

NEP Canada awarded \$185 million Judgement in Post-Acquisition Dispute

FTI Case Overview

Overview of the Dispute

The assets which are the subject of this dispute involve a number of oil fields in Alberta. Those assets included wells, pipelines and facilities in the Pembina field, the Leduc-Woodbend field and others.

NEP acquired the equity (associated with the assets) for \$175 million through a Share Purchase Agreement with MEC dated August 18, 2011, which closed on September 30, 2011.¹ Shortly after closing, NEP discovered that among other things, the assets were plagued by numerous longstanding regulatory non-compliances.²

The review of the pipeline infrastructure acquired by NEP revealed that MEC OpCo “(i) had operated pipelines in contravention of its licences; (ii) had not properly discontinued or abandoned pipelines; and (iii) had not maintained proper depth of cover on a number of pipelines. The evidence is that approximately 90 percent of MEC OpCo’s pipelines were improperly licensed.”³ “NEP also discovered that MEC OpCo had not discontinued or properly abandoned pipelines that were no longer in operation.”⁴

The Court found that NEP had proven, on a balance of probabilities, that i) there was a breach of contract, for which NEP was entitled to damages; ii) that half-truths and positive misrepresentations by the Defendants amounted to fraudulent misrepresentations and deceit in respect of the Share Transaction; and, iii) “that Merit breached its duty to perform in good faith when it failed to disclose ongoing regulatory non-compliances within MEC OpCo to NEP.”⁵

Damages – Loss of Opportunity

The Court noted that “NEP’s underlying claim is that had it been able to follow its expressly intended plan, it could have sold the Transaction Assets at their Fair Market Value in 2014. However, because of deceit and misrepresentation by Merit, NEP was not in a position to monetize the Transaction Assets until 2016 at the earliest, by which time commodity prices had dropped dramatically and the oil and gas business environment had changed substantially.”⁶

FTI “determined the fair market value of the Transaction Assets as at June 2014 and December 2014, and set it as the first bookend. . . . To do so, FTI estimated the value that NEP’s assets would have had in 2014 had it been able to achieve December 2016 production by 2014.”⁷ This reflects the progress that NEP would have made “but for” the actions of the Defendants.

¹ NEP Canada at para 232 and 699

² NEP Canada at para 233

³ NEP Canada at para 239

⁴ NEP Canada at para 251

⁵ NEP Canada at paras 750, 924, 973

⁶ NEP Canada at para 1165

⁷ NEP Canada at para 1167

Then, since NEP owned the assets at the time of FTI's initial reports, FTI determined the fair market values of the December 2016 reserves in 2017, the then current date. In order to arrive at the loss of opportunity, FTI deducted this from the 2014 values. Messrs. Mizrahi and Helkaa provided testimony at trial in respect of this evidence.

In 2018, NEP sold the assets and the trial was reopened. FTI provided a report outlining an opinion on how the sale transaction impacted its calculation of damages. Mr. Mizrahi provided testimony at trial in respect of the transaction and the loss of opportunity.

FTI demonstrated "that the actual damages claimed by NEP for the 'Loss of Opportunity' were understated in the original trial. Rather than a range of \$250,000,000 to \$391,000,000 that was initially claimed (with a midpoint of \$320,500,000), the actual loss suffered," based on the crystallizing event of the asset sale, was between \$274 million and \$416 million (with a midpoint of \$345 million).⁸

Damages Decision

The Court "found Mr. Mizrahi to be an extremely qualified expert in respect of: (i) the proper methods for the valuing oil and gas companies and their assets, generally; (ii) market conditions at relevant points in time; and (iii) the value of NEP and its assets at relevant points in time."⁹ The Court deemed the midpoint of \$345million determined by FTI to be appropriate.¹⁰

Similarly, the Court accepted Mr. Helkaa's evidence, including on the way market trends impacted valuations at various points in time. For instance, in respect of the issue of whether the "but for" values would have changed if development were delayed, the Court stated "As Mr. Helkaa explained, despite the drop in spot oil prices in late 2014, the values of oil and gas assets in the transactional market

did not begin to materially decline until the third quarter of 2015. I accept this evidence. Therefore, in my view, there is no material difference between the range calculated as at June 30/December 31, 2014 (the 2014 FMV) and April 30, 2015."¹¹

In quantifying damages for loss of opportunity, courts consider the probability of securing the lost benefit and apply the probability measure to the value of the lost benefit.¹² In this case, the Court identified factors such as timing (i.e. of development and resale) and fluctuations in oil and gas commodity prices in its discussion of contingencies. The Court applied 35% to the loss of opportunity damages. As a result, the Plaintiff was awarded \$120.8 million (\$345 million x 35%) with respect to the loss of opportunity.¹³

In addition to this, the Plaintiff was awarded damages for remediation, shut-in production, and borrowing costs, bringing total damages to \$184.6 million.

FTI's Team of Experts

Neal Mizrahi is a Senior Managing Director in FTI's Economic and Financial Consulting in Toronto group specializing in damages and the quantification of economic losses. Deryck Helkaa is a Senior Managing Director in FTI's Corporate Finance group in Calgary focusing on distressed oil and gas companies operating in Western Canada.

⁸ NEP Canada at para 1055

⁹ NEP Canada para 1065

¹⁰ NEP Canada para 1223, 1224

¹¹ NEP Canada at para 1223

¹² NEP Canada at para 1225

¹³ NEP Canada at paras 1231, 1232, 1224

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