; and 2) the existence of limitation of liability or exclusion clauses that limit or preclude recovery of damages.

¹⁵⁸ *Eagle Resources*, *supra* note 156 at para 17.

A. Limitation Periods Generally

Limitation periods can be a harsh limitation on the ability to recover damages. A mistake as to the applicable limitation period can result in a total bar to a claim. Two important issues regarding the operation of limitation periods in PSAs are the impact of survival periods for representations and warranties often found in energy PSAs and the special rules regarding limitation periods applicable to environmental contamination claims.

The *Limitations Act* provides that a claimant must seek a remedial order within two years from the date the claimant first knew or ought to have known, that the “injury” for which the claimant seeks a remedial order had occurred, was attributable to the defendant, and warranted bringing a proceeding.¹⁵⁹ “Knew, or ought to have known” imports the concept of “discoverability” which importantly does not require perfect knowledge or certainty.¹⁶⁰ However, determining the applicable limitation period is very fact specific and can be difficult to assess. The nature and terms of the parties’ agreement are important in assessing how the limitations rules apply¹⁶¹ and what constitutes the “injury” under the *Limitations Act*.

To illustrate some of the issues involved in attempting to assess the appropriate limitation period, we use the example of a dispute relating to the preparation of interim and final statements of adjustments. Generally a PSA will provide for a final adjustment to be made post-Closing, with audit rights within a certain stipulated time period.¹⁶² For example, the CAPL PTP¹⁶³ provides that a final statement of adjustments must be prepared and delivered by the vendor, with the purchaser

¹⁵⁹ *Limitations Act*, RSA 2000, c L-12, s 3 [*Limitations Act*].

¹⁶⁰ *Epcor Power LP v Petrobank Energy & Resources Ltd*, 2010 ABQB 463, 495 AR 173 at para 45 [*Epcor Power*], citing *Hill v South Alberta Land Registration District*, 1993 ABCA 75, 135 AR 266.

¹⁶¹ *Epcor Power*, *supra* note 160 at para 72.

¹⁶² See for example section 4.00 of the CAPL PTP *supra* note 2.

¹⁶³ CAPL PTP, *supra* note 2.

then having six months after receipt of the final statement of adjustments to conduct an audit to confirm the adjustments. The CAPL PTP further extends the limitation period applicable to adjustment claims.¹⁶⁴ The difficulty is in assessing when the purchaser “knew or ought to have known” of any injury arising out of the adjustments.

Depending on the specific facts at issue, arguably a purchaser may have knowledge of an issue when the interim statement of adjustments is prepared, when the final statement of adjustments is actually received or when the results of an audit are received. Assessment of limitations periods are very fact specific and require an assessment and evidence of when the purchaser, using reasonable diligence, should have known there was an issue.¹⁶⁵

B. Contractual Limitation Periods versus Statutory Limitation Periods

Most PSAs include a clause specifying the length of time that the representations and warranties survive after Closing, referred to as the “survival period”. During the survival period, the parties can discover a breach and commence a claim. However, after the survival period, no claims for a breach of a representation or warranty can be made. The parties are free to negotiate the length of this period. Commonly this period will be for a period between 9 to 18 months.

Since the representations and warranties of a vendor are generally more onerous than the representations and warranties of the purchaser, the vendor would likely try to limit the length of the survival period as much as possible to narrow any future potential liability. The vendor may push for the representations and warranties to terminate at Closing whereas the purchaser would

¹⁶⁴ CAPL PTP, *supra* note 2, clause 4.02E.

¹⁶⁵ For example, if issue is identified by an audit, the limitation would generally be extended to be 2 years from the date the agreement permitted the audit to be conducted. However, there is a possible argument that, in some circumstances, the purchaser, using reasonable diligence, should have known it was overcharged prior to the disclosure of same in an audit, in which case the claim is not, technically, “disclosed by an audit”. This would make the limitation period earlier and would require evidence demonstrating knowledge of the issue.

likely seek to preserve any claim it may have with the vendor at least until statutory limitations bar any claims.

The interplay between survival periods and the statutory limitation period applicable to ordinary claims may at times conflict. Section 7(2) of *Limitations Act* stipulates “an agreement that purports to provide for the reduction of a limitation period provided by this Act is not valid.”¹⁶⁶ Since the survival period of the representations and warranties in a PSA is often less than two years, these clauses could potentially be inconsistent with the *Limitations Act* and be deemed invalid.

This issue was considered in *NOV v Enerflow*.¹⁶⁷ In this case, NOV Enerflow ULC ("NOV") and Enerflow Industries Inc. ("Enerflow") were parties to PSA. The PSA included a number of representations and warranties with respect to the business of Enerflow. The PSA also included a survival period for those representations and warranties that read:

The representations and warranties of Enerflow Canada and the Shareholders contained in this Agreement...shall survive the Closing and shall continue in full force and effect for the benefit of the Purchasers provided, however, that Enerflow Canada and any Shareholder shall not have any liability hereunder in respect of any representation and warranty unless a claim in respect thereof is made within the following time periods:

[...]

(c) in the case of a claim in respect of a representation or warranty other than Sections 8.2, 8.3, 8.4, 8.17, 8.32, 8.35, 8.36 and 8.46, within a period of two (2) years from the Closing Date;

provided, however that no claim in respect thereof after the Closing shall be valid unless made in accordance with the provisions set forth in Article 18 (for greater clarity, the Parties acknowledge and agree that any claim made in accordance with the provisions set forth in Article 18 prior to the applicable expiration date of such

¹⁶⁶ *Limitations Act*; *supra* note 159; see also *The Limitations Act*, RSS 2004, c L-16.1, s 21 where, in Saskatchewan, the legislation speaks to the enforceability of an agreement providing for the extension of a limitation period, but is silent on the enforceability of an agreement providing for the reduction of a limitation period

¹⁶⁷ *NOV Enerflow*, *supra* note 3.

representation or warranty shall survive such expiration date until such claim is finally resolved and all payments have been made with respect thereto).

After the transaction closed, NOV commenced a claim against Enerflow for misrepresentation and breach of contract based on alleged breaches of representations and warranties under the PSA. The initial claim was commenced within the time period stipulated under the PSA. However, subsequent to the commencement of the claim, NOV discovered further issues with respect to the sale and sought to amend its claim to include further breaches. Enerflow resisted these amendments, arguing that the representations and warranties under the PSA had expired.

The Court reviewed existing case law on the subject that seemed contradictory. In *Edmonton (City) v Transalta Energy Marketing Corporation*,¹⁶⁸ the Court had dismissed the City of Edmonton's argument that a survival period in a PSA was offside the *Limitations Act*, concluding that the survival period was valid as it "is simply a clause which puts limits on the warranties provided under the Agreement. It does not address the issue of the limitation period to commence an action."¹⁶⁹ However, in *Shaver*,¹⁷⁰ the Court had acknowledged the conflict, stating "the only way that I can see to reconcile all this is to interpret s 7(1)(2) the way that a plaintiff or a practicing lawyer would. What is the last day that the Act allows the plaintiff to sue? Does the contract choose a date earlier or later than that? If earlier, that contract is invalid; if later, that is valid."¹⁷¹ *Shaver* decision implies that it may not be clear at the outset of the contract whether a survival period will be barred by the *Limitations Act* and a case-by-case analysis would be required to determine the validity of a survival provision.

¹⁶⁸ *Edmonton (City) v Transalta Energy Marketing Corp*, 2008 ABQB 426, 441 AR 228 [*Edmonton City*].

¹⁶⁹ *Edmonton City*, *supra* note 168 at para 83.

¹⁷⁰ *Shaver v Co-operators General Insurance Company*, 2011 ABCA 367, 515 AR 345 [*Shaver*].

¹⁷¹ *Shaver*, *supra* note 170 at para 36.

In *NOV v Enerflow*, the Court distinguished the *Shaver* decision on the basis that it was a tort claim involving a motor vehicle accident and did not involve a contractual right of indemnification under a PSA between sophisticated commercial parties. However, the Court did not expressly adopt the reasoning in *Edmonton (City)*, referring instead to the position recently affirmed by the Ontario Court of Appeal in *NFC Acquisition LP*¹⁷² where the Court stated:

The right of indemnity was purely contractual in nature in a commercial agreement between sophisticated parties. The various indemnity rights granted were, by agreement, time limited. The timely notice requirement was a mutually agreed contractual condition precedent for triggering a right of indemnity. Once a timely notice is given, the cause of action accrued and at that point, the statutory limitation period begins to run. Notice provisions of this kind are acceptable in the context of commercial agreements between sophisticated parties.¹⁷³

While the *NOV v Enerflow* decision follows the *NFC Acquisition LP* decision, it does not appear to stand for the position that all survival periods that shorten the time to bring a claim are outside the *Limitations Act*. The Court seemed to suggest that it did not offend the *Limitations Act* because the survival period did not preclude a party from bringing a claim in its entirety. Justice McCarthy stated: “[t]hat is not to say NOV could not still bring a claim for breach of representation or warranty after May 11, 2014; however, such claims would be hopeless if the representations and warranties on which they were based had expired.”¹⁷⁴ *NOV v Enerflow* appears to distinguish between two types of contractual clauses: a clause that purports to waive all rights to access the courts and bring a claim would be outside the *Limitations Act*, whereas a clause that provides for representations and warranties to expire at a particular point in time would not. The Court stated that in the latter type of clause a claim is not precluded (and therefore not outside the *Limitations Act*), it just would never be successful.

¹⁷² *NFC Acquisition LP v Centennial 2000 Inc*, 2011 ONCA 43, 78 BLR (4th) 11.

¹⁷³ *Ibid* at para 4.

¹⁷⁴ *NOV Enerflow*, *supra* note 3 at para 47.

For example, in the CAPL PTP, the language does not deal with “expiry” like the contract in *NOV v Enerflow* but has language that “each Party waives any rights it may have at law or otherwise to commence a claim or action for breach of a representation or warranty after that period.”¹⁷⁵ The clause does not simply put “limits on the warranties provided under the Agreement” or on the triggering of contractual rights conditional upon certain events, but rather, the clause provides that a party waives its rights. This clause is arguably offside the *Limitations Act* and is distinguishable from the clause in *NOV v Enerflow*.

C. Limitation Period for Environmental Contamination

One unique statutory limitations issue that impacts energy-related PSAs is the Alberta *Environmental Protection and Enhancement Act* (“EPEA”)¹⁷⁶, which allows for the extension of the ordinary limitation periods under the *Limitations Act* for claims relating to environmental contamination.

These provisions acknowledge the practical realities that environmental contamination often goes undiscovered for many years, potentially making it difficult for plaintiffs to bring a claim to recover damages within statutory limitation periods. *EPEA* provides that the limitation period for an action claiming an “alleged adverse effect resulting from the alleged release of a substance into the environment” can be extended on application to the Court of Queen’s Bench.¹⁷⁷ Adverse effect is expressly defined in *EPEA* to mean “impairment of or damage to the environment, human health or safety or property”. Section 218 of *EPEA* sets out a number of factors for courts to consider with respect to an application to extend a limitation period, including: when the adverse effect

¹⁷⁵ CAPL PTP, *supra* note 2, clause 6.05(B),

¹⁷⁶ *Environmental Protection and Enhancement Act*, RSA 2000, c E-12 [*EPEA*].

¹⁷⁷ *EPEA*, *supra* note 176, s 218.

occurred; whether the adverse effect ought to have been discovered by the claimant through the exercise of due diligence; whether the defendant will be prejudiced from maintaining a defence to the claim on the merits; and any other relevant criteria.

There is not a great deal of case law interpreting this section of *EPEA*.¹⁷⁸ In *Lakeview*,¹⁷⁹ the Court outlined the following two-step analysis for considering when a section 218 extension should be granted:

1. Is there sufficient evidence on the section 218 factors to grant an extension of the limitation period?; and
2. If there is not enough evidence to make that determination, or if there is sufficient evidence but an issue for trial could be determined prematurely, has the claimant shown a good arguable case for an extension? If so, the claimant is entitled to an extension of the limitation period subject to a final determination of the issue at trial.¹⁸⁰

The Court noted that the test respects the purpose of section 218 “while acknowledging the legitimate interest of a claimant to know whether to spend further resources on their claim” and “allows the court to extend the limitation period for obviously meritorious section 218 cases or to weed out cases that are attempting to ‘abuse the system’.”¹⁸¹ In *Brookfield Residential*,¹⁸² the Court applied this test and dismissed a request to extend the limitation period for a claim relating to

¹⁷⁸ Cases dealing with this provision include: *Wainwright Equipment Rentals v Imperial Oil Ltd*, 2003 ABQB 898, 343 AR 191; *Jager Industries Inc v Canadian Occidental Petroleum Ltd*, 2001 ABQB 182, 294 AR 355; *Lakeview Village Professional Centre Corporation v Suncor Energy Inc*, 2016 ABQB 288, 39 Alta LR (6th) 193 [*Lakeview*]; *Brookfield Residential (Alberta) LP (Carma Developers LP) v Imperial Oil Limited*, 2017 ABQB 218, 53 Alta LR (6th) 288 [*Brookfield Residential*].

¹⁷⁹ *Lakeview*, *supra* note 178.

¹⁸⁰ *Lakeview*, *supra* note 178 at para 19.

¹⁸¹ *Lakeview*, *supra* note 178 at para 20.

¹⁸² *Brookfield Residential*, *supra* note 178 at para 99-100.

contamination that occurred in the 1950s. The Court held that there was significant prejudice to the defendant in the action given the length of time since the contamination occurred, noting that witnesses, documents and experts would be difficult if not impossible to procure to defend the claim.¹⁸³

In the context of the purchase and sale of a property, the practical take-away from this decision is that parties should take steps to contractually allocate liabilities for environmental contamination to avoid the possibility of potential liability unlimited by statutory time constraints. This can be done through the use of carefully drafted due diligence provisions, representations and warranties and indemnities in purchase and sale agreements. Such contractual provisions would likely be important factors considered by the courts under section 218 of *EPEA*.

D. Limitation of Liability Clauses

Another limitation on the recovery of losses is the possible existence of a contractual clause limiting or excluding liability. Limitation of liability or exclusion clauses generally place a cap on the amount either party can recover by reason of a breach of an agreement or in some way limit the possibility or extent of recovery for particular losses. Generally, these clauses are permissible under Canadian law and will be enforced. However, such clauses require clear contractual terms as to what liability will be excluded.¹⁸⁴

A limitation of liability clause or exclusion clause can take many forms. For example, the parties can exclude liability for certain types of claims (for example, an entire agreement clause that excludes liability for pre-contractual representations); exclude specific types of damages (for

¹⁸³ *Brookfield Residential*, *supra* note 178 at para 99-100.

¹⁸⁴ *Tercon Contractors Ltd v British Columbia (Transportation and Highways)*, 2010 SCC 4, [2010] 1 SCR 69 at para 73 [*Tercon*] sets out a number of examples of what language of well drafted exclusion clauses.

example by excluding liability for consequential damages); provide an overall aggregate monetary cap on liability; or exclude claims being brought at a particular point in time (for example survival periods for representations and warranties). For example, the CAPL PTP provides for two alternative clauses limiting liability. Alternate A of the CAPL PTP “includes, without limitation, any claims relating to its representations and warranties”.¹⁸⁵ Alternate B of the CAPL PTP stipulates that no claim under the agreement can be paid by either Party that exceeds a negotiated amount.¹⁸⁶

The leading Canadian case regarding the enforceability of exclusion or limitation of liability clauses is *Tercon*¹⁸⁷ where the Supreme Court of Canada developed the following test to determine when a clause will be enforceable: (1) whether the exclusion clause applies to the circumstances established in the evidence; (2) whether the exclusion clause was unconscionable at the time it was entered into; and (3) whether the court should refuse to enforce a valid and applicable exclusion clause because of the existence of overriding public policy.¹⁸⁸

In the energy context, where parties are usually sophisticated commercial entities with independent legal advice, it will likely be difficult for a party to successfully avoid the application of a limitation of liability clause on the basis of unenforceability for reasons of unconscionability or public policy unless there is some evidence of fraud or deceit. Unconscionability will generally not exist as there is generally no imbalance in bargaining powers.¹⁸⁹ Further, the threshold to determine unconscionability is quite high and for example, would require behavior that was “contemptuous

¹⁸⁵ CAPL PTP, *supra* note 2.

¹⁸⁶ CAPL PTP, *supra* note 2.

¹⁸⁷ *Tercon*, *supra* note 184.

¹⁸⁸ *Tercon*, *supra* note 184 at paras 122-123.

¹⁸⁹ *Horizon Resource Management Ltd v Blaze Energy Ltd*, 2011 ABQB 658, 526 AR 206 at para 1021; see also *John Deere Financial Inc v 1232291 Ontario Inc (Northern Haul Contracting)*, 2016 ONCA 838, 272 ACWS (3d) 737 at para 46 and *Curtis Chandler v Karl Hollett*, 2017 ONSC 2969, 69 BLR (5th) 259 at para 55.

of its contractual obligation and reckless as to the consequences of its breach” such that a party is deemed to have forfeited the assistance of the Court.¹⁹⁰ Public policy exceptions are also rare. For example in *Tercon*, Binnie J stated “[c]onduct approaching serious criminality or egregious fraud” would be examples of considerations of public policy.¹⁹¹ As such, the primary consideration for parties is the first part of the test: whether it in fact applies to the claimed losses.

In relation to the third part of the test, courts will assess the express language of the exclusion clause and the objective intentions of the parties at the time the contract was entered into to determine whether the exclusion clause applies to the circumstances.¹⁹² Such an analysis will be on the basis of principles of contractual interpretation which are outlined in Part I of this paper. Limitation of liability clauses are not interpreted in isolation from the rest of the agreement at issue and are strictly construed, with any ambiguity generally being resolved against the party seeking to rely on it.¹⁹³

The scope of the limitation of liability provision is very important. For example, does the clause only limit liability for breaches of contract or does it include liability for tort claims, such as negligence or misrepresentation? The Supreme Court of Canada has held that whether words of an exclusion clause extend to include negligence is a matter of construction and the clause need not expressly include negligence in order for it to be considered part of the exclusion.¹⁹⁴

In *Tercon*, the Court highlighted a number of exclusion clauses from prior cases which it deemed to be sufficiently clear and precise enough to warrant enforcement. The Court found that

¹⁹⁰ *Plas-Tex Canada Ltd v Dow Chemical of Canada Limited*, 2004 ABCA 309, 357 AR 139 at para 120.

¹⁹¹ *Tercon*, *supra* note 184 at para 1017.

¹⁹² *Tercon*, *supra* note 184 at para 122.

¹⁹³ *Spartek Systems Inc v Brown*, 2014 ABQB 526, 596 AR 60 at para 274.

¹⁹⁴ *Miida Electronics Inc v Mitsui OSK Lines Ltd*, [1986] 1 SCR 752, [1986] SCJ No 38 at para 53.

“sophisticated parties can draft very clear exclusion and limitation clauses when they are minded to do so.”¹⁹⁵ Because the Court found the exclusion clause at issue in *Tercon* to be rather “curious,” it listed several examples of benchmark clauses that would otherwise be considered unambiguous.¹⁹⁶

An example of how the construction of the limitation of liability clause can cause problems in the energy transaction context is *IFP Technologies*.¹⁹⁷ The Court of Appeal raised two considerations with respect to a limitation of liability clause in the underlying contract which limited damages to \$16 million: (1) whether the limitation of liability clause would have an impact on the continued ownership by IFP of the assets subject to the dispute or on its entitlement to net revenue from primary production from the assets;¹⁹⁸ and (2) whether the limitation of liability clause precluded recovery of the significant legal costs incurred by the successful party.¹⁹⁹

The Court of Appeal did not answer either question (stating that it was a consideration appropriate for the Court of Queen’s Bench who would properly determine the issue of the assessment of damages)²⁰⁰ but the Court’s reference to those issues highlights some of the difficulties in

¹⁹⁵ *Tercon*, *supra* note 184 at para 73.

¹⁹⁶ The limitation of liability clause in *Syncrude Canada Ltd v Hunter Engineering Co*, [1989] 1 SCR 426, [1989] SCJ No 23 (SCC), for example, provided that “[n]otwithstanding any other provision in this contract or any applicable statutory provisions neither the Seller nor the Buyer shall be liable to the other for special or consequential damages or damages for loss of use arising directly or indirectly from any breach of this contract, fundamental or otherwise” (at 450). The Court found this to be clear and unambiguous. The limitation clause in issue in *Guarantee Co of North America v Gordon Capital Corp*, [1999] 3 SCR 423, [1999] SCJ No 60 provided that legal proceedings for the recovery of “any loss hereunder shall not be brought . . . after the expiration of 24 months from the discovery of such loss” (at para 5). Once again, the Court found this language clear. The Ontario Court of Appeal similarly found the language of a limitation of liability clause to be clear in *Fraser Jewellers (1982) Ltd v Dominion Electric Protection Co*, 34 OR (3d) 1, 148 DLR (4th) 496 (ON CA). The clause provided in part that if the defendant “should be found liable for loss, damage or injury due to a failure of service or equipment in any respect, its liability shall be limited to a sum equal to 100% of the annual service charge or \$10,000.00, whichever is less, as the agreed upon damages and not as a penalty, as the exclusive remedy” (at 4).

¹⁹⁷ *IFP Technologies*, *supra* note 5.

¹⁹⁸ *IFP Technologies*, *supra* note 5 at para 217.

¹⁹⁹ *IFP Technologies*, *supra* note 5 at para 218.

²⁰⁰ *IFP Technologies*, *supra* note 5 at para 219.

interpreting and construing limitation of liability clauses. We expect further litigation on these issues in the future.

V. CONCLUSION

In conclusion, the litigation of purchase and sale agreements can be quickly complicated as a myriad of legal principles, interpretation rules, and complicated fact patterns impact how, when, where and why parties can bring claims to recover losses. As deal flow increases, we anticipate that the issues identified in this paper relating to pre-Closing and post-Closing disputes will increasingly need to be addressed by parties and courts.