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The Synthetic Transportation of Natural Gas

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Case Commented On: *Apache Canada Ltd v TransAlta Cogeneration LP*, 2015 ABQB 650

In this decision Master Robertson concluded that the synthetic transportation of natural gas through a series of swap arrangements does not trigger the seller's right of first refusal in a natural gas sales contract so as to allow the seller to re-acquire the gas, or that volume of gas, at the contract price and re-sell for its own account at the market price.

Apache agreed to sell natural gas to TAU for the specific purpose of fueling a cogeneration facility in Windsor, Ontario (the Windsor facility). The point of sale (i.e. where TAU took delivery of the gas) was Empress, Alberta. The contract had a 15-year term commencing in 1996. At that time, natural gas prices were depressed and Apache agreed to accept a fixed price with an escalation clause rather than a price determined by reference to an evolving spot market. Both parties clearly contemplated that TAU, having taken delivery of the gas at Empress, would transport that gas to its Windsor facility using TransCanada's mainline and Union Gas's facilities in Ontario. Indeed, the contract required TAU to arrange take-away pipeline capacity through agreements with "Buyer's Transporters" (s.9.03) that were (at para 39):

> ...required to transport on a firm basis all volumes of Gas up to the DCQ [Daily Contract Quantity] from the Delivery point to the Project Facility ... on terms acceptable to the Parties acting reasonably, which agreements shall, at a minimum, commit Buyer's Transporters to accept such Gas for transport to Buyer commencing on or before December 1, 1996 and continuing for the balance of the Term.

The term "Buyer's Transporters" was defined as follows:

> any owner or owners of pipeline facilities, or other transporters having access to pipeline facilities by arrangement or agreement with the owner, either directly or indirectly, with whom Buyer, an Affiliate of Buyer or any other Person on behalf of Buyer, contracts for the transportation of the Gas purchased by Buyer from Seller hereunder from the Delivery Point to the Project Facility, or to such other point as Buyer may determine from time to time, including but not limited to TCPL and Union Gas.

Another clause in the contract also spoke to this issue (s.6.03):

> Buyer shall be responsible for obtaining firm transportation service on the TCPL System and the Union System for the transport of the Gas subject to this Agreement from the Delivery Point to the Project Facility, or such other ultimate destination as may apply in the circumstances.

Given the depressed state of the market and the possibility of recovery over the course of the contract, Apache was clearly concerned to protect itself from a scenario in which TAU purchased gas at the contract price and then re-sold it at the market price. To address that concern the contract included a clause dealing with the "Alternate Use of Gas". Part (a) of that clause addressed the scenario in which TAU did not require the gas for its Windsor facility but where it, or an affiliated company, required the gas for another facility. Part (a) clearly permitted TAU to reallocate the purchased volumes in accordance with this clause. Part (b) dealt with contract volumes not required by the Windsor facility or by TAU affiliates, in which case TAU was required to offer the volumes back to Apache for it to re-purchase at the contract price. Only if Apache failed to exercise that option (the right of first refusal (ROFR)) was TAU to be free to sell the gas to others. The text of these clauses provided as follows:

> 2.05 Alternate Use of Gas
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> (a) Notwithstanding anything in this Agreement to the contrary, *if Buyer does not require Gas to be available for purchase by it hereunder for the Project Facility*, Buyer shall have the right to nominate for and receive all volumes of Gas up to the DCQ, to the extent not required at the Project Facility, for utilization at such other project facilities as it may require in which either Buyer or its Affiliates have a material interest, or, subject to the provisions of this Section 2.05, or for the re-sale of such Gas to such persons as it deems appropriate. All other terms and conditions of this Agreement shall apply with respect to such sale of Gas.
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> (b) *If any volumes of Gas in excess of those required for the Project Facility are not required by Buyer or its Affiliates*, such Gas shall be made available to Seller for re-purchase by it at Buyer's cost thereof (taking into account whether or not Seller charges Buyer with the NOVA Charges applicable to such Gas) determined at the Delivery Point. If Seller does not elect to re-purchase such excess Gas on that basis within two (2) business day [sic] of it being offered by Buyer to Seller, Buyer or its Affiliates shall be free to sell such Gas to any other person(s) on terms and conditions no more favorable to such person(s) than those offered to Seller (emphasis supplied).

As TCPL's mainline tolls increased over the duration of the contract TAU began to explore different transportation options eventually concluding (by 2006) a series of swap arrangements (effected through a series of 8 purchase and sale transactions) in which TAU swapped gas at Empress in return for delivery of other gas at the Dawn hub in Sarnia for onward shipment to the Windsor facility (hence the "synthetic transportation" term used in the title to this post). Apache argued that the agreement required physical delivery of the particular gas, and, that absent such transportation and delivery, that its ROFR had been triggered and that, had it been aware of what was happening, it would have exercised that right. Having been denied that option it alleged that it suffered losses in excess of $8 million.

Master Robertson decided in favour of TAU on, I think, three main grounds.

The first ground was that while the contract did make reference to the transportation of the purchased natural gas through the facilities of TCPL and Union these references could not be interpreted as a covenant by TAU to use those facilities for several reasons. First the definition of "buyer's transporters" made it clear that the reference to TCPL and Union was not exhaustive of the transportation possibilities open to TAU. Second, and more generally, a contextual interpretation of the contract was that the on-going transportation of the natural gas ex-Empress was TAU's responsibility. TAU was obliged to provide firm take away capacity but that should not be interpreted as a covenant that it use particular facilities. In one particular scenario at least (a TAU affiliate seeking to use the natural gas in Alberta), there would clearly be no need to use either TCPL's main line or the Ontario facilities of Union Gas.

The second ground, was that, to the extent that Apache's argument was based on the idea that TAU was obliged to transport this particular gas to its Windsor facility absent which the ROFR was triggered, that must be wrong since both parties must have understood (see especially at paras 15 – 19 & 72) that, unlike oil, natural gas is not batched for delivery but is instead commingled as soon as it is in the pipeline. Thus, there could be no expectation that TAU would transport these particular molecules to its Windsor facility.

And third, the trigger to the ROFR under both paragraphs (a) and (b) of s.2.05 (see italicized text above), was the idea that the natural gas was not required by either the Windsor facility or by any other facilities of TAU or its affiliates. The natural gas was in fact required for the Windsor facility because the gas delivered at Empress provided the essential underpinning for the delivery of other gas at Windsor. Master Robertson put it this way in the substantive concluding paragraph (at para 85) of his well-reasoned and commercially realistic judgment:

> Apache concedes that TransAlta required the volumes of gas for the project facility in Windsor. TransAlta then used all of this fungible commodity – these "volumes of Gas" - to arrange for equivalent amounts of gas to be delivered to the facility project in Windsor, and not for any other purpose. There were no "volumes of Gas in excess of those required for the Project Facility ... not required by Buyer." Therefore, the right of first refusal was not triggered. The agreement was not breached.