Court of Queen's Bench of Alberta

Citation: Marathon Canada Limited v. Enron Canada Corp., 2008 ABQB 408

Date: 20080702
Docket: 0201 07692
Registry: Calgary

Between:

Marathon Canada Limited

Plaintiff
(Defendant by Counterclaim)

\- and -

Enron Canada Corp.

Defendant
(Plaintiff by Counterclaim)

\- and -

Marathon Oil Company and Husky Oil Operations Limited

(Defendants by Counterclaim)

Reasons for Judgment
of the
Honourable Mr. Justice T.F. McMahon

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I. Introduction

(a) The Parties

[1] Both this claim and the counterclaim arise out of a natural gas purchase Agreement dated January 30, 1995 ("the Agreement"), between Enron Capital and Trade Resources Canada Corp. ("ECT") as buyer and Tarragon Oil and Gas Limited ("Tarragon") as seller. The Plaintiff (Defendant by counterclaim) in these proceedings Marathon Canada Limited ("Marathon Canada") is the successor to Tarragon by a plan of arrangement.

[2] Marathon Canada was a wholly owned subsidiary of Marathon Oil Company ("Marathon US") when this action began. The Defendant (Plaintiff by counterclaim) in these proceedings Enron Canada Corp.("Enron Canada") is the successor to ETC. Enron Canada was, at all relevant times, an indirect subsidiary of Enron Corp. a US company.

[3] Also named as Defendants by counterclaim are Marathon US and Husky Oil Operations Limited (“Husky”). The latter indirectly acquired all the shares of Marathon Canada from Marathon US during the course of this litigation and Marathon Canada was dissolved. All three Defendants by counterclaim were represented at trial by the same counsel and no issue arose among them.

[4] All payment obligations of ECT under the Agreement were guaranteed to a maximum of ten million dollars by Enron Corp., pursuant to a guarantee also dated January 30, 1995. By a guarantee dated March 15, 2000, Marathon US guaranteed all payment obligations of Marathon Canada under the Agreement to a maximum of sixteen million dollars.

(b) **The Agreement**

[5] The Agreement, generally referred to as the master Agreement, contemplated that the parties would, from time to time, enter into confirmation letters which would specify the details of each transaction under the master Agreement including the price, volume (DCQ or daily contract quantity), period of delivery and delivery point.

[6] Two “packages” or transactions were agreed to under this master Agreement. Package one was for 7,500 MMBtu’s per day from February 1, 1995 to November 1, 2014 for a fixed escalating price. Package two was for a further 7,500 MMBtu’s per day from April 1, 1995 to November 1, 2014, also for a fixed escalating price.

[7] By an Agreement reached on August 28, 1997, package one was terminated by a payment by ECT to Tarragon of $4.1 million. At trial then, only package two was in issue under the master Agreement.

(c) **The Claim**

[8] Marathon Canada claims to have properly terminated the Agreement effective December 1, 2001 whereupon it ceased the delivery of gas. It was not paid for the November 2001 deliveries in the amount of $560,007.94 and sues for that amount, plus interest.

[9] It seeks as well a declaration that it validly terminated the Agreement. Enron Canada does not dispute the amount claimed and admits that it was not paid.

[10] Enron Canada claims that the termination of the Agreement by Marathon Canada and its cessation of gas delivery was not valid. By its counterclaim, Enron Canada alleges that as a consequence, it had to purchase replacement gas for a period of time on the “spot” market at higher prices. It claims damages for that alleged breach. It alleges further that it later validly terminated the Agreement because of Marathon Canada’s failure to deliver gas and that it is entitled to liquidated damages as defined in the Agreement. Depending upon several factors, Enron Canada’s claim varies upwards to about $126 million including contractual interest to January 31, 2007.

Conclusion

[11] I find that Marathon Canada lawfully terminated the Agreement effective December 1, 2001. Marathon Canada is entitled to damages as hereinafter set out. The counterclaim of Enron Canada is dismissed.

II. Relevant Provisions of the Agreement

[12] Collected here are the primary terms of the Agreement relied upon by one party or another.

ARTICLE 1.
DEFINITIONS

Material Adverse Change

[13] "Material Adverse Change" means (i)with respect to Buyer, Enron Corp. shall have long-term debt unsupported by third part credit enhancement that is rated by Standard & Poors below BBB-; or (ii)with respect to Seller, Seller shall have any of the following:

(a) Funded Debt at any one time which exceeds 100% of Net Worth; or

(b) Net Worth below $225 million; or

(c) No availability under its third part credit facilities to post a Letter of Credit in the amount of Liquidated Damages that would then be owed hereunder (notwithstanding whether a Triggering Event has occurred) or to deposit equivalent in value collateral (and proceeds thereof) as security for the payment of such Liquidated Damages to Buyer; or

(d) Cash Flow Ratio less than 2.0 to 1.0 at the end of any fiscal quarter.

ARTICLE 9.

Defaults and Remedies

[14] **9.1.** Early Termination

If a Triggering Event (defined in Section 9.3 below) occurs with respect to either Party at any time during the term of this Agreement, the other party (the "Notifying Party") may, upon two Business Days' written notice to the first Party, and which

notice shall be given no later than sixty Days after the occurrence of the Triggering Event, establish a date on which this Agreement will terminate (the "Early Termination Date"), except as provided in Section 15.2 hereof. Notwithstanding the foregoing, if a Triggering Event occurs, the Notifying Party may in its sole discretion (without waiving any of its rights to later declare an Early Termination Date) agree, as a condition to continuing to perform its obligations under this Agreement, to accept from the Affected Party (defined in Section 9.3) (i)a letter of credit, (ii)cash prepayments, or (iii)other security in a form acceptable to the Notifying Party.

[15] **9.2.** Liquidated Damages

If an Early Termination Date occurs, the Notifying Party shall in good faith calculate its Liquidated Damages resulting from the termination of this Transaction. For the purposes of Article 9, the term liquidated damages ("Liquidated Damages"), with respect to the Notifying Party, shall mean the present value of the economic loss, if any, (including any costs and minus the present value of the economic gain, if any) deemed to have been suffered by the Notifying Party in securing a replacement contract as a result of the termination of the Parties' obligations under this Transaction. The present value of the economic loss deemed to have been suffered by the Notifying Party resulting from the termination of the Parties' obligations under this Transaction will be determined by subtracting (a) the present value of the remaining term, quantities and prices under this Transaction had it not been terminated (the "Present Value of the Remainder of the Transaction") from (b) the present value of the replacement contract for the remainder of the Period of Delivery (the "Present Value of the Replacement Contract"). For both (a) and (b), the Notifying Party shall not include the AECO "C" - Empress Transportation Charge in its calculations.

(a) The Present Value of the Remainder of the Transaction shall be calculated as follows:

For each Month remaining in the Period of Delivery, multiply the number of Days in the applicable Month by the DCQ to obtain the total monthly volume and multiply the total monthly volume by the Canadian dollar per GJ price, which is set out in the Confirmation Letter as the Contract Price for the Applicable Month. This total monthly price shall then be multiplied by the average of the three monthly discount factors that are derived from the Canadian interest rate swap curves obtained from three leading dealers in the interest rate swap market (the "Monthly Discount Factor"). The result is the Present Value of the Remainder of the Transaction for the applicable Month. Finally, add up the Present Value of the Remainder of the

Transaction for each Month to obtain the total Present Value of the Remainder of the Transaction.

(b) The Present Value of the Replacement Contract shall be calculated as follows:

For each Month remaining in the Period of Delivery, the Notifying Party shall obtain a quote from each of three leading dealers in the energy swap market for: a NYMEX gas futures contract swap, a US -Canadian dollar currency swap, the Canadian Government yield curve, and a Henry Hub-Empress basis differential swap, each for the remaining Period of Delivery under this Transaction. The Notifying Party shall take the four quotes from each of the dealers and do the following calculations: For each dealer's quote: begin with the NYMEX quote in US dollars per MMBtu, subtract from it the basis differential quote in US dollars per MMBtu (unless the basis differential quoted for the applicable Month is positive, indicating that intra-Alberta Gas is more valuable than Gas at Henry Hub, Louisiana, in which case, add the basis differential quote in US dollars per MMBtu); multiply that figure by the MMBtu to GJ conversion factor; multiply that figure by the US/Canadian dollar currency swap figure, and the result of these calculations will yield a Canadian dollar per GJ price for the applicable Month, multiply the number of Days in the applicable Month by the DCQ to obtain the total monthly volume and multiply the total monthly volume by the Canadian dollar per GJ price. This total monthly price shall then be multiplied by the Monthly Discount Factor for such Month. The result is the Present Value of the Replacement Contract for this Transaction for the applicable Month. Finally, add up the Present Value of the Replacement Contract for each Month to obtain that dealer's quote for the total Present Value of the Replacement Contract for this Transaction. The average of the three dealer's quotes shall be the Present Value of the Replacement Contract for this Transaction.

(c) If Seller is the Notifying Party, Seller shall use the procedure set forth this Section 9.2, and the quotes from the three leading dealers shall be for a NYMEX gas futures contract swap bid, a US-Canadian dollar currency swap offer and a Henry Hub-Empress basis differential swap bid.

If the remaining Period of Delivery in this Transaction is longer than five years, Seller shall obtain three bids for Henry Hub-Empress basis differential swaps for the five years immediately following the date of the bids and average those three bids (the "5-Year Basis

Differential Bid”). An escalation factor of 5% per calendar year shall be multiplied by the 5-Year Basis Differential Bid, and the absolute value of that product shall be subtracted from the 5-Year Basis Differential Bid to determine the deemed Henry Hub-Empress basis differential bid for the sixth year. Each subsequent calendar year’s deemed basis differential bid shall be calculated in the same manner, using a 5% escalation factor and the previous calendar year’s deemed basis differential bid. If Seller is the Notifying Party, the deemed basis differential bid will become more negative.

______(d) If Buyer is the Notifying Party, Buyer shall use the procedure set forth in this Section 9.2, and the quotes from the three leading dealers shall be for a NYMEX gas futures contract swap offer, a US-Canadian dollar currency swap bid and a Henry Hub-Empress basis differential swap offer.

____________If the remaining Period of Delivery in this Transaction is longer than five years, Buyer shall obtain three offers for Henry Hub-Empress basis differential swaps for the five years immediately following the date of the offers and average those three offers (the average being the “5-Year Basis Differential Offer). An escalation factor of 5% per calendar year shall be multiplied by the 5-Year Basis Differential Offer, and the absolute value of that product shall be added to the 5-Year Basis Differential Offer to determine the deemed Henry Hub-Empress basis differential offer for the sixth year. Each subsequent calendar year’s deemed Henry Hub-Empress basis differential offer shall be calculated in the same manner, using a 5% escalation factor and the previous calendar year’s deemed Henry Hub-Empress basis differential offer. If Buyer is the Notifying Party, the deemed Henry Hub-Empress basis differential offer will become more positive.

______(e) If any calculation of Liquidated Damages results in a net gain due to the Notifying Party, damages shall be deemed to be zero. The Notifying Party shall give the Affected Party notice of the Notifying Party’s Liquidated Damages, if any, accompanied by a statement in reasonable detail stating how the amount was calculated. The Affected Party shall pay such Liquidated Damages to the Notifying Party within ten Days of receipt of such notice. At the time for payment of any amount due under this Article 9, each Party shall pay the other Party all additional amounts payable by it pursuant to this Agreement, but all such amounts shall be netted and aggregated with any Liquidated Damages payable hereunder.

[16] **9.3.** Triggering Event shall mean with respect to a Party (the "Affected Party"):

(h) the occurrence, in the reasonable opinion of the Notifying Party, of a Material Adverse Change of the Affected Party; provided that such Material Adverse Change shall not be considered to be a Triggering Event if the Affected Party establishes, and maintains throughout the term hereof, a Letter of Credit (naming the Notifying Party as the beneficiary thereof) in an amount equal to the greater of (i)the Notifying Party's Liquidated Damages or (ii)if the Notifying Party is the Seller, the aggregate of the amounts Seller is entitled to receive during the sixty-Day period preceding the Material Adverse Change. The amount of such Letter of Credit shall be adjusted quarterly if necessary, to cover the Notifying Party's Liquidated Damages at that point in time; or

[17] **9.6** Collateral Requirement

If at any time and from time to time during the term of this Agreement (and notwithstanding whether a Triggering Event has occurred), the sum total of the Liquidated Damages that would be owed to a Party (the "Beneficiary Party") should exceed $10 million, with respect to Liquidated Damages that would be owed by Seller or $15 million, with respect to Liquidated Damages that would be owed by Buyer, the Beneficiary Party may request the other Party (the "Account Party") to establish a Letter of Credit in an amount equal to the Liquidated Damages in excess of such amounts or to deliver such other collateral as may be reasonably acceptable to the Beneficiary Party. The Letter of Credit or other collateral must be delivered within ten Days of the date of such notice. Upon the request of the Beneficiary Party, any such Letter of Credit shall be increased or reduced correspondingly to the amount of such excess Liquidated Damages. To calculate Liquidated Damages for the purposes of Section 9.6, the Parties agree: That the procedures set forth in Section 9.2 shall be used to calculate Liquidated Damages for the purposes of Section 9.6, except that the Beneficiary Party shall obtain both bids and offers from three leading dealers in the energy swap market for a NYMEX gas futures contract swap, a US-Canadian dollar currency swap and a Henry Hub-Empress basis differential swap. The Beneficiary Party shall use the mid-point between each bid and offer as the relevant quote from each dealer; and if the remaining Period of Delivery in this Transaction is longer than five years, the Beneficiary Party shall obtain three bids and offers for Henry Hub-Empress basis differential swaps for the five years immediately following the date of the bids and offers, average the three mid-points and such average shall be the deemed Henry Hub-Empress differential for the remaining Period of Delivery. No escalation factor shall be applied.

ARTICLE 11

Succession and Assignment

[18] **11.1.** Transfer or Assignment

Neither Party shall assign this Agreement without prior written approval of the other Party, which may be withheld or given entirely at the option of such Party; provided, however, either Party may assign its interest hereunder to any of its Affiliates without the prior written approval of the other Party, but no such assignment shall operate to relieve the assigning Party of its obligations hereunder.

ARTICLE 15

Miscellaneous

[19] **15.5** Merged Document

This Agreement, the Exhibits hereto, and the Confirmation Letter constitute the entire Agreement between the Parties hereto. There are no prior or contemporaneous Agreements or representations affecting the subject matter hereof other than those herein expressed. No amendment, modification or change to this Agreement shall be enforceable, except as specifically provided for in this Agreement, unless reduced to writing and executed by both Parties.

[20] **15.10.** Preparation

This Agreement was negotiated and prepared by both Parties hereto with advice of counsel to the extent deemed necessary by each Party, and was not prepared by any Party to the exclusion of the other, and, accordingly, shall not be construed against either Party by reason of its preparation.

III. Definition of Terms:

[21] An understanding of some of the terms used in evidence and in this judgment is necessary.

1. In the money/out of the money

A seller is said to be in the money under a gas purchase contract when, at a given point in time, the contract price at which it sells its gas is above the then current market price. At that time the buyer is out of the money because it is paying more for

the gas purchased under the contract than it would at current market prices. The roles are reversed when the contract price is below the current market price.

2. <u>Mark to market evaluation</u>

There is an active market among dealers (Enron Corp. and its related companies were among the largest) in the buying and selling of natural gas contracts. The price of gas moves virtually constantly. Dealers must value their positions under each contract against daily movement in the market price for gas comparable in quantity, delivery point and term. The mark is the contract price. A report filed by Stanley Wong, a consultant retained by Enron Canada, said at paragraph 57:

> Mark to market simply measures the extent to which contract price is above or below the current market value of a comparable contract. It is the standard method used by parties to value natural gas contracts for purposes of a monetization between parties (unwinding the transaction by payment equivalent to the difference between contract price and market value) or sale of the contact to a dealer. This method is also used to value contracts for the forward sale (or purchase) of other tradable commodities and financial derivatives.

3. <u>One-way and two-way contracts</u>

Gas purchase contracts typically contemplate payments to be made by a party upon early termination - ie: termination before the end of the contract term. Early termination can occur when a "Triggering Event" or an "event of default" has occurred and the non-defaulting party chooses to terminate the contract. T. J. Nakaska, an accountant with PriceWaterhouseCoopers Inc., provided the simplest explanation in a report filed by him.

He states that under a two-way contract:

> It does not matter how the Triggering Event or the Event of Default occurred (or who was at fault). On termination, the counter party who is "out of the money" pays the counter party who is "in the money.

Under a one-way contract, if the defaulting party is out of the money, it must pay that amount to the counter party who is in the money. However, if it is the non-defaulting party who is out of the money, the contract does not call for the non-defaulting party to make that payment. Witnesses referred to this scenario as a "walk away" provision.

4. NYMEX

NYMEX means New York Mercantile Exchange which has a trading pit for numerous energy contracts, including a group of natural gas contracts for future delivery at Henry Hubb, Louisiana.

5. Henry Hubb

Henry Hubb is a location in Louisiana, U.S.A. where several gas pipelines interconnect.

IV. Factual History

[22] Performance of the Agreement proceeded reasonably smoothly until the fall of 2001 when the troubled affairs of Enron Corp. in the United States began to play out on the business pages of newspapers and in electronic media across North America. In August, the Chief Executive Officer of Enron Corp., Jeffrey Skilling, resigned. In October, the Chief Financial Officer of Enron Corp., was fired. The share price of Enron Corp. fell rapidly. Its financial statements for prior periods were restated. On November 9, 2001, a proposed merger of Enron Corp. with Dynegy Inc. (another energy marketer and dealer) was announced. At the same time, Marathon US and Marathon Canada began considering their options under this Agreement if a default or assignment occurred.

[23] Also, on November 9, 2001, Standard and Poors, a credit rating agency, lowered its long term corporate credit rating on Enron Corp. to BBB-, which is the lowest of its investment grade ratings. Marathon US and its related companies had extensive dealings with Enron Corp. and its affiliates. Hence, the Marathon US credit group closely monitored Enron Corp's deteriorating financial status. The information was shared with employees of Marathon Canada, including a recommendation on November 21, 2001 by the credit group that future credit with Enron Corp. be suspended effective December 1, 2001.

[24] The pace of events then accelerated. On November 27th the manager of Natural Gas Marketing at Marathon US, Dan Mowrey, informed Elsie Biever, Marathon Canada's manager of Natural Gas Marketing, and Dave Causey, Supervisor of Credit of Marathon US that he wished to have the Agreement with Enron Canada terminated should Enron Corp's rating fall to junk bond status. Mr. Causey acknowledged that he and Ms. Biever had discussed preparing a notification letter in advance to respond quickly "if the opportunity arises". The obvious inference is that the event was seen as an "opportunity" and not a problem because Marathon Canada was then out of the money on that Agreement in the order of $70 million.

[25] On November 28, 2001, Dynegy abandoned its proposed merger. On the same day, and with the collapse of the Dynegy merger, Standard and Poors cut Enron Corp.'s ratings to junk bond status, that is, below BBB-. In fact, it was not a slippage of just one notch to BB+ but a free fall 6 notches to B-. The news was communicated immediately to Marathon Canada. A few days later, Enron Corp.

filed for Chapter 11 Re-organization with a US Bankruptcy court and soon thereafter it closed its doors.

[26] Within about one hour of learning of the Standard and Poors down grade to junk bond status on November 28th, Marathon Canada faxed a letter to Enron Canada alleging a material adverse change and terminating the Agreement effective 8 a.m., December 1, 2001.

Specifically, the letter said:

> It has come to Marathon's attention that a Triggering Event (as defined in the Agreement) has occurred; in particular, it is Marathon's reasonable opinion that there has been an occurrence of a Material Adverse Change (as defined in the Agreement) with respect to Enron, in that Enron Corp. has, as of November 28, 2001, long-term debt unsupported by third party credit enhancement that is rated by Standard & Poors below BBB-.
>
> As a result, Marathon hereby gives notice, in accordance with Section 9.1 of the Agreement, that the Agreement shall terminate as at 08:00 hours on December 1, 2001, that being the end of the November 30, 2001 gas day.
>
> Pursuant to Section 9.2 of the Agreement, Marathon hereby also gives notice that the calculation of the Liquidated Damages suffered by Marathon by virtue of the early termination of the Agreement results in a net gain due to Marathon. Pursuant to Section 9.2(e) of the Agreement, because the calculation of Liquidated Damages results in a net gain due to Marathon, damages shall be deemed to be zero.

[27] On November 30th , Enron Canada responded that it was solvent and that no Triggering Event had occurred.

[28] Enron Canada, on November 30, 2001, brought a stay application in Alberta under the *Canada Business Corporation Act*, R.S.C. 1985, c. C-44 - first ex parte and then on notice in a bid to rescue its business. A large number of its counter parties had terminated or had threatened to terminate contracts. The application was unsuccessful and Enron Canada began to wind down its affairs.

[29] Enron Canada then purported to terminate the Agreement effective December 18, 2001 as a result of Marathon Canada's actions but the letter referenced the wrong Agreement. On December 31, 2001 Enron Canada again purported to terminate - this time the correct Agreement - effective January 2, 2002. Then, on April 15, 2002, Enron Canada wrote that if it's earlier termination was, for some reason, ineffective, it was now terminating effective April 17, 2002 for non delivery of gas.

In due course this litigation followed.

V. Enron Canada's Financial Position

[30] Enron Canada was described by its President, P.R. Milnthorpe, (2000-2002) as one of the largest traders and market makers of natural gas and power in Canada. It was the "crown jewel" in the Enron world.

[31] In 2001, it was on track to post mark to market earnings exceeding $500 million. It dealt with hundreds of counter parties and was involved in more than 10 thousand transactions in a year. Mr. Milnthorpe was succeeded as President by Mr. Kitagawa. He had been the company's Treasurer since 1996 and retained that title when he became President until his departure in March 2003. It was he that negotiated the Agreement with Tarragon. He said the net asset value of Enron Canada in November, 2001 was $2 billion of which about $1.1 billion was comprised of in the money third party trading contracts. The balance represented inter company receivables and contracts.

[32] The third party contracts numbered 277 in November 2001, of which about 100 were terminated by the counter parties, including Marathon Canada, in late November and early December. By February, 2002 Mr. Kitagawa's role was to wind down the operation of Enron Canada and "monetize" its trading contracts. Those contracts that weren't settled by payment to or by Enron Canada might be sold and assigned to another third party. The value of a contract at a given point in time was determined by a mark to market valuation based on forward curves. Mr. Kitagawa described a forward curve as:

> A forward curve is the market consensus of the expected future prices of a commodity. Typically, it's done one month in advance and it can go out for twenty years. So, it is basically the month to month price of the commodity in the future. It's anchored by actual transactions in the market place, and it is the consensus view of the market makers and market participants of what the expected future prices of the commodity are going to be.
>
> Q. Sir, I'm sorry, what do you mean by "future prices are anchored by actual transactions? What do you mean by "anchored?
>
> A. "Participants actually transact in the future or they will transact for multi year terms which gives us an indication of the expectations of buyer and seller in terms of pricing in the future. So, market makers basically derive the curves off of actual transactions that occur in the market place as well as the market consensus of the market makers."
>
> Q. And, sir, in your experience during your time at Enron Canada, what access to information did Enron Canada have to formulate its forward curves?
>
> A. Enron Canada has probably the most comprehensive access of any participant in North America. We had access to Enron North America's forward curves for natural gas and power, and since they were the largest trader of natural gas and power in North America, those would likely be the most accurate data base of information on forward curves available in the market place.

[33] The difference between the contract price and the market price as projected is multiplied by the contract volume and the sum then discounted at projected discount rates. The result is a mark to market value on that day of the remaining volumes in the contract. Once Mr. Kitagawa had a value of a contract, he could either attempt to settle with the counter party or sell the contract (if the contract permitted assignment) to another party - thus, "monetizing" the contract.

[34] In late November, 2001, Enron Canada engaged the accounting firm PriceWaterhouseCoopers Inc. to do an independent review of the Enron Canada financial position to provide "comfort" to creditors and counter parties.

[35] When Enron Canada began its CBCA proceedings, PriceWaterhouseCoopers was prepared to be appointed monitor but that did not occur.

[36] The review presented these conclusions:

1. At December 31, 2001, the unrestricted cash balance available to Enron Canada was $68 million.

2. At that date, Enron Canada had no bank debt nor any outstanding letters of credit.

3. Enron Canada calculated that its third party contracts had a mark to market value in its favor of approximately of $498 million on November 11, 2001. PriceWaterhouseCoopers could not verify that value and recognized that Enron Canada might not be able to settle or sell those contracts for that much. Nevertheless, there seemed to be considerable value in those contracts.

4. Enron Canada Power Corp. (ECPC) was a wholly owned subsidiary of Enron Canada and was in the process of selling a power purchase Agreement from which it would net $141.1 million. Those proceeds were available to Enron Canada.

[37] Thus, it appears that Enron Canada had the ability to continue its profitable business had Enron Corp. not failed. It also had the ability to post security for payment to Marathon had it been demanded by Marathon. There was one element of uncertainty. Enron Canada reported its cash position to Enron Corp. From time to time, Enron Corp. would withdraw money from Enron Canada's account. It could so unilaterally at least until some time in November, 2001 when Enron Canada put a stop to the practice. Whether Enron Canada could have maintained that position over the longer term or against creditors of Enron Corp. is a question that never had to be answered.

VI. Admissibility of Certain Opinion Evidence

[38] Objection was taken by both parties from time to time in respect of the reports of the other parties' experts on the basis that the expert opined on the ultimate issue and offered an interpretation of various contract terms and provisions.

[39] After argument and consideration of the authorities provided, I made the ruling which now follows.

[40] It is generally accepted that if opinion evidence is to be excluded it is not because it encroaches on what used to be known as the ultimate issue doctrine, but for other reasons, such as relevance and necessity: ***R. v. Mohan*** [1994] 2 S.C.R. 9 at 25.

[41] Where the court can draw necessary inferences or conclusions from established facts, opinion evidence is not necessary to assist the court. Mere helpfulness is not enough to allow expert evidence - it must be necessary: **R. v. D.D.** [2000] 2 S.C.R. 275 where Major, J. approves a statement of the rule by Professor D. Paciocco in a 1998 article by him.

[42] There is seldom a clear line of demarcation between what is necessary and what is not. The closer the opinion comes to an opinion on the ultimate issue, the stricter the need to show necessity. It is generally not the role of an expert to draw legal conclusions or to engage in a legal analysis: ***Hovsepian v. Westfair Foods Ltd.***, 22 Alta. L.R. (4th) 241. On the other hand, it is trite to say that no contract is made in a vacuum. Evidence of the commercial context, the commercial purpose or the commercial setting of the contract is admissible within limits: ***Reardon Smith Line Ltd. v. Yngvar Hanson-Tangen*** [1976] 1 W.L.R. 989 at 995 (H.L.); ***Bank of British Columbia v. Turbo Resources Ltd.***, (1983) 148 D.L.R. (3rd) 590 at para 607-08 (Alta.C.A.); ***Gainers Inc. v. Pocklington Financial Corp***. [2008] A.B.C.A. 151.

[43] Opinion evidence of industry practice as pleaded here is admissible to explain a written contract where there is ambiguity or where there is silence: ***CP Hotels v. Bank of Montreal***, [1987] 1 S.C.R. 711 at para 774; but not to assist in interpreting an ordinary English word: ***Harris v. Nugent*** [1996] A.J. No. 1068 at para.14.

[44] Opinion evidence is admissible to assist the court in finding the meaning of technical terms in a contract: ***United Canso Oil and Gas Limited v. Washoe Northern Inc.***, (1990)78 Alta.C.A. (2nd) 79 at para. 88. Opinion evidence is also admissible to assist the court when dealing with the unique context of the oil and gas industry: ***Bank of Montreal v. Dynex Petroleum Ltd.***, [2002] 1 S.C.R. 146.

[45] Where there is a standard or common practice in an industry in relation to the performance of contracts that evidence is in some cases admissible. An expert can also opine that a party's conduct was inconsistent with that standard practice. What he cannot do is offer an opinion that a party was therefore at law in breach of its contract.

[46] Upon review of the various experts reports tendered by both sides, I found statements that can be said to offend the rules as I have described them. It was not, however, feasible to sever those statements from the reports in any reasonable way. Many of the experts, for example, offered their interpretation of certain contract provisions in the context of describing industry practice.
I accept that in order to explain industry practice as he or she sees it, the expert must necessarily refer to the contract terms which lead industry players to perform in a certain way. He or she is entitled to state the assumptions made - or the assumptions or opinions made generally in the industry - about the meaning of the contract terms to support or explain industry conduct.

[47] If, of course, as said by Slatter, J. (as he then was) in ***Envirodrive Inc. v. 836442 Alberta Ltd.***, 2005 ABQB 446 at para. 132, those assumptions prove to be wrong, then the opinion would have little value.

[48] I therefore ruled that I would receive the reports in the form provided and deal with any encroachment on these rules in weighing the opinion in my final judgment.

VII. Expert Evidence

[49] Marathon Canada qualified two witnesses to give opinion evidence on liability issues and two others on damage issues pertaining to Enron Canada's counterclaim. Enron Canada qualified three opinion witnesses on liability issues and two others on its damage issues. A very brief summary of their credentials and the substance of their opinions will be useful at this stage.

Enron Canada's Experts

[50] **Vernon Jones**

> Mr. Jones is employed with Grant Thornton LLP in Houston, Texas. He is currently their Director of Economic Advisory Services and provides management and litigation assistance to clients. He has many years of experience in the energy industry and has given evidence on about ten prior occasions. He was qualified to give opinion evidence in the matter of credit and notice practices in the derivatives industry, including in an insolvency or a perceived insolvency context. He offered the opinion that Marathon Canada failed to act in accord with industry practice in terminating the Agreement. He said that in his experience in the industry, Marathon Canada ought to have given Enron Canada the opportunity to cure specific credit worthiness concerns. Mr. Jones, in his report, frequently purported to interpret the Agreement notwithstanding his lack of legal training and on occasion usurped the role of counsel in arguing the case. After the ruling to which I have already referred, his oral evidence was somewhat more restricted.

[51] **J. Stephens Allen**

Mr. Allen is a chartered accountant and a partner in the firm R.S.M. Richter Inc. He has extensive experience in corporate re-structuring, bankruptcies, insolvencies, and receiverships. He has testified many times before Alberta Courts. He has on numerous occasions been appointed by Alberta Courts as a monitor, receiver, or receiver manager in a variety of complex circumstances. He was qualified to give opinion evidence as a chartered accountant with special expertise in insolvency matters. In summary, Mr. Allen offered the opinion that based upon a review of Tarragon and Marathon Canada's financial statements, those entities failed to comply with certain covenants in the Agreement, which failure could be construed as a material adverse change. That later conclusion encroaches upon the Court's task and carries no weight. His interpretation of the financial statements was proper. He opined further that Enron Canada had sufficient resources on November 28, 2001 to post significant security had it been demanded by Marathon Canada.

[52] **J. Robert Broxson**

Mr. Broxson is a Managing Director in Houston, Texas with Lexecon, a subsidiary of FTI Consulting Inc., a business advisory firm. He provides advice to clients in the natural gas and power industries. He has held senior positions with major energy companies in the United States and in Canada. He was qualified to give opinion evidence as to notice and credit practices in the derivatives industry. It was Mr. Broxson's evidence that certain standard industry practice had evolved in respect of gas contracts. He said that industry, in his experience, does not treat a material adverse change as a basis for contract termination without more. It was his opinion that industry practice required Marathon Canada to undertake a dialogue with Enron Canada about its credit concerns and give Enron Canada a reasonable time to satisfy those concerns before terminating the contract. Lastly, he said that Enron Canada could have sold the Agreement in November, 2001 to a third party had it not been terminated.

Mr. Broxson purported to interpret several articles in the Agreement, including Article 9.3(h), which of course is not his function.

[53] **Denise McGlone**

Ms. McGlone has worked in the financial industry for twenty five years. She has built and managed global derivatives units with major financial institutions such as First Chicago Corporation and Security Pacific Merchant Bank. She has been internationally recognized in the risk management business. She was recently Assistant Treasurer at Lucente Technologies in New Jersey. Ms. McGlone was qualified to give opinion evidence regarding the derivatives industry including derivatives industry practice concerning settlement of damages upon termination. She gave very helpful evidence as to the history and development of the derivatives

industry. She offered her opinion that industry practice was to settle damages on a full two way basis even if the contract language suggested a one way settlement. Like Mr. Jones, Ms. McGlone delivered some argument disguised as opinion and I have not been influenced by it.

[54] **Stanley Wong**

Mr. Wong has a undergraduate degree in chemistry and an MBA in Marketing and Finance. He has twenty years experience in gas marketing, transportation and supplies strategies. He has acted as an expert witness in gas marketing contract settlements and evaluations. Mr. Wong was qualified to give opinion evidence on Canadian natural gas industry practice, including the settlement of damages on termination of such contracts and the quantification of damages and its methodology for natural gas forward contracts.

Regarding Enron's counterclaim, Mr. Wong gave his opinion of the damages calculated under the terms of the Agreement. His calculations were made as at four different dates and included mark to market valuations as well as failure to delivery damages pursuant to Article 5.3 of the Agreement.

His conclusions as to damages were:

December 1, 2001 -	$68,737,762.00
December 18, 2001 -	$66,666,000.00
January 4, 2002 -	$65,646,000.00
April 17, 2002 -	$81,503,647.00
(all before interest)	

In its closing argument, Enron Canada did not advance a claim based upon the December 18, 2001 or the January 4, 2002 dates.

Mr. Wong offered an interpretation of Article 9.2(e) which again is beyond his mandate.

<u>Marathon Canada's Experts</u>

[55] **Dr. Laurence Booth**

Dr. Booth teaches corporate finance at the Rotman School of Management, University of Toronto. He holds the C.I.T. Chair in Structural Finance. He is a prolific author in matters of finance and capital markets. He has testified frequently in rate hearings and in civil litigation. He was qualified to give opinion evidence in the area of corporate finance including investment grade and non-investment grade bond ratings. Dr. Booth was called to comment upon the common meaning and significance of Standard and Poors bond ratings

in the context of natural gas sale Agreements. He said that investment grade ratings run from AAA down to BBB-. They are regarded as investments that can be held by financial institutions without any special provisions. The next lowest ratings begin at BB+ and run down to B- . These indicate increasing speculative risk. The last rating is D which arises when a default has occurred. From BB+ and down the ratings refer to non-investment grade securities commonly referred to as junk status.

It was within Dr. Booth's expertise to match the S and P categories to the contract wording. In so far as he then concluded that a material adverse change had occurred, that is a conclusion for the Court to draw.

[56] **John Williams**

Mr. Williams is a chartered accountant and a senior vice- president with KPMG Forensic Inc.. He is responsible for his firm's litigation and forensic practice in western Canada. He has testified in several Provincial Superior Courts and in the Federal Court of Canada. He was qualified to give opinion evidence as a chartered accountant and chartered business valuator. His primary objective was to respond to some of Mr. Allen's opinions and calculations. It was his opinion that even if Enron Canada could have posted substantial security, in November, 2001, that information may not have been available to Marathon Canada since Enron Canada was an indirect subsidiary of Enron Corp. and not a public company.

[57] **Dr. Gordon Sick**

Dr. Sick is a professor of finance at the Haskayne School of Business, at the University of Calgary. He has a BSc in mathematics, masters degrees Mathematics and Business Administration and a PhD in Business Administration. He has taught at Yale University, University of British Columbia, University of Alberta, and the University of Calgary. He has published widely including contributions to textbooks on corporate finance.

He has a special interest in commodity valuation including futures and options. He has given evidence before the Federal Tax Court and before several regulatory boards. Dr. Sick was qualified to give opinion evidence in the area of corporate finance including asset valuation. Dr. Sick's reports were co-authored with a colleague, Mark Cassano, who holds a PhD in Economics from Yale University. Only Dr. Sick testified. Given the completeness of his testimony, I draw no negative inference from counsel's decision to avoid repetitive testimony from Dr. Cassano.

It was common ground that Enron's claim for damages was to be calculated as the difference between:

1. The present value of the payments that would have been made if the Agreement not been terminated, denominated in Canadian dollars, and
2. The present value of the replacement contract for the gas not delivered over the balance of the term of the Agreement, based on futures prices.

The calculation of the first part is not complex. The difficulty in dispute relates primarily to the valuation of the replacement contract (i.e.: the present value of what Enron Canada would have to pay to replace the gas not delivered by Marathon Canada).

Dr. Sick took a markedly different approach than did Mr. Wong.

Dr. Sick gave his opinion of the following data required to calculate the replacement value under the terms of the Agreement:

1. He relied upon NYMEX Gas Futures prices for so long as there were reliable NYMEX quotes that is, about five years. Thereafter, he extrapolated from those prices to estimate futures prices through to the end of the Agreement. For this latter period, he used a Kalman filter model (discussed later).

2. He calculated a US and Canadian dollar currency swap or forward exchange rate as required by the Agreement. This is necessary because NYMEX prices are quoted in US dollars but the Agreement is in Canadian dollars. A forward currency contract is a present contract to buy and sell a certain quantity of foreign currency for a set price at a single pre-determined future time. Because the Agreement contemplates a cash flow payable monthly, a calculation must be made monthly.

3. The Agreement required monthly discount factors derived from Canadian interest rate swap curves. Those discount factors are used to calculate the present value of damages.

Like Mr. Wong, Dr. Sick provided the currency swaps and discount factors for 4 potential termination dates. The actual calculation of damages using this data was left to another witness, Mr. David Vetsch.

Dr. Sick purported to interpret Article 9.2 in his Rebuttal report, but that again is the Court's role.

[58] **David Vetsch**

Mr. Vetsch is a consultant to the oil and gas industry in Calgary, employed with the Ziff Energy Group. He specializes in natural gas issues and has been in the industry

for more than twenty five years. He holds a Bachelor's Degree in Mechanical Engineering and has provided opinion evidence before the Alberta Energy and Utilities Board on several occasions. He was qualified to give opinion evidence as to natural gas contracts, sales, supplies, marketing and markets. In part, using the data provided by Dr. Sick, Mr. Vetsch provided his calculation of Enron Canada's damages under the counterclaim at the same four dates. He also commented upon Mr. Wong's calculation of damages and compared it to his own. His calculations, including failure to deliver damages, was as follows (all exclusive of interest):

December 1, 2001 - $55,212,000.00
December 18, 2001 - $55,821,000.00
January 4, 2002 - $53,998,000.00
April 17, 2002 - $74,575,000.00

On his view that article 9.2(e) of the Agreement created a one way contract, the December 1, 2001 damages would be reduced to zero.

Mr. Vetsch also offered an interpretation of Article 9.2 which is not for him to do.

VIII. The Novel Science Issue

[59] On the issue of the calculation of damages, Enron Canada moved to exclude the evidence of Dr. Sick in so far as it was based upon his use of a Kalman filter model as a predictor of natural gas futures curves. Dr. Sick was qualified to give the evidence addressed in his report. The objection taken was that the methodology used by him was novel in relation to the forecast of natural gas prices and that it did not meet the threshold test for reliability.

[60] Marathon Canada initially argued that the report and opinion should be received and any ruling on novelty be reserved for final judgment in the context of all of the evidence. In response, Enron Canada referred me to ***R. v. J.J.*** [2000] 2 S.C.R. 600, where for the court, Binnie J. said that the admissibility of expert evidence should be scrutinized at the time the evidence is proffered. I ruled that where the challenge to admissibility is founded upon an allegation of a novel technique or method underlying the opinion, the court must first hear the evidence to have the impugned method explained and its novelty or reliability tested by cross-examination. I heard the evidence of Dr. Sick and then ruled that I would hear argument and decide upon the admissibility issue before hearing other evidence, some of which would be based upon Dr. Sick's opinion. After argument, I ruled the evidence was admissible with reasons to follow.

[61] These are my reasons.

It is now common to describe judges as "gate keepers" standing in the way of the introduction into evidence of what has been more bluntly called "junk science": ***R. v. J.J***. at paragraph 25. The ground rules for the admissibility of expert evidence changed with ***Mohan.*** The court there set out four criteria to consider for the admissibility of expert evidence:

1. Relevance

2. Necessity

3. Absence of any exclusionary Rule

4. A properly qualified expert

[62] In respect of novel scientific evidence, Sopinka J. said at page 25:

> In summary, therefore, it appears from the foregoing that expert evidence which advances a novel scientific theory or technique is subjected to special scrutiny to determine whether it meets a basic threshold of reliability and whether it is essential in the sense that the trier of fact will be unable to come to a satisfactory conclusion without the assistance of the expert.

[63] The risk to be avoided by this special scrutiny was described by Sopinka J. in ***Mohan*** at page 21:

> Dressed up in scientific language which the jury does not easily understand and submitted through a witness of impressive antecedents, this evidence is apt to be accepted by the jury as being virtually infallible and as has having more weight than it deserves.

[64] That risk is less likely to be present in a case tried by judge alone. It is unlikely that expert opinion evidence would be viewed by a trial judge as "virtually infallible" ***Chan v. Erin Mills Town Centre Corp.*** [2005] O. J. No. 5027 at paragraph 31:

> It is difficult to find a civil case tried by judge alone, where novel scientific evidence was excluded because it failed to meet a threshold test of reliability. The reason may be that the metaphor of the judge as gatekeeper loses much of its symbolic force when it is the judge who is the trier of fact. This is not to say that a trial judge is excused from scrutinizing evidence, as improperly admitted evidence can surely have an impact on a trial, but the likelihood of a trial judge being overwhelmed by the "mystic infallibility" of the evidence and misusing the evidence to distort the fact- finding process, is far more remote. The dangers that the principles are designed to avoid begin to fall away.

Nevertheless, the analysis should be done. I will approach the issue on the basis that this method of forecasting gas prices in particular is novel.

[65] The first issue, then, in determining the admissibility of opinion evidence based upon novel scientific technique is reliability. Here it is uncontradicted that the Kalman model is and has been used to forecast prices for commodities such as copper, gold and oil. The objection taken is as to its reliability in forecasting long term natural gas prices because natural gas prices, unlike other commodities, are seasonally sensitive. Dr. Sick agreed that to his knowledge a Kalman model had not been previously so used.

[66] It is important to record that no evidence was adduced to challenge this use of the Kalman model except by way of cross-examination. No other witnesses were called to show that the model had been previously tested and failed in forecasting natural gas prices or that it had been the subject of professional comment or publication rejecting such use. I have only the evidence of Dr. Sick and such concessions as he made in cross-examination. Nevertheless, Marathon bears the burden of proving the technique's reliability on a balance of probabilities.

[67] The point here, then, is a narrow one - that an economic price forecasting model which had been peer reviewed, tested and employed by others in respect of different commodities cannot meet the threshold test of reliability for first time use for a different commodity. The issue is admissibility not weight, which is, of course, a separate matter.

[68] Futures markets are a reasonable predictor of future prices of commodities and therefore useful as a measure of damages in a case such as this. The difficulty is that futures markets for natural gas in 2002 went out only 5 years while this Agreement had 13 years left when delivery by Marathon Canada ceased. The challenge, then, for both parties was to provide a reasonable estimate of future natural gas prices for the last 8 years of the Agreement. Dr. Sick and his associates used a Kalman filter model which he described as a "mathematical model used to extrapolate futures and forward price curves to longer maturities than are quoted in the markets. It combines historical information about spot and futures prices with current information about the futures price curve to extrapolate or estimate the futures price curve for longer maturities."

[69] In Dr. Sick's opinion, the Kalman filter's use of historical data "leads to more accurate assessments of the long term forward prices that are essential in the evaluation of the Agreement". The Kalman filter model is, in his words, the "gold standard" in the economic world in dealing with a mass of data.

[70] Because natural gas use has a seasonal component (winter peaks/summer lows), additional factors must be built into the model to estimate future prices. Dr. Sick's evidence was that the Kalman filter model has been accepted by the econometric community as a valid tool for predicting future prices for commodities such as gold, copper and oil. That assertion was not countered by any contrary evidence. As to economics, he said:

> But economics, for example, it's been widely tested - for example, in this particular type of markets we are talking about, Eduardo Schwartz's paper is an example of an implementation and a test of

> the usefulness and the accuracy of the Kalman filter in this setting. If we want to just talk more broadly just about economics, then go to the references here, for example, we see that there's this book in 1989, page 54 of my report, by A.C. Harvey. That's completely - a whole book published by Cambridge University Press devoted to the Kalman filter in economics.

[71] As to whether this method was generally accepted, he said:

> Well, I do know of industrial uses of, and it is certainly well accepted in academia. There are many papers that have been published using Kalman filters. Industrial uses, for example, I mention I am going to - I mention that I have a relationship with BHB Billiton. I know that BHB Billiton does have Kalman filter estimates. Their chief trader did Kalman filter estimates for them for commodity markets.

[72] The primary attack on the use of the Kalman filter model for natural gas was based upon the seasonal factors in gas prices. Dr. Sick said that he had effectively built those factors into his model and was satisfied with the results. He acknowledged that certain choices had to be made to deal with the seasonality factors.

[73] He defended his choice in this way:

> In economics, we don't like to be subject to - accused of data mining. In other words, we keep - look at 5 different models, 10 different models; keep running the models until we finally get one that suits our purpose best. That's called data mining. We did not want to do that. We chose what we believed was a suitable model that would explain what was going on and went with it and didn't go changing around until we found a model that was a little more to our purpose or whatever our purpose was.

[74] Despite vigorous cross-examination, his evidence was not shaken and no contrary evidence was called.

[75] To test the reliability of the Kalman filter model projections, he compared them to the actual New York Mercantile Exchange (Nymex) prices for 3 years of future deliveries at certain dates. The model closely resembled the actual Nymex prices for the period for which Nymex future prices were available, and so, supported his conclusion that the model provided a reasonable projection of future price curves.

[76] I conclude that the evidence based upon the Kalman model meets the threshold test for reliability. As to the other criteria for assessing the admissibility of expert evidence, there is no doubt that it was necessary in the sense that a reasonable projection of future natural gas prices is not a

subject within the knowledge of a person without specialized training. The quantum of damages cannot be determined without weighing all of the evidence including that of Dr. Sick.. I bear in mind also that this evidence relates only to the assessment of damages and not to anything approaching the ultimate issue.

[77] Enron argues that the Kalman model had not been tested, peer reviewed or generally accepted as to natural gas price projections. That, in my view, is too narrow an inquiry. The model has been tested, used and peer reviewed by publication in respect to other commodities. A distinguishing characteristic of natural gas, that is, it's seasonality, is not sufficient to exclude the evidence entirely, on the basis that the model is unreliable.

[78] Lastly, to deal with the other ***Mohan*** criteria, not contested by Enron Canada, this evidence does not run afoul of any other exclusionary rule and is spoken to by a properly qualified expert.

[79] For these reasons, I concluded that Dr. Sick's evidence of future natural gas price curves based upon his methodology using the Kalman filter model was admissible evidence.

IX. Analysis

[80] Marathon Canada must rely upon a contractual right of early termination of the Agreement to justify the cessation of gas delivery effective December 1, 2001.

(a) Early Termination

[81] Article 9.1 of the Agreement, set out earlier, permits a "notifying party" to set an early termination date upon two business days notice when a Triggering Event has occurred with respect to the other party. Marathon Canada's letter of November 28, 2001 gave such notice of termination effective December 1, 2001. The issue then is whether a Triggering Event had occurred upon which such notice of termination could be based.

(b) Triggering Event

[82] Article 9.3(h), set out earlier, defines a Triggering Event as meaning the occurrence in the reasonable opinion of the notifying party (Marathon Canada) of a material adverse change of the Affected Party (Enron Canada). This Article goes on to define when a material adverse change is not a Triggering Event. That is when the Affected Party (Enron Canada) "establishes, and maintains throughout the term hereof" a letter of credit in the defined amount. There is no dispute that Enron Canada did not at any time prior to December 1, 2001 establish and maintain a letter of credit in any amount in favor of Marathon Canada. Enron Canada argues that the provisions of Article 9.3(i) somehow "clarifies" the plain wording of Article 9.3(h) but the various sub paragraphs of Article 9.3 are disjunctive. They are alternate meanings of "Triggering Event". Article 9.3(i) defines another and a different circumstance that will be a Triggering Event. It does not clarify or amend the plain meaning of 9.3(h). Enron Canada also pleads that it easily could have and would have provided such a letter of credit if it had been asked for. That is not, however, what this provision calls for. \

[83] Words in a contract are to be given their plain, literal and ordinary meaning. The general rule is that a Court will give "slavish effect" to a written agreement: ***Wilde v. Archean Energy Ltd.***, 2007 ABCA 385 at para. 43.

[84] Given that a letter of credit was never posted by Enron Canada, I need not decide whether a material adverse change would be a Triggering Event had a letter of credit been posted in the two days notice period before termination became effective.

[85] Enron Canada argues that Article 9.3(h) should be read to mean that a material Adverse change is **not** a Triggering Event if "performance assurance" is provided, and that because the Agreement is silent as to when the performance assurance must be provided, and in what form and for what amount, industry custom can be read in to the Agreement.

[86] However, the term "performance assurance" appears nowhere in this Agreement.

[87] The parties have expressly agreed only to a Letter of Credit in this context. And the Letter of Credit, the parties have said, is to be established and maintained "throughout the term hereof".

[88] Article 9.3(h) does not require any demand for "performance assurance", any notice to the Affected Party, any dialogue or negotiation between the parties nor any defined time for posting "performance assurance" before a Triggering Event has occurred.

[89] The language of Article 9.3(h) is clear and understandable.

[90] These are sophisticated parties led by experienced executives and advised by learned professionals. If they choose not to comply with a clear and unequivocal term of the Agreement, they must accept the consequences. The remaining question, then, is whether, in the reasonable opinion of Marathon Canada, a material adverse change of Enron Canada had occurred on November 28, 2001.

(c) Material Adverse Change

[91] The Agreement provides, as set out earlier, that a Material Adverse Change with respect to Enron Canada means "Enron Corp. shall have long term debt unsupported by third party credit enhancement that is rated by Standard and Poors below BBB-". There is no Standard and Poors rating category described exactly as "long term debt unsupported by third party credit enhancement". It was the uncontradicted evidence of Dr. Booth that the nearest Standard and Poors categories were "long term corporate credit" and "senior unsecured debt". In both of those Standard and Poors categories, Enron Corp.'s credit rating dropped below BBB- on November 28, 2001.

[92] Dr. Booth's opinion, which I find credible, was that the phrase "unsupported by third party credit enhancement" meant an absence of external (third party) credit support. The senior unsecured

debt rating met that definition as did the long term corporate credit rating. Both were, in his opinion, the equivalent of the rating described in Article 9.3(h).

[93] The Enron Corp. ratings immediately before November 28, 2001 were BBB-. The highest Standard and Poors rating for Enron Corp. after the downgrade was B-, a drop of 6 categories. Dr. Booth described this as a "very significant change in credit ratings". Any rating below BBB- was non-investment grade or "junk" status. The corporate credit and debt ratings are an assessment of a company's ability to meet its obligations unless supported (enhanced) in some way. The lower the corporate credit or debt rating, the greater the perceived risk of default.

[94] For whatever reason, the parties to this Agreement chose to measure Enron Canada's performance ability by reference to the debt rating of its indirect parent, Enron Corp. Enron Corp. had guaranteed the payment obligations of Enron Canada. As a consequence, a Material Adverse Change had occurred for Enron Canada as defined.

[95] Enron Canada also argues that Marathon Canada did not form a "reasonable opinion" that a Material Adverse Change had occurred as contemplated by Article 9.3(h). I see no merit in that argument. Marathon Canada reacted within hours of the Standard and Poors downgrade. Marathon Canada must have of necessity formed the opinion that a Material Adverse Change had occurred in order to react as it did. Having concluded that they were correct, I find that Marathon Canada's decision was reasonable. As well, Enron Canada, in its response two days later to Marathon Canada's termination letter, did not deny a Material Adverse Change. Instead, Enron Canada took pains to separate themselves from Enron Corp. urging that Enron Canada was solvent, that no Triggering Event had occurred with respect to Enron Canada and "any Material Adverse Change that may have occurred was solely attributable to Enron Corp." That, of course, was precisely what is contemplated by the Agreement.

[96] In addition, in December 2, 2001, Mr. R. Milnthorp, President and CEO of Enron Canada, wrote all of Enron Canada's counter parties including Marathon and said:

> Under many of Enron Canada's trading contracts, Enron Corp's credit down grade to below investment grade amounts to a Material Adverse Change.

[97] There can be no doubt of the reasonableness of Marathon Canada's opinion that a Material Adverse Change had occurred on November 28, 2001permitting Marathon Canada to establish an early termination date.

(d) Industry Custom and Practice

[98] Enron Canada pleaded and argued that industry practice required that Marathon Canada give notice requesting Enron Canada to provide performance assurance (for example, by posting a letter of credit or cash) and then giving Enron Canada reasonable time (three to ten days) to comply, all before the right to early termination arose.

[99] Much of Enron Canada's evidence, including from its expert witnesses was intended to support this position.

[100] The first issue is the admissibility of such evidence. The words of Lord Wilberforce are often repeated or paraphrased:

> No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as "the surrounding circumstances" but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.
>
> ***Reardon Smith Line Ltd. v. Yngvar Hansen- Tangen***, (supra)
> ***Paddon Hughes Development Co. v. Pancontinental Oil Ltd.***, 223 A.R. 180 (C.A.)

[101] Citing Lord Wilberforce in ***Bank of British Columbia v. Turbo Resources Ltd.***, (supra) Laycraft, J.A, as he then was, said at page 608:

> Consideration of the commercial setting in which a contract is made is not, of course, to be confused with parol evidence of the intention of the parties. That is not admissible. But the commercial setting of the contract assists in ascertaining the intention of the parties from the language they have used.

[102] Some of the evidence of Enron Canada's lay witnesses was evidence of intention disguised as evidence of commercial context. Mr. Kitagawa, for example, was asked: "What did you contemplate there" at the time of negotiations and "from commercial context." This is parol evidence of intent and is not admissible. There are other examples which I need not list.

[103] Evidence of commercial context is not admissible to contradict the plain words of the Agreement. It is from the words which the parties have chosen to use that a Court must find its interpretation of the contract: ***Prenor Trust Co. of Canada v. Kerkhoff Properties Inc.*** [1994] 9 W.W.R. 170, 21 Alta.L.R. (3d) 122 (Q.B.).

[104] This is not a search for the meaning of technical terms or terms of art which would permit expert assistance, as discussed earlier.

[105] Essentially, Enron Canada's witnesses - both lay and expert - say that it was common practice in the natural gas industry for an opportunity to be given to cure a perceived credit concern before

invoking termination rights. Vernon Jones, an expert called by Enron Canada, gave a complex five step process which he opined should precede termination, including formal notices of concern, time for the recipient party to reflect, evaluate, respond, enter into discussions and, if agreeable, post security. None of this is mandated by the terms of this Agreement.

[106] Mr. Jones talked about “good trading partners” working to resolve problems and being responsive and responsible. He said there are “expectations” that this kind of process will be followed. He did make a passing reference to the real world by his admission that “good trading partners are not expected to ignore their own economic considerations”.

[107] J. R. Broxson, another of Enron Canada’s experts on credit practices in the derivatives industry, opined that when a “credit event” occurred, industry standard and expectation is that a dialogue will occur before termination rights are exercised.

[108] Enron Canada’s lay witnesses advanced the same theory. Mr. Milnthorpe said that he would “reach out to them” if a counter party of Enron Canada’s suffered a Material Adverse Change. He did acknowledge that if there was a Triggering Event he would generally skip the dialogue and terminate.

[109] In any event, one would have thought that the expectations of shareholders would be that the company would act in their best interest. One would also think that the expectations of a contracting party would be that it could rely upon the clear terms of the Agreement; that the other party would do the same; and that contract terms are enforceable.

[110] If this practice, as described by Enron Canada’s witnesses, was as widely accepted as they suggest, then one would expect that had Enron Canada been out of the money on this Agreement (ie: had been contractually committed for the next 13 years to pay more for Marathon Canada’s gas than the current spot price) and had Marathon Canada suffered a Material Adverse Change, Enron Canada would have invited Marathon Canada to cure the event and forgone its termination right, and continued to pay the higher price. That does not seem to be likely, unless for some other reason (such as the need for an uninterrupted gas flow) its self interest dictated otherwise.

[111] Realistically, the Jones scenario may be expected only when it is in the notifying party’s interest to maintain the contract. Had Marathon Canada been in the money (selling its gas for more than the current spot price), it seems very unlikely that Marathon Canada would have given notice of early termination. Instead it would have tried to maintain the Agreement so long as it was being paid.

[112] In short, within the limits of the contract terms, self interest will dictate the contracting parties actions. Certainty of terms is essential to derivatives trading. Certainty is best achieved by unambiguous contract language rather than by superimposing on contract language evidence of industry “expectations”.

[113] Knowledge of any such industry practice was denied by E. Schmaltz of Marathon Canada, who was the person responsible for negotiating the Agreement. She worked for Tarragon and then Marathon Canada from 1993 to 1997. She has some thirty years experience in the gas industry. As well, there was no evidence that the alleged practice was ever discussed between Enron Canada and Marathon Canada at the time the Agreement was negotiated.

[114] In order to have any relevance that practice must be "so well recognized and well known among people engaged in the industry and so prevailing as to justify presumption that everyone that enters into a contract does so with the intention of being bound by that practice": ***Sun Sudan Oil Co. v. Methanex Corp.*** [1992] A.J. No. 1003 at page 25.

[115] It is also significant that at about the same time that Marathon Canada gave notice on November 28, 2008, a number of other counter parties to Enron Canada's contracts took similar action. Enron Canada's President, R. Milnthorpe, deposed an affidavit sworn November 30, 2001 and filed in its CBCA proceedings that:

> 57. the dramatic decline in Enron Corp.'s financial position has impacted Enron Canada in the following ways:
>
> a. under virtually all of Enron Canada's trading contracts, the "junk bond" status rating of Enron Corp. amounts to a Material Adverse Change;
>
> b. several counter parties claim that the down grade of Enron Corp. to "junk bond" status constitutes a default by Enron Canada, resulting in automatic termination of their trading contracts or entitling them to terminate their contracts by notice;
>
> c. some counter parties have failed to pay amounts due to Enron Canada pursuant to their trading contracts;
>
> d. several counter parties have suspended their delivery or receipt obligations.

[116] Those reactions by other counter parties in the industry do not support the proposition that there was a widely recognized industry practice to negotiate before terminating.

[117] The evidence also establishes that Enron Canada and Enron Corp. used a standard form for gas purchase Agreements as a starting point in negotiations. Article 15.10, quoted earlier, precluded the Agreement being construed against one party or the other. Nevertheless, 112 Agreements between Enron Canada and other gas suppliers were introduced in this litigation. They contained similar provisions as to termination and Triggering Events.

[118] There was evidence that Enron Canada has access to Enron Corp's "legal trading committee" comprised of "in house" lawyers for various Enron entities. That committee had responsibility for drafting and amending Agreements for all Enron Corp.'s affiliates.

[119] Ms. Schmaltz said that there was little room for negotiation with Enron Canada over the terms of the Agreement, apart from the variables of volume, price, term, escalator, and delivery point. Mr. Milnthorpe acknowledged that clauses regarding Triggering Events and termination were typically not negotiated. In those circumstances, it is unlikely that Enron Canada, in 1995, recognized and intended that it and Marathon Canada be bound by any industry practice that did not find its way into contract language.

[120] Enron also argues that such notice and opportunity to provide performance assurance ought to be implied into the provisions of Article 9.3(h). The answer is that Article 15.5 precludes any such implied term: ***Freyburg v. Fletcher Challenge Oil and Gas Inc.***, 2005 ABCA 46 at para. 55-56.

[121] The importance of the termination provision in derivative contracts has been emphasized more than once: **Re Blue Range Resources Corporation,** 192 D.L.R. (4th) 281; also the decision of Hart, J. dated December 6, 2001 in the CBCA proceedings in this case.

[122] In addition, the Enron standard agreement which formed the basis for this Agreement stands in marked contrast to industry standard agreements. The latter did not speak to Material Adverse Changes or Triggering Events but contained language of "reasonable grounds for insecurity" of payment.

[123] The Gas Industry Standard Board (GISB) May 1996 formal Agreement, for example, provided that if a party has reasonable grounds for insecurity of payment, then such party may demand adequate assurance of performance such as a letter of credit or pre-payment. This is the kind of process which Enron Canada now seeks to have read into the Agreement in this case but this Agreement lacks that language. The GISB January 2000 formal Agreement contained similar language to its earlier version.

[124] For whatever reason, the parties here chose not to use the GISB language nor to amend their 1995 long term contract anytime before November 28, 2001 to adopt the GISB language or anything like it.

[125] In summary, I conclude:

1. The evidence does not establish industry practice so well known as to justify a presumed intent to be bound by it;

2. As described by Enron Canada, the alleged practice runs contrary to the plain language of the contract to which effect must be given: ***Cargill Gas Marketing Ltd. v. Alberta Northeast Ltd.***, 2008 ABQB 59; ***Microcell Connexions Inc. v. Telus Mobility Inc***., 1999 ABQB

94, aff'd 1999 ABCA 183; ***Prenor Trust Co. Of Canada v. Kerkhoff Properties Inc.***, (supra).

3. Industry practice as evidenced by contract language has evolved since this Agreement in 1995. While changing practice may lead to new contract terms, that is accomplished by negotiation and agreement and not by seeking to have new provisions implied into a long term contract that the parties have declined to amend. If a 1995 Agreement was inconsistent with practice in 2001, the remedy was to amend the Agreement. The parties chose not to do that.

(e) Material Adverse Change by Marathon Canada

[126] There was evidence from Enron Canada's witnesses that Marathon Canada may have incurred a material adverse change as defined by the Agreement. Whether or not that occurred, Enron Canada did not act upon it and so the allegation is of no relevance now. Enron Canada argues that its passive reaction to Marathon Canada's material adverse change event is supportive of its proposition that there is an industry practise which Marathon Canada failed to follow. For the reason set out earlier, I conclude there was no such industry practise which would bind the parties here.

(f) A Duty of Good Faith

[127] Enron Canada raises a good faith argument.

[128] In narrow circumstances a duty of good faith may arise in commercial contracts either from a proper interpretation of the contract or by operation of law. The latter is illustrated by legal rules about illegal or unconscionable contracts. More commonly, any duty to act in good faith will be found in a proper interpretation of the agreement that the parties have made: ***Mesa Operating Ltd. Partnership v. Amoco Canada Resources Ltd.***, (1994) 19 Alta.L.R. (3rd) 38 (C.A) at para. 15

[129] I agree with the decision of the Ontario Court of Appeal in ***Transamerica Life Canada Inc. v. ING Canada Inc.***, [2003] O.J. 4656 at para. 53:

> Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained-for, rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they have entered into

[130] There have been cases where the relationship between the parties attracts a duty to act in good faith, for example, employment and insurance contracts. This, of course, is not such a case.

[131] To arise from an interpretation of the contract, the alleged duty must be consistent with the express terms to which the parties have agreed. The parties expectations are best found in their clear words. Where their words are equivocal or absent, there may be room to imply expectations having regard to commercial context. That is not the case here as I've already concluded. Exercising one's contractual right of termination is not evidence of a breach of good faith.

(g) Unjust Enrichment

[132] Enron Canada also argues that Marathon Canada was unjustly enriched when, by termination of the Agreement, it shed a significant out-of-the-money position to the detriment of Enron Canada which lost an asset of the same value. Enron Canada relies upon ***Sorochan v. Sorochan*** [1986] 2 S.C.R. 38 at 44.

[133] The complete answer is that the early termination of the agreement by Marathon Canada was in accord with the terms of the Agreement and those terms were a "juristic reason for the enrichment".

[134] When the parties have entered into a carefully negotiated commercial contract, as here, a Court should be reluctant "to find a gap to fill with unjust enrichment": ***Harris v. Nugent*** (supra) at para. 40.

(h) Adverse Inference

[135] Enron Canada argues that an adverse inference should arise from the failure of Marathon Canada to call as a witness Mr. Robert Shepherd, it's president from late 2000 to October 2003, which time-frame includes the date of the early termination of the Agreement. Mr. Shepherd's name was on the witness list provided by Marathon Canada to Enron Canada before trial. No notice was served by Marathon Canada under Rule 296.1(1). Witness lists were exchanged between counsel as a result of a direction by this Court. The purpose of a witness list, however, is trial efficiency – to assist the opposing party in trial preparation and avoid adjournment requests. It is not intended to be a commitment to call all persons on the list.

[136] The evidence, including examination of discovery evidence read in by Enron Canada, makes it clear that Mr. Shepherd's role was merely to sign the termination letter. He did not prepare the letter nor was he involved in the administration of the Agreement. At most, he was only kept informed by those employees that did testify. Those facts, in the absence of any evidence of material knowledge which Mr. Shepherd might have, explain adequately the decision not to call him and thus preclude any adverse inference.

(i) Read-ins from Examination for Discovery

[137] Two issues arose when counsel began to read-in answers given on examination for discovery by the opposing party. The first related to Rule 214(4) which provides:

> If part only of an examination is used, the Court may, at the request of any party against whom it is so used, direct that any other part of the examination be also used, if it is so connected with the part so used that the first mentioned part ought not to be used without the other part.

On several occasions when I ruled that the answer read was so connected to another answer that the latter ought to be read as well, I gave the party reading in the answer the option to withdraw both.

[138] A contrary decision was reached in ***Kapelus v. University of British Columbia*** [1998] BCJ 1559 under the B.C. Rules:

> A Plaintiff does not have the right to withdraw a portion of an examination for discovery after it has been put in evidence; she is bound by her decision to put in that evidence

[139] The question is a matter of discretion for the trial judge. I conclude that a party ought not to be obliged to put into its case answers from examination for discovery which it did not intend to include, whether by inadvertence, or by a ruling made under Rule 214(4) after a request by the other party; so long as the party reading in has not yet closed its case.

[140] The authors of the Alberta Civil Procedure Handbook, 2008 at page 258 say:

> If the party reading in does not like the addition but the Judge allows it, the party reading in can withdraw both.

No authority is given but the principle is sound and I respectfully agree with it.

[141] I was referred to ***Hayhurst v. Innisfail Motors Ltd.***, [1935] 1 W.W.R. 385 at 389. However that decision did not deal with an application to withdraw a read-in after a direction under Rule 214(4). The thrust of that decision is that a party reading in from an examination for discovery must accept the burden as well as the benefit of that evidence. There, the motion was to dismiss the action at the close of the Plaintiff's case.

[142] The second issue arose after the close of Enron Canada's case. Enron Canada had tendered two large volumes of read-ins from examination for discovery including additions made pursuant to Rule 214(4). That was done during the course of Enron Canada's case. It was agreed counsel need not go through the laborious process of reading each question and answer into the record. Instead, I directed that the volumes be provided to the court reporter and incorporated into the record as though read. That would save many hours of Court time and still provide a fully searchable record on the Summation program which was being used – which merely marking the volumes as exhibits would not. Enron Canada then completed and closed its case and Marathon Canada began and completed its case. On the last day of trial, Enron Canada applied to withdraw some of its read-ins. I denied that application for the following reasons.

[143] Marathon Canada had completed its evidence. It would be unfair to Marathon Canada to permit Enron Canada to withdraw read-ins after having heard its opponent's case. If a party intends to apply to withdraw read-ins, it must do so before the close of its case. The decision is then a matter of judicial discretion in all of the circumstances: ***Sleeman and Sleeman v. Foothills School District No. 38*** (1946) 1 W.W.R. 145 at para. 149; ***Lifemax Natural Foods Inc. v. Sahota*** [2000] O.J. 3209 (Ont.C.A.)

[144] It is the timing of the application to withdraw that is critical. The discretion may be exercised to permit withdrawal of a read-in where the application is made before the close of a party's case: ***Kirkby v. Booth*** (1963) 42 D.L.R. (2nd) 32.

[145] But where the opposing party has closed its case and relied upon the read-ins, the application to withdraw will be refused: ***Lededynski v. Westfair Foods Ltd.*** [2000] M.J. 422.

[146] Given the timing of the application in this case, I refused the application to withdraw any of the read-ins.

X. Damages

(a) Marathon Canada's Claim

[147] The claim of Marathon Canada is undisputed. The amount is $560,007.94 plus interest at the Toronto Dominion Bank prime rate plus 2% from December 27, 2001 to the date of this judgment. The base amount represents gas delivered in November, 2001 for which payment was not made. The payment was due on the first business day after December 25 which was December 27th. The interest rate is defined in the Agreement.

(b) One Way or Two Way Contract

[148] The calculation of damages depends, in part, on the resolution of this issue. The definition of these terms was provided earlier. It is undisputed that at any of the dates of termination, whether by Marathon Canada or Enron Canada, Marathon Canada was "out of the money"in the tens of millions of dollars. That is, the present value of the gas remaining to be delivered under the Agreement valued at projected future prices far exceeded the present value calculated at the contract prices. Thus, Marathon Canada was out of the money because it was contractually obliged to sell its gas at less than projected market prices over the balance of the term of the Agreement.

[149] The lawful termination of the Agreement would therefore benefit Marathon Canada which could have at that time sold its gas at a higher price via a replacement contract.

[150] Marathon Canada argues that damages should be calculated under Article 9.2 on a one way or a walk away basis if it lawfully terminated the Agreement. Thus, it would collect its unpaid November 2001 invoice plus interest and would not have to compensate Enron Canada for the loss

of it's favorable contract prices over the balance of the term of the Agreement (i.e.: Marathon Canada could walk away from its out-of-the-money position).

[151] Enron Canada argues that even if Marathon Canada did lawfully terminate the Agreement, Enron Canada is nevertheless entitled to liquidated damages based on the loss of its in the money position, less a set-off of Marathon Canada's unpaid November invoice. That would be a two way calculation of damages.

[152] The issue only arises if Marathon Canada lawfully terminated the Agreement as I have concluded was the case.

[153] It is convenient to set out here again the relevant portions of Article 9.2:

> 9.2 Liquidated Damages
>
> If an Earlier Termination Date occurs, the Notifying Party shall in good faith calculate its Liquidated Damages resulting from the termination of this Transaction. For the purposes of Article 9, the term liquidated damages ("Liquidated Damages") with respect to the Notifying Party, shall mean the present value of the economic loss, if any, (including any costs and minus the present value of the economic gain, if any) deemed to have been suffered by the Notifying Party in securing a replacement contract as a result of the termination of the Parties obligations under this Transaction.

[154] The Article then goes on to describe the complex formula for the calculation of the damages and concludes with Article 9.2 (e):

> If any calculation of Liquidated Damages results in a net gain due to the Notifying Party, damages shall be deemed to be zero. The Notifying Party shall give the Affected Party notice of the Notifying Party's Liquidated Damages, if any, accompanied by a statement in reasonable detail stating how the amount was calculated. The Affected Party shall pay such Liquidated Damages to the Notifying Party within ten days of receipt of such notice.

[155] In its analysis of Article 9.2 Enron Canada argues that the first sentence of Article 9.2(e) is void for uncertainty and should be severed from the Agreement. It does not offer an alternative interpretation which would make use of those words.

[156] Denise McGlone, Enron Canada's expert, explained that "a derivatives contract is a liability to the party which is out of the money so termination results in a gain for that party because they are relieved from future performance of unfavourable contract terms". On the other hand, a party which is in the money will, on termination, suffer the loss of a favourable contract.

[157] Ms. McGlone found the first sentence Article 9.2(e) to be ambiguous. The essential argument is that there is no "net gain due" to a notifying party (Marathon Canada) who is out of the money. Enron Canada acknowledges that Marathon Canada incurred a "gain" when (and if) it lawfully terminated the Agreement, and so avoided the balance of an unfavourable contract, unless and until that payment is made.

[158] They say that "due to" contemplates a payment owing and there can be no payment owing and payable from an in the money party (Enron Canada) to an out of the money party (Marathon Canada).

[159] The sentence seems to have been drafted with little regard for plain language. Nevertheless, the court should strive to give it meaning before severing it out: ***Marquest Indust. Ltd. v. Willows Poultry Farms Ltd.*** (1968) 1 D.L.R. (3d) 513 at 517-518 (B.C.C.A.)

[160] Both parties, as I observed earlier, are major and sophisticated players in the industry. Both had access to experienced professionals. Enron Corp. used the advice of its legal trading committee to draft and amend Agreements.

[161] Both one way and two way provisions were commonly used by Enron Canada, although the one way clauses were being replaced from time to time by two way clauses in later years.

[162] At his cross-examination for the CBCA proceedings in December 2001, Mr. Milnthorpe acknowledged that some 460 million dollars worth Enron Canada's contracts retained the one way clause. A schedule appended to his affidavit characterizes the Marathon Agreement "one way".

[163] I conclude that Article 9.2 is a one way or walk away provision for several reasons:

1. The entirety of Article 9.2 speaks only to damages incurred by the notifying party (Marathon Canada). It does not address damages incurred by the affected party (Enron Canada). There is no reference to damages flowing to or due to the affected party – a provision which is essential for a two way clause.

2. A notifying party is either in the money or out of the money at termination. If it is in the money, the calculation is simple. If it is out of the money (as here), then its "gain" is merely the avoidance of future performance of an unfavorable contract. There are no "damages" to be paid to it (ie: damages are zero).

3. If it were otherwise, then the affected party would be paid its in the money position, meaning damages would flow two ways which the Agreement does not contemplate.

4. It would be curious if the parties intended that a party which was in the money could "monetize" its position by crafting its own default, and so oblige the notifying party to pay it out – particularly where the Agreement was non-assignable which would prevent the defaulting party from getting its contract value by sale.

5. Several obvious two way contracts were produced to which Enron Canada was a party. In one such contract, this appears:

> If the Termination Payment constitutes a gain to the notifying party, the notifying party shall pay the amount of such gain to the affected party and if the termination payment constitutes a loss to the notifying party, the affected party shall pay the amount of such loss to the notifying party.

[164] That provision contemplates payments flowing both ways no matter who terminates and who defaults. There is no "deemed to be zero" provision.

6. The evidence establishes that Enron Canada contract language began to change from one way to two way provisions in the late 1990's. The agreement quoted above was made in 1999. Also produced at trial was a letter dated May 12, 2000, from Enron Canada amending a 1998 gas purchase Agreement by substituting two way language for one way language. Mr. Milnthorpe acknowledged that Enron Canada was engaged in an "amending project" about this time which, among other changes, removed one way language and inserted two way language. He was not aware of any such amendment being proposed to the Agreement with Marathon Canada.

7. Ms. McGlone, with impressive experience in the derivatives industry, said in her report:

> Under older versions of derivative contracts, settlement on termination can be based on one way or two way payment mechanisms. One way payment (also known as a limited two way payment or walk away provision) requires the non-defaulting party to calculate the net amount of its gains and losses on termination. If that calculation results in a net loss to the non-defaulting party, the defaulting party if obliged to pay that amount to the non-defaulting party. However, if the calculation results in a net gain to the non-defaulting party, it may claim to be entitled to walk away from making any payment to the defaulting party.

[165] Ms. McGlone was critical of walk away provisions, saying that a negotiated solution rather than termination was essential to keep the gas flowing. However, replacement contracts are available and so it just becomes a question of price. I do not find sufficient ambiguity in Article 9.2 to either sever it or ignore it. I conclude it is intended to create a one way or walk away circumstance which, in this case, Marathon Canada can rely upon.

(c) Relief from Forfeiture

[166] Enron Canada argues in this context that a one way provision is a penalty in that it permits Marathon Canada to walk away from a multi million dollar liability. Ms. McGlone explained that in the early years, in the derivatives industry, there was only a limited trading market through which an in the money party could realize on or cash out (monetize is the term she used) its position. Thus, an in the money party would be tempted to create its own default and so compel the out of the money party to pay out the contract. The one way clause was designed to discourage such conduct. As the trading market became more established, the justification for one way clauses was lost. As discussed above, newer contracts contain two way provisions and some older contracts were amended. What is significant is that the contract in this case was not amended.

[167] Enron Canada and Ms. McGlone cited criticisms of one way clauses from academic writers and commentators from as early as 1990, yet this 1995 Agreement contained the clause and was never amended.

[168] Enron Canada argues that a one way clause is a forfeiture provision from which relief can be given under section 10 of the ***Judicature Act*** R.S.A. 2000 Chapter J-2.

[169] Relief from forfeiture is discretionary. Relevant factors are the conduct of the parties seeking relief, the gravity of the breach, the disparity between the value forfeited and the damage caused by the breach. The result must be "harsh and unconscionable": ***Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.***, [1994] 2 S.C.R. 490 at 504; ***Digger Excavating (1983) Ltd. v. Bowlen*** (2001), 286 A.R. 291 (C.A.) at 299.

[170] Of some interest is an American decision, ***Drexel Burnham Lambert Products Corporation v. Midland Bank PLC***, 1992 U.S. Dist. LEXIS 21223 paragraph 13-15, which concluded that a one way clause in a derivative instrument was neither a penalty nor unconscionable.

[171] In this jurisdiction, it is clear that the enforcement of a specific provision in a contract cannot be a penalty: ***Digger Excavating (1983) Ltd. v. Bowlen*** (supra) at para. 29; ***Jim Pattison Industries Ltd. v. 1854 Holdings Ltd.*** (1990), 76 D.L.R. (4th) 119 (B.C.C.A.) at paras. 61 & 62.

[172] The parties here have expressly contracted for a one way clause – which in certain circumstances had the potential to benefit either of them. It would unfair and inequitable to deny enforcement of that provision. This is not a case of unequal bargaining power or unconscionable conduct. The result is what the parties bargained for.

[173] I conclude that relief from forfeiture is not available to Enron Canada but if it were, I would decline to grant it for the reasons given.

(d) Enron Canada's Damage Claim

[174] Enron Canada's liquidated damages have to be assessed if I am incorrect in either of these two conclusions:

> (1) That Marathon Canada lawfully terminated the Agreement as at December 1, 2001; or
> (2) that Article 9.2 of the Agreement is a two way clause and does not permit Marathon Canada to walk away from its out of the money position even if it lawfully terminated the Agreement.

[175] In either event, Enron Canada's damages would be assessed as of December 1, 2001.

[176] Article 9.2 defines liquidated damages as the difference between the present value of the remainder of the existing Agreement and the present value of a replacement contract. The calculation for the former is fairly straight forward. The calculation of the latter was more contentious.

[177] Those calculations require the Notifying Party to obtain a quote from each of three "leading dealers"for:

1. A NYMEX gas futures contract swap;

2. A US- Canada dollar currency swap (meaning exchange rates because Henry Hubb prices are in US dollars and this Agreement is in Canadian dollars);

3. The Canadian Government yield curve - to obtain discount factors for a present value calculation;

4. A Henry Hubb Louisiana - Empress Alberta basis differential swap. NYMEX prices are for delivery at Henry Hubb. This Agreement calls for delivery at Empress Alberta.

[178] The calculations were done by Mr. Wong for Enron Canada and by Dr. Sick and Mr. Vetsch for Marathon Canada. There were several differences between them:

1. **Natural gas futures**

[179] Mr. Wong obtained what he called quotes from three dealers in late 2006, some five years after termination of the Agreement. Those quotes were for the period 2001-2006. Reliable data was not available for any longer period. Dr. Sick and Mr. Vetsch, instead, used actual NYMEX futures settlement prices. They criticized Mr. Wong's data on the basis that it did not and could not represent a quote because it was obtained five or six years after the event. A true quote is tested by the parties willingness to deal at that price which of course could not occur years after the event. As well, Mr. Wong admittedly used midpoint quotes rather than bid and offer quotes as called for in Article 9.2. The result then is that neither party was able to precisely comply with the formula called for by the Agreement.

[180] To a limited extent, Mr. Wong's quotes reflected NYMEX settlement prices which were used by Dr. Sick. The NYMEX settlement prices are objective, transparent, and a reliable measure of the futures prices at the time. I prefer the Sick-Vetsch approach for the first five years after 2001, which was the extent of the NYMEX data. In fact, there is little dollar difference between Mr. Wong and Dr. Sick for this period of time.

[181] The calculation of futures prices beyond the first five years to the end of the Agreement - a further eight years, was a challenge for both sides. Mr. Wong said he projected prices in a linear way because his dealer quotes showed an increase of 8 cents from the second last period to the last period. He assumed the same increase would occur annually for the next 8 years. This was a very beneficial assumption for his client. Natural gas prices move both up and down. Mr. Wong's data showed one increase of 2 cents and 2 decreases of 4 cents each in the prior 3 years. A straight line projection from those years would have yielded a much different result. He offered no economic or statistical rationale other than to say that he had done it this way before.

[182] Dr. Sick, in contrast, employed the Kalman filter model discussed earlier. I had concluded that it met the threshold test of reliability. That model is an accepted tool for forecasting future prices of other commodities, including oil. Dr. Sick's evidence was that he had built in factors to account for the seasonal fluctuation of gas prices. I have no doubt that forecasting future natural gas prices is a high risk assignment. Traders such as Enron Canada and Enron Corp. must do it constantly. They can, of course, hedge that risk in the market.

[183] Although it ought to have been available, no evidence was led as to the methods used by Enron Corp. in its trading business. The use of the Kalman filter model by Dr. Sick is at least an attempt to bring some econometric rationale to the task. Mr.Vetsch, whose experience was considerable, found that method to be acceptable. What does not strike me as acceptable is to simply draw a straight line projection from the last two favorable years as Mr. Wong did.

[184] Neither the straight line projection nor the projections based on the Kalman filter model were mandated by the Agreement. Both parties saw that the formula called for by the Agreement would not work for the final eight years of the Agreement because the data was not available. The Court should endeavour to give effect to the intent of the parties to calculate damages. It is open, then, for me to rely upon one of the alternate calculations offered: ***Missilinda of Canada Ltd. v. Husky Oil Operations Ltd.*** (2007) 212 Man.R. (2d) 252 (C.A.); ***Kentucky Fried Chicken Canada v. Scott's***

Food Services [1998] O.J.No. 4368, at paras. 27, 34. For the reasons given, I would prefer the method used by Dr. Sick and Mr. Vetsch.

2. **Forward Foreign Exchange Rates**

[185] Once again, the Agreement called for quotes from three leading dealers. Neither party did this directly. Mr. Wong used price data sheets he obtained from dealers which reflected gas prices in both Canadian and US dollars, but at different delivery points. He then made his own calculation of the exchange rate from those numbers. His report acknowledged that none of his dealers could provide a currency swap quote as called for by the Agreement because of the length of time which had passed since 2001.

[186] The result he uses is, therefore, his calculation and not a "from a dealer" for a US-Canada dollar currency swap.

[187] Once again, then, neither party could comply directly with the requirement in Article 9.2. It was Dr. Sick's opinion that forward foreign exchange rates can be simply and accurately determined by reliance upon widely published forward interest rates based in different currencies.

[188] This is a field of finance and economics that is clearly in Dr. Sick's expertise and I have accepted his evidence in this regard.

3. **Discount Factors from Canadian Government Bond Yield Curves**

[189] Mr. Wong, in his rebuttal report, accepted the interest rate and the discount factors used by Dr. Sick and Mr. Vetsch.

4. **Henry Hubb - Empress Basis Differential**

[190] This differential is the difference in the price of gas between the Henry Hubb of Louisiana and the Empress Alberta delivery points. The difference between the two parties here relates to the 5% escalation factor referred to in Article 9.2(c). If the seller is the notifying party, the basis differential becomes more negative by 5% per year, after year 5.

[191] Mr. Wong assumed that for a termination date of December 1, 2001 there was no notifying party. That, however, is clearly incorrect because Marathon Canada gave notice of termination effective December 1, 2001 and so became the notifying party and is thus entitled to the negative 5% escalator.

5. **Conclusion - Re: Enron Canada's Damage Claim**

[192] If Enron Canada were entitled to damages, I conclude that the proper valuation date is December 1, 2001 when Marathon Canada ceased delivery. The proper amount of Enron Canada's damages is fifty five million, two hundred twelve thousand dollars ($55, 212,000.00).

[193] Marathon Oil Company's liability is limited to sixteen million ($16,000,000.00) under its guarantee. Marathon Canada would have been entitled to a set off of its damages in the amount of five hundred and sixty thousand dollars and seven dollars and ninety four cents ($560,007.94).

[194] Enron Canada would have been entitled to interest from December 1, 2001 to the date of this judgment at lawful rates.

(e) Restriction on the Assignment of the Agreement

[195] There was evidence from some Enron Canada witnesses that had Marathon Canada not ceased delivery of gas on December 1, 2001, Enron Canada could have sold the agreement to others given its in the money position. However, the agreement provided by Article 11.1 quoted earlier, that:

> Neither party shall assign this agreement without prior written approval of the other party, which may be withheld or given entirely at the option of such party...

Such approval is not limited by language such as "not to be unreasonably withheld". If Enron Canada were entitled only to unliquidated damages at common law, then this restriction on assignability may impact the value of the lost contract. No evidence was led by either party on the value of this agreement in those circumstances.

[196] In that event, Article 15.1 of the agreement would be relevant:

> 15.1 If no remedy or measure of damages is expressly provided, the obligors liability shall be limited to direct damages only, all other remedies or damages are waived. In no event shall either party be liable for consequential, incidental, punitive or indirect damages, in tort, contract or otherwise.

[197] The agreement, however, provides a formula for the calculation of damages and Enron Canada need not look to the right to assign for that purpose.

(f) Liability of Husky Oil Operations Limited (Husky)

[198] Enron Canada claims also against Husky. On October 1, 2003, Marathon US sold all of its shares in Marathon Canada to Husky MCL Holdings Ltd. (Husky MCL). Marathon US agreed to assume the conduct of this litigation and to indemnify Husky MCL should Marathon Canada be found liable. Husky MCL sold those shares on the same date to the named defendant by counterclaim, Husky. Marathon Canada then began dissolution proceedings. By January 19, 2004,

the dissolution of Marathon Canada had been completed and its assets distributed to its sole shareholder, Husky.

[199] By virtue of Section 227 of the ***Alberta Business Corporations Act***, R.S.A. 2000 Chap. B-9, Enron Canada is entitled to claim against Husky to the extent of the value of the property received – which in this case well exceeds Enron Canada's claims.

[200] The right of Husky to defend the claim was upheld by the Alberta Court of Appeal in ***Enron Canada Corp. v. Husky Oil Operations Limited*** (2007) 401 A.R. 291.

[201] In the result, had I found for Enron Canada on its counterclaim against Marathon Canada I would also find that Enron Canada was entitled to judgment against Husky for the full amount of that judgment.

Conclusion

[202] Marathon Canada will have judgment against Enron Canada in the amount of $560,007.94 plus interest from December 27, 2001 to the date of this judgment at the rate of the Toronto Dominion Bank prime rate plus 2%.

[203] The counterclaim of Enron Canada is dismissed.

[204] Cost may be spoken to if not agreed upon.

Heard the 29th day of October, 2007 to February 6, 2008.
Dated at the City of Calgary, Alberta this 2nd day of July, 2008.

T.F. McMahon
J.C.Q.B.A.

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