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Competition Law and the Upstream Oil and Gas Industry

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Decision commented on:

321665 Alberta Ltd. v Husky Oil Operations Ltd, 2013 ABCA 221.

I suspect that there will be sighs of relief in the board rooms of downtown Calgary (or at least so soon as the occupants of those office towers are able to think about something other than the consequences of the current disastrous flooding) as a result of this decision in which the Alberta Court of Appeal unanimously allowed an appeal on a civil action based on sections 36 and 45 of the federal *Competition Act*, RSC 1985, c C-34 (as they stood at the relevant time) which had been successful at trial.

The Facts

Two major operators, Exxonmobil Canada and Husky Oil Operations Ltd (E & H), with properties in the Rainbow Lake area decided to make efforts to reduce their operating costs by contracting with a single fluid hauling company. Some of E & H properties were jointly owned but some were not. E & H followed a transparent procedure in pursuing their objectives. They invited bids from the two companies most active in the fluid hauling business in the area, Kolt (or 665 Ltd) and Cardusty. In the end E & H preferred Cardusty. Husky had previously been Kolt's largest client. At around the same time Kolt also lost CNRL as a client when CNRL opted to install a pipeline for fluids rather than relying on trucking services. In the space of a little more than a year Kolt determined that it was unable to carry on business and shut down operations. Kolt blamed E & H for the precipitous decline in its business and sought to rely on the combination of section 45 (prohibition on any combination designed to prevent or lessen unduly competition) and section 36 (private cause of action) of the *Competition Act* in order to achieve that goal. Justice Belzil at trial had found in favour of Kolt and awarded damages "at large" of $5 million and punitive damages of $500,000 against each of E & H (see 2011 ABQB 292 and 2012 ABQB 76) as well as a sum for investigation costs.

The Judgment on Appeal

The Court of Appeal comprehensively overturned almost every aspect of Justice Belzil's judgment. In the course of doing so the Court established (or re-affirmed) a number of important propositions.

1. The standard of review of a finding by the trial judge of an arrangement that unduly lessens competition is: (a) *correctness* in relation to the process followed and the criteria applied, and (b) *reasonableness* in relation to the application of this to the facts at hand

(at para 19). (That said it is not at all clear that the Court actually applied these standards in reaching it conclusion that there was reversible error!).

2. Co-owners and joint operators in the upstream oil and gas industry are not insulated from the application of the *Competition Act* by virtue of being co-owners. They are not a "single economic entity" and the terms of the operating agreement make that clear (at paras 26 & 30). Such owners can engage in anti-competitive behaviour and in some cases abuse their market power; but the routine and required consultation between the operator and its joint operators as to how best to manage operations is not itself anti-competitive behaviour (at para 28):

> The simple fact that Husky and Mobil jointly owned numerous facilities in the Rainbow Lake area assumes that they would work together to produce and develop petroleum substances from their assets. Owners of any co-owned asset must, by necessity, be able to agree as to how to properly manage their operations, particularly in a situation where, as here, the owners equally shared the costs. Indeed, the oil and gas regime in Alberta anticipates and relies on cooperation between and amongst owners of properties. As the appointed operator, Husky was obligated to conduct joint operations in a good and workmanlike fashion, consistent with accepted operating practices, and included the responsibility to consult with Mobil in carrying out joint operations.

3. An appellate court will not interfere with a trial judge's assessment of damages unless there was no evidence on which the trial judge could have reached his or her conclusion or where he or she proceeded upon a mistaken or wrong principle or where the result was wholly erroneous (at para 40).

4. An award of damages "at large" may be used when the nature of the tort makes it impossible to prove damages with precision. It is not a substitute for the proper assessment of damages and the outcome must still reasonably approximate actual or foreseeable loss. An award of damages "at large" must be supported by appropriate reasons (at paras 42 – 46). (The Court indicated that had it upheld the findings of the trial judge on liability it would have significantly reduced the damages under this heading. The Court described the trial judge's reasons as "somewhat opaque.")

5. Punitive damages should be reserved for exceptional circumstances where the respondents' conduct is "high-handed, malicious, arbitrary or highly reprehensible" or consists of "advertent wrongful acts that are so malicious and outrageous that they are deserving of punishment on their own (at para 48)" The standard of review for an award of punitive damages is "based on the principle of rationality, and the reviewing court's analysis 'should be based upon the court's estimation as to whether the punitive damages serve a rational purpose'" (at para 49). (The Court concluded that none of these epithets applied to E & H; in particular there was no evidence that E & H were trying to force Kolt out of business, and indeed this would have been contrary to their long-term best interests (at 53). Somewhat more strangely the Court observed that even if some form of retribution were required (at para 54) "[a] significant award of damages alone will carry with it a certain punitive effect." I thought that an ordinary tort damages award was supposed to be compensatory (as the court itself says at para. 43, or occasionally designed to prevent an enrichment, *AG v Blake*, 2000 UKHL 45)).

6. A claim for "investigation costs" under section 36 of the *Act* must be supported by specific records. Mere participation in litigation is not compensable as part of investigation costs (at para 59). (The Court would have disallowed the claim for investigation costs.)

The Court also offered a number of helpful observations which will assist future plaintiffs in assessing whether they have a cause of action. The Court observed for example that the process followed by E & H was open and transparent. Kolt was permitted to and indeed encouraged to bid. It was not frozen out of the process which was very much a competitive process. The presence of these elements suggested healthy competition and suggested that Kolt's real objection was to the form of competitive arrangement or contracting practices that E & H wanted to put in place in an effort to drive down costs. The Court of Appeal could see nothing wrong with this arrangement (at 23):

> Kolt's position is that the *Act* precluded Husky and Mobil from restructuring their services by entering into an exclusive arrangement with Cardusty (or Kolt, for that matter) for their joint operations. We disagree. We can discern no reason why Husky and Mobil should not be permitted to rationalize their operations, particularly when the purpose was to increase efficiencies and reduce unnecessary costs. To find otherwise would necessarily undermine the competitive nature of Husky and Mobil's operations by driving up their costs, and create unnecessary inefficiencies in a highly competitive industry that attempts to efficiently and effectively develop and produce scarce, natural resources. That cannot have been the intent of the *Act*. We simply do not accept that Husky and Mobil were bound to continue their previous practice of dividing up their fluid hauling requirements between Kolt and Cardusty, to their detriment.

In more technical terms one might say that this was simply not an example of a long term contract being used to foreclose entry or competition; and framed in terms of statutory interpretation, the trial judge's approach (or at least his conclusion) failed to give any effect to the word "undue" (at para 24). It cannot be the case that any change in the competitive environment of a particular sector is actionable; a point that the court illustrated (at para 25) by noting that E & H were free to elect to replace trucking services with pipeline services.

The Court made a similar point in concluding that this was not an appropriate case for punitive damages (at para 51):

> … the parties involved are each corporations whose reason for existence is to generate a profit for shareholders. While they must do so within the confines of the law, the impugned conduct in this case was not such as to warrant the court's sense of retribution or denunciation. Neither Husky nor Mobil made any attempt to hide their motives from Kolt (or Cardusty), but instead sought their input and feedback on methods by which they might better improve their fluid hauling processes. Rather than terminate their contractual arrangement with Kolt on short notice, which they were legally entitled to do, they undertook an extensive, qualitative review of both Kolt and Cardusty over a period of months before making their decision, and promptly advised Kolt that they would not be called upon for further fluid hauling, other than on an emergency basis.

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