

Focus ENERGY LAW

Quebec natural gas contracts need work



Stefan Chripounoff

The natural gas industry in North America has gone through radical changes over the past decade. These principally stem from the ever-increasing production, through unconventional reserves, of shale natural gas in the U.S.

The resulting increase in U.S. exports to Canada has caused a shift of the gas traditionally flowing from western to eastern Canadian provinces to a more predominant south to north flow into Canada through the Michigan/Ontario border at a location known as Dawn Hub.

The increase in the volume of transactions at Dawn Hub has enhanced its market liquidity, allowing it to offer more competitive pricing. Receiving U.S. gas deliveries there is now especially attractive for eastern Canadian provinces such as Quebec, which should also benefit from lower transportation costs compared to the long-haul costs incurred to transport natural gas from Western Canada to Quebec.

Importantly, the overall savings that will normally result from the Dawn Hub offering has caused Quebec's main local distribution company, Gaz Métro, to migrate its supply structure from Empress to Dawn Hub for direct purchase customers as of Nov. 1, 2016. As a result, Quebec clients may notice that the price they pay for their gas at Dawn Hub is currently higher than what they would pay at Western Canada's AECO Hub in Alberta. They must, however, also take into account their concomitant transportation cost savings. This change in the supply structure will certainly warrant some explanations by natural gas suppliers to their Quebec-based clientele.



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This will not be the first time that a natural gas supplier has been obligated to provide an explanation of the industry's technical aspects to its clients, so as to fill the knowledge gap that often exists between them. For instance, in *Athena Energy Marketing v. Peyrow* 2012 QCCS 5878, the Superior Court of Quebec held that, upon concluding a multi-year natural gas purchase transaction, the supplier has a duty to inform its customer that historical consumption data should not be used as the basis to establish future consumption requirements if the configuration of the client's installations and the information it provides to the supplier presage a reduction in future consumption.

Given that the commonly used GasEDI Base Contract for sale and purchase of natural gas (the GasEDI Base Contract) across

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Canada is completely silent on the supplier's informational obligation toward its clients, it would certainly be appropriate to include specific language to delineate this obligation in Quebec. The GasEDI Base Contract should thus be modified to specify that the supplier is not responsible for establishing or even estimating its Quebec clients' natural gas requirements.

Several other modifications to the GasEDI Base Contract should be considered in order to adapt it to Quebec's legal landscape. For example, Quebec law provides that a party must be afforded a reasonable grace period to remedy a default, if the default constitutes grounds for terminating the agreement between the parties. However, the GasEDI Base Contract arguably allows for the termination of the agreement in the event of certain defaults without any grace period for curing

them. Any such termination could in all likelihood be successfully contested before a Quebec court. Another dispute could arise regarding whether it is reasonable for the GasEDI Base Contract to provide only two business days to remedy a default in payment. A longer cure period should be stipulated to avoid any such controversy.

Furthermore, the general provision in the GasEDI Base Contract that all legal fees incurred by the non-defaulting party are to be paid by the defaulting party in the event of termination is also invalid under Quebec law. The contract should rather provide that either a specific or determinable amount of legal fees as per a calculation formula are to be paid by the defaulting party (the precise amount or the formula in question must be carefully chosen, to avoid being subsequently set aside by Quebec courts for want of reasonableness) in such circumstances. The parties could also refer all disputes to arbitration, in which case it is possible to contractually agree that the losing party shall pay the legal fees of the successful party.

The GasEDI Base Contract could also be amended to refer disputes to arbitration for other reasons. The arbitration clause could require that the arbitrator(s) possess a certain level of expertise in the natural gas industry, making the outcome of any dispute more predictable and potentially less lengthy and costly.

When considering these above-mentioned legal particularities as well as other recent industry changes, one thing is clear: doing business in Quebec is unique, as compared to the rest of Canada. In the end, adapting to Quebec's distinctiveness will remain the key for successful natural gas dealings within that province.

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Reputation: Separate foreign operating company may not give same protection

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closure will promote good governance in accordance with international standards such as the U.N. Guiding Principles on Business and Human Rights, a standard which has been expressly endorsed by the government of Canada for the extractive sector. Similar, or even more far-reaching, legisla-

tion may be introduced in Canada in the coming years.

These legal developments highlight that human rights issues are another legal risk of doing business in challenging jurisdictions where the rule of law may not be well established, and that the use of a separate foreign operating company may not afford the same level of insulation of liability as it

has historically provided.

In light of these trends, Canadian energy and extractive companies should:

- Conduct risk assessment to identify legal and reputational risks involving human rights;
- Develop policies and procedures for conducting human rights due diligence on company operations, foreign subsidiaries,

business partners and supply chains to manage and mitigate risk; and

- Understand the risks and opportunities associated with adoption and application of international standards such as the U.N. guiding principles, and ensure that, prior to adoption, the company has processes in place to ensure, and to paper,

compliance with those standards.

Getting ahead of the curve in managing human rights risk is not just a good idea for a company's reputation, but is also increasingly a crucial piece of legal risk management.

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