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OIL AND GAS M&A TRENDS in Canada

Despite widespread anticipation that 2015 would see an increase in oil and gas M&A and related financing activity, there turned out to be significantly less activity in 2015 than there was in 2014, as crude oil prices remained below US$50/bbl and more recently fell below US$40/bbl.

With few exceptions, oil and gas M&A activity was limited to smaller and fewer transactions in 2015. Hostile acquisitions of size were limited to Suncor's $4.1 billion hostile offer for Canadian Oil Sands. Consensual acquisitions of size were rare (with exceptions such as Crescent Point's $1.5 billion acquisition of Legacy Oil + Gas and Whitecap Resources' $500 million acquisition of Beaumont Energy) as agreements on the relative valuations and on who the surviving management would be remained difficult to achieve.

With the continuation of a low commodity price environment for significantly longer than most oil and gas company boards of directors and management teams hoped for and with highly prioritized, or for many subsistence-level, capital programs and slashed g&a budgets already implemented, pressure continues to grow on the boards of directors and the management teams internally and from lenders, potential merger partners and potential acquirors externally.

Boards of directors are now frequently in the position of having to respond to approaches at a significant premium to current trading prices that 18 months ago would have been characterized as a more than adequate change of control premium but which now, in the context of historically (short term) low commodity prices, are considered by the board or management to be opportunistic and unreflective of true fair value. At the same time, the board must be wary of the possibility that the company's shareholders may be pleased to have the opportunity to accept the premium price.

Compounding the current low commodity prices in curtailing M&A and related financing activity has been uncertainty in numerous categories, including:

- future commodity prices
- governmental uncertainty federally with the recent election of the Liberals and the potential impact of:
  - foreign investment review
  - climate change legislation
- governmental uncertainty in Alberta with the election of the NDP and the potential impact of:
  - royalty review
  - climate change legislation
  - corporate tax increases
  - a more distant relationship with the business comunity
- infrastructure limitations, including pipelines for market access, impacted by:
  - the rejection of Keystone XL by President Obama
  - First Nations and environmental considerations in the advancement of proposed projects

All in all, this creates a difficult context in which to undertake M&A activity, domestically and in respect of potential foreign players making capital allocations within their global portfolios on a competitive basis with opportunities in other jurisdictions in Canada, and incrementally in Alberta. However, at least some of the uncertainty should be resolved in early 2016, including with respect to climate change legislation and Alberta's royalty review. At the same time, other drivers will increase pressure on exploration and development and oilfield service entities in 2016. It does not seem overly bold – particularly in light of the minimal activity in 2015 – to predict that oil and gas M&A and related financing activity will increase in 2016.

1 | The future of hostile bids

While applicable securities laws require a takeover bid to be open for a minimum of 35 days, shareholder rights plans ("SRPs") have allowed potential targets to extend that period, typically to 60 days. In light of the routine application by hostile acquirors to the appropriate securities regulatory authorities to attempt to "cease trade" such SRPs, and the somewhat inconsistent decisions of those regulatory authorities and the rationale for them, the Canadian Securities Administrators (the "CSA"), excluding Québec's Autorité des marchés financiers (the "AMF"), published a proposal to regulate SRPs in 2013. The AMF concurrently published its own regulatory approach to SRPs. The two approaches were largely irreconcilable and in September of 2014 the CSA and AMF abandoned their earlier legislative efforts and announced a proposal to amend applicable securities legislation to require all formal takeover bids to have:

- a minimum tender period of 120 days;
- a minimum tender condition of more than 50% of the outstanding securities not owned by the bidder; and
- a 10 day extension period if the minimum tender condition is met.

(Other than the 120 day minimum tender period, the other requirements are common for SRPs.) The 120 day minimum tender period was proposed to be waivable by the target board. Proposed amendments to applicable securities legislation embodying these changes were published in March 2015 but have not yet been adopted.

In that environment, on October 5, 2015, Suncor commenced an unsolicited share exchange takeover bid for Canadian Oil Sands, intended to be a "permitted bid" under a pre-existing SRP of Canadian Oil Sands ("Original SRP") that required a 60 day minimum tender period and minimum tender conditions of more than 66⅔% of the outstanding shares and more than 50% of outstanding shares not owned by the offeror (i.e. Suncor). On October 7, 2015, Canadian Oil Sands announced the adoption of a new SRP (to supplement the Original SRP) that extended the minimum tender period to 120 days ("Amended SRP"). The Amended SRP resulted in the Suncor offer no longer being a "permitted bid".

On November 30, 2015, the Alberta Securities Commission ("ASC"), in response to an application by Suncor to cease trade the Amended SRP to effectively nullify the purported amendments, determined to cease trade the Amended SRP effective January 4, 2016. In Solomon-like fashion, the ASC determined it was in the public interest to allow the operation of the Amended SRP to potentially achieve upside for the Canadian Oil Sands shareholders but directed the end of the Amended SRP (by cease trade) after (having regard to the Holiday Season) effectively a 90 day minimum tender period, but not the full 120 days sought by the Amended SRP**.** At a minimum, the ASC determination allowed the SRP to keep a bidder at bay for longer than the historic period allowed by Canadian securities commissions in the context of evidence that a value maximization process was underway. At the same time, the ASC did not defer to the 120 day period included in the proposed amendments to securities legislation.

While it will take more decisions to clarify if there has been a regulatory shift, it appears that, while 120 days will not be protected as a new minimum tender period, with the right market circumstances and a proper value maximization process still underway targets may hope for 60 or more days to maximize value. The implementation of a modified legislative proposal (perhaps with a waivable 90 day rather than 120 day minimum tender period), would end the uncertainty. That anticipated softening in the length of the minimum tender period is supported by the practical implications of a 120 day tender period insofar as corporate legislation entitling a bidder to obtain any remaining securities when 90% or more of the securities have been tendered to the bid is not available on the expiry of 120 days after the date of a bid. As a result, in order to enable a successful bidder to avail itself of those compulsory acquisition provisions, which are a critical component of the overall takeover bid regime, a minimum tender period shorter than 120 days would be necessary.

We expect shareholder approved 100-110 day minimum tender period SRPs (if you think your shareholders will approve them) or tactical SRPs to be the flavour of the day and notwithstanding the relative (to many other developed nations) target friendly status of takeover bid legislation in Canada, we expect hostile approaches will increase markedly in the oil patch in 2016.

2 | Sources to contribute to unlocking value

At least three collateral structures are expected to offer the opportunity to unlock value for exploration and development companies in 2016: royalty vehicles, midstream structures and SPACs.

Royalty Vehicles Continue

Notwithstanding a generally slow year for M&A activity in 2015, royalty vehicles continued to be buyers, advantaged by a lower cost of capital. Following its spin-off from Encana, PrairieSky Royalty, a vehicle designed to collect royalties from petroleum and natural gas production on fee-simple and gross overriding royalty lands and distribute a majority of its free cash flow to shareholders in the form of dividends, continued its expansion. In November, it announced an agreement to pay $1.8 billion, comprised of $680 million in cash and 44.4 million PrairieSky shares, to Canadian Natural Resources for approximately 5.4 million acres of royalty lands throughout Western Canada, including 2.2 million acres of fee simple mineral title lands. This was after June's announcement that Ontario Teachers' Pension Plan had agreed to acquire Cenovus Energy's wholly-owned subsidiary, Heritage Royalty Limited Partnership

(“HRP”), for $3.3 billion. HRP owns a broad portfolio of oil and gas royalties in Western Canada. PrairieSky, Freehold Royalties and other similarly structured vehicles are expected to continue to be advantaged buyers in 2016 that will assist exploration and development companies in unlocking value from their royalty interests that can be applied to cash-starved capital programs.

Mid-stream Structures

Exploration and development companies with midstream assets will continue to consider the monetization of all or a portion of the independent value of those assets as an income stream to a third party or to established midstream entities by separating and devolving the midstream assets into separate vehicles backed, depending on the intended risk profile of the investment and the circumstances of the exploration and development company, by committed reserves and take-or-pay contracts. The amounts paid for investments in those midstream vehicles (and their income streams) will give the exploration and development companies access to valued additional capital. Such transactions were completed at small and large levels in 2015 (including the establishment of the Veresen Midstream Limited Partnership by Veresen and KKR to acquire natural gas gathering and compression assets supporting Montney development from Encana and Mitsubishi). In addition, a couple of sizable oilpatch participants currently have midstream asset disposition programs aimed at capitalizing on that structure. At the same time, the existing midstream entities and new market entrants in that space (such as CPPIB’s initiative to invest $1 billion in energy infrastructure acquisitions with Wolf Infrastructure Inc.) continue to seek additional assets.

SPACs come to the Oilpatch

After years of being generally facilitated by the rules of the Toronto Stock Exchange but not used, special purpose acquisition vehicles (“SPACs”) made their debut in 2015 with the $100 million issue by Dundee Acquisition Ltd. Following the U. S. structure, SPACs are publicly-traded shell companies that raise capital from public investors (with investors having the right to get their money back if acquisitions are not made) and seek to acquire one or more companies. The Dundee SPAC required significant exemptive relief but now the legal path is reasonably well travelled.

SPACs are founded by a sponsor (or founder) with the credibility and expertise to raise funds and identify a promising operating business. At least 90% of the proceeds raised from the IPO must be placed in escrow to be applied towards funding of a qualifying acquisition. Consistent with U. S. market practice, 100% of the gross proceeds of the funds raised in respect of the Dundee SPAC, and of subsequent examples, from public investors have been escrowed. The founder’s initial equity investment (which has no access to the escrowed funds) effectively pays for the initial underwriting commissions, the costs of the IPO and the funds needed to search for a business following the closing of the IPO and other ordinary expenses (e.g. auditing, public disclosure, etc.). After the SPAC is listed, it has a maximum of 36 months to complete a qualifying acquisition, however, again consistent with U. S. market practice, the initial period required to complete a qualifying acquisition by Canadian SPACs to date has been 21 to 24 months, with an extension to up to 36 months possible with public shareholder approval (although subject to public shareholders’ redemption rights at that time).

One or more SPACs with qualified and experienced management teams are expected to make their appearance in the oil and gas space in 2016, providing a new source of merger and acquisition activity.

3 | Opportunities for new Government to take more sophisticated approach to foreign investment

Inbound foreign investment in Canada's oil and gas sector will continue to be curtailed in 2016, although the new Liberal government has indicated that it recognizes the importance of foreign investment and may look to loosen the rules on investments by state-owned enterprises ("SOEs"). Although depressed commodity prices will continue to dampen investment from all sources, regulatory impediments posed by the Investment Canada Act will, if anything, diminish in 2016, continuing the 2015 trend.

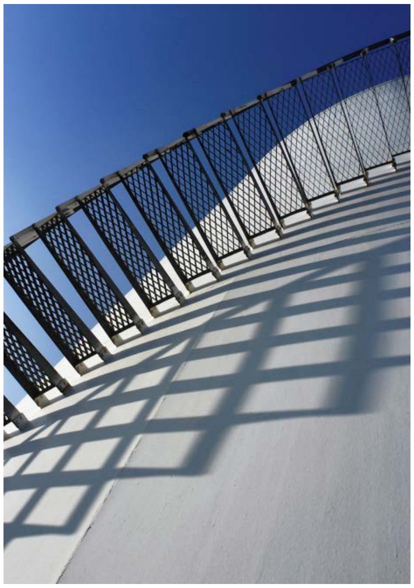
- The threshold for federal government scrutiny of acquisitions of control by investors from WTO member countries increased from $369 million based on book value to $600 million, based on enterprise value, in April 2015. This threshold will increase to $1 billion in 2019.
- Canada is party to both the Trans-Pacific Partnership with 11 other Asia-Pacific Rim countries as well as the Comprehensive Economic and Trade Agreement with Europe. Upon ratification (which could take years), both agreements will increase the review threshold for investors from signatory countries to $1.5 billion for their private investments. SOEs will continue to be reviewed for acquisitions based on $369+ million book value of the Canadian business (to be updated for inflation in January 2016).
- The change in federal government following the October 2015 election presents an opportunity for the new government to take a more nuanced approach to SOE investments, particularly to re-think the previous Conservative government's effective moratorium on large SOE investments in the Canadian oilsands. This policy has been widely criticized after the flow of foreign investment into the sector declined sharply following its announcement in late 2012. While other factors have contributed to this decline, the policy is seen as being targeted in particular against China and Russia – the new government may take a more multilateral approach to foreign policy than its predecessor.
- Despite the change in government, foreign investment in Canada will continue to be scrutinized – and at times challenged – if it raises national security concerns. A maturing of the process will see increased scope for approvals subject to conditions, as opposed to simply blocking an investment. A recent application for judicial review of the issuance of a national security notice without meaningful reasons or opportunity for defense will, if successful, lead to a less political and more predictable foreign investment climate generally.

4 | Pension funds and private equity may step up

Pension funds made considerable investments in 2015, including Ontario Teachers' Pension Plan's acquisition of Cenovus Energy's oil and gas royalties for $3.3 billion and CPPIB's initiative to invest $1 billion in energy infrastructure acquisitions with Wolf Infrastructure Inc.

While many of the key private equity players in Canadian oil and gas are well stocked with available capital and, in many cases, management teams, the pricing requirements of the private equity players were not easily met in 2015. If and when the forward price curves move up, particularly for oil and natural gas liquids, the price gap could be quickly reduced and private equity will again be a participant.

5 | Workouts and recaps will accelerate



The continued low commodity price environment has continued to have a compound effect on available cash flows and reserve valuations that has required covenant breach waivers and downward borrowing base revisions for a growing number of oil and gas companies. With an increasing number of "special loans", the Canadian banks continue to be less aggressive than their peers internationally in dealing with breached lending arrangements. Instead, they have pressured managements of companies with non-performing loans to slash g&a and capital expenditures to subsistence levels but not "tipping them over" into receivership or bankruptcy – remaining biased against becoming owners of an extensive portfolio of oil and gas assets.

However, Spyglass Resources may be among many exploration and development companies that are forced into receivership. Others have transferred assets to lenders in satisfaction of loan liabilities apart from receivership processes. At least a few of the Canadian banks are focused on establishing operating vehicles to take on assets until commodity prices improve.

One issue that should achieve clarification early in 2016 is how abandonment and reclamation costs are to be dealt with, as between lending institutions and the province, in an insolvency situation. Currently before the Court of Queen's Bench of Alberta is an application by ATB Financial in relation to RedWater Oil Corp., a small oil and gas producer that went into receivership in May, to essentially determine whether the Alberta Energy Regulator ("AER") effectively has a priority in the insolvency over the lending institution with respect to amounts claimed by the AER to be a shortfall in respect of security for abandonment and reclamation costs. Relatively inflexible positions taken to date by the AER in relation to Licensee Liability Rating ("LLR") liabilities have broad application across the industry as it is becoming difficult, if not impossible, for some smaller companies with LLR ratios of less than 1.0 to find willing receivers to act in receivership, *Bankruptcy and Insolvency Act* or *Companies' Creditors Arrangement Act* proceedings. Arguments advanced by the AER (and supported by the Orphan Well Association and CAPP), if accepted by the court, could have a material negative effect on lending practices to smaller producers that would seriously impact the ability of such producers to secure financing. The application was heard by Chief Justice Neil C. Wittmann on December 16-18, who reserved his decision. It is expected that the judgment, once pronounced, will be appealed to the Alberta Court of Appeal and, possibly, to the Supreme Court of Canada, if leave is granted by that court.

Connacher Oil and Gas won shareholder and debtholder support for a $1 billion debt-for-equity swap. PennWest Exploration's sale of assets to Cardinal Energy, with the latter financed by a concurrent underwritten equity offering, put a management team back into properties and assisted PennWest's debt reduction program. Recapitalizations, in various forms, are expected to be an increasingly frequent type of transaction in 2016.

6 | Shareholder activism – An exercise in quiet power

As readers of our *2015 Oil and Gas M&A Trends* publication will recall, at this time last year we anticipated that shareholder activism in the sector would escalate from activity levels in 2014, spurred on by a precipitous drop in commodity prices that would favour strong boards and management and strategic thinking against the backdrop of a relatively activist-friendly legal regime.

However, the sheer scale and duration of the commodity price decline in 2015 diminished the significance of many of those supportive aspects; when the industry itself is drowning in debt, cash flows are shrinking and forward strips are varying daily and dramatically, the ability to orchestrate organizational change is overwhelmed by the immediacy of the survival instinct. "Preserving and enhancing shareholder value", ever the activist promise, seemed rather a fanciful dream in the circumstances.

That is not to suggest that activism disappeared from the Canadian oil & gas industry in 2015. Indeed, year-to-date public activist activity is roughly consistent in pure numbers with 2014 and the influence of activists was apparent in a number of significant transactions in 2015, from the acquisition of an Americas Petrogas subsidiary by Tecpetrol (with Horizon Capital objecting) to the aborted sale of Pacific Exploration and Production (formerly Pacific Rubiales) to ALFA and Harbour Energy (with O'Hara Administration objecting).

Looking ahead to 2016, however, and with commodity prices looking to have bottomed and expected to follow a "low and slow" recovery trajectory, opportunities for activists to truly impact the management and direction of both the "walking dead", who simply cannot survive long enough for higher commodity prices to arrive, and those with relatively strong balance sheets should once again play themselves out.

As a semblance of stability once again takes hold in the industry, the exercise of quiet power by activist investors in boardrooms across the patch can be expected to increase, driving changes to boards, the consideration of strategic alternatives and merger activity. Of course where boards and management remain intransigent and resistant to the alternatives available, the Canadian legal landscape remains inviting and facilitative of more aggressive activist activity if necessary. As a result, it's certainly foreseeable that public activist campaigns will again play a more prominent role in those circumstances.

However, educated by the experience of more public activist campaigns and recognizing the vulnerabilities created by the Canadian legal landscape, boards of directors would be expected to follow the trendline of increasing shareholder engagement rather than antagonism and thus drive strategic initiatives proposed or supported by activists from the boardroom table and not the town square.

The legal considerations which drive the potential for activist activity remain largely the same as in prior years, including:

- Early warning disclosure obligations accruing at a 10% shareholding threshold, allowing the quiet accumulation of a significant toehold;
- Ability to solicit up to 15 shareholders without a proxy circular or to publicly broadcast without a proxy circular;
- Ability to requisition a meeting at a 5% shareholding threshold;
- Ability to submit proposals for meetings at a 1% shareholding threshold;
- TSX issuers not being permitted to have staggered boards, allowing wholesale board replacement annually; and
- TSX issuers being susceptible to "withhold the vote" campaigns due to majority voting standard requirements.

It bears mention, however, that in light of the CSA's proposal to amend takeover bid legislation to require takeover bids to be open for a minimum tender period of 120 days, it can be anticipated that, if adopted unchanged, unsolicited takeover bids may diminish even further in frequency. Left with no viable acquisition alternative in the face of an unresponsive target board, acquirors may turn to an activist approach to try and further their interests, including among others by proposing changes to the board of directors.

As a result of all of the foregoing considerations, we are of the view that activism will play an influential role in the changes anticipated to occur in the Canadian oil and gas industry in 2016, to a significant extent out of the public eye but with the potential for more public engagement in the face of uncooperative boards of directors.

7 | Alberta energy companies slash costs, look to terminations as last resort

In December 2014, oil prices were about US$60/bbl. Twelve months later, oil prices are at an 11-year low, hovering around US$35/bbl. In response to this new economic reality and increased regulatory uncertainty in Alberta, many energy companies have cut capital expenditures, instituted compensation freezes or wage rollbacks, asked employees to take unpaid days off, or terminated contractors and employees. For example, at least 17 major projects representing 1.3 million bpd of production, have been cancelled.

The contrast between the 2015 downturn and the 2008/09 recession appears to be rather stark. In 2008, companies cut jobs almost immediately and at a much quicker rate than they have in 2015. However, only about 19,500 oil and gas positions were terminated in 2009 before Alberta's economy quickly entered an uptick and employment opportunities returned. By comparison, 2015 appears to signal a drawn-out downturn for the oil and gas industry. Most employers have looked to terminations as a last resort and have been methodical in seeking alternative and sometimes creative cost-saving measures designed to retain talent.

For instance, a popular tool among employers looking to avoid terminations is a temporary wage rollback. Employers can unilaterally reduce employee remuneration, so long as it does not amount to a fundamental change to the employment relationship. Employers are able to reduce wages by up to 10% before having to seek the consent of the affected employee or risk constructive termination claims. In 2015, there have been numerous instances of employers rolling back salaries by between 10% and 20%. More often than not, affected employees in the oil and gas industry tacitly consent to the reduction without complaint, as the alternative would be to leave the employer and enter a depressed job market.

Notwithstanding a hesitancy to terminate employees, according to the Canadian Association of Petroleum Producers the current downturn has led to over 40,000 terminations in Canada's oil and gas sector since January, with the vast majority of these lost jobs in Alberta. Through the first 11 months of 2015, over 14,000 losses are attributable to group terminations by large employers in the oil and gas sector. Unfortunately, we expect this negative trend will continue into 2016.

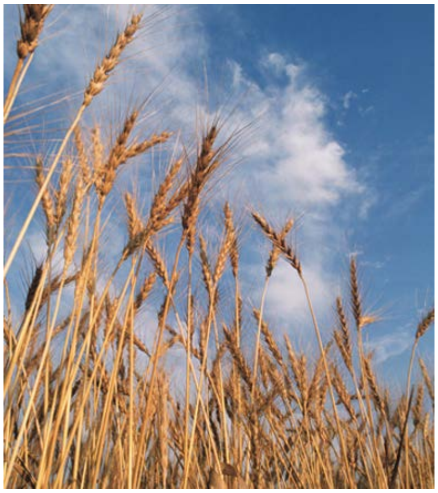
8 | Pipe dreams deferred

It has not been a banner year for major inter-provincial or international pipeline projects in Canada. Apart from Enbridge finally being granted leave to open its Line 9 Reversal Project, 2015 brought little progress to report on the market access front as most of the major projects have been mired in various procedural delays. Despite plummeting oil and gas prices, no proponents have cancelled their major oil pipeline projects, and access to tidewater remains crucial to the viability of Canada's energy sector. In fact, with President Obama's symbolic rejection of Keystone XL (an indiscreet indictment of the carbon footprint of Canada's oil sands) and the ever-increasing reliance by the US on its domestic oil and gas, the issue of access to markets beyond the US is top of mind for oil and gas producers. Shell Canada, for example, cited lack of pipeline capacity to export markets as one of the reasons for its cancellation of the 80,000 bpd

Carmon Creek oil sands project, which was in mid-construction and for which Shell took a $2-billion impairment charge.

Significantly, 2015 marks the end of the Harper era, which made market access a priority, but failed to deliver in a meaningful way. Arguably, the former Prime Minister's streamlining of the environmental assessment process through amendments to the *Canadian Environmental Assessment Act* and the *National Energy Board Act*, among others, fuelled anti-pipeline fervour and increased provincial intervention rather than expediting approvals for proposed projects. The election of the Liberal majority government will have implications for the development and permitting of federally-regulated pipelines. Prime Minister Trudeau's mandate letters to his Ministers of Environment and Climate Change, Natural Resources, and Fisheries, Oceans and the Canadian Coast Guard reveal that:

- a review of Canada's environmental assessment process to regain public trust is to be undertaken immediately;
- the National Energy Board ("NEB") is to be modernized to ensure its composition reflects regional views and has sufficient expertise in fields such as environmental science, community development, and Indigenous traditional knowledge; and
- a moratorium on crude oil tanker traffic on British Columbia's North Coast is to be formalized.



Alberta Premier Notley's recent announcement of her Climate Leadership Plan, which includes an absolute cap on carbon emissions from oil sands development of 100 Mt per annum and a performance-based carbon tax, may also have implications for the amount of pipeline capacity actually required. Though current emissions from the oil sands only total 70 Mt, leaving substantial room for growth in that sector, it is less growth than previously forecast and changes the assessment of the need for, and economics of, the major pipeline projects we describe below. Due to increased global oil supplies and significantly lower prices, in June of 2015, the Canadian Association of Petroleum Producers adjusted its previous forecast of oil production growth (the majority of which is from the oil sands) from 3.7 million bpd in 2014 up to 5.3 million bpd in 2030, the 2030 forecast being 1.1 million bpd lower than the forecast made only one year earlier. Absent significant technological advancements in oil sands emissions management, the 100 MT cap (expected to be reached within the next decade) will bring those growth projections down further. So, while the lack of adequate pipeline infrastructure remains a pressing concern, the issue of how many pipelines are needed is a live one.

The following is a status update on some of the proposed projects.

Kinder Morgan filed its application for approval of the $5.4 billion (now said to have ballooned to $6.8 billion) Trans Mountain Expansion Project with the NEB on December 16, 2013. Two years later, and with numerous procedural and physical hurdles behind it, the project is in the final stretch of the NEB's hearing process. Assuming issuance of the Certificate of Public Convenience and Necessity, Kinder Morgan projects that the Trans Mountain Expansion could be in service in late 2018, though the recent extension in the review process suggests an in-service date no sooner than early 2019.

The Energy East Pipeline is TransCanada's $15.7 billion project comprised of a proposed 4,600 km pipeline to carry 1. 1 mbbls of crude oil per day from Alberta and Saskatchewan to refineries in Eastern Canada (Montréal, Lévis and Saint John). As in the case of the Trans Mountain Expansion project, the federal government has confirmed that the review of Energy East will continue despite the imminent review of environmental assessment and NEB processes. Though the oil and gas industry is reeling from the regulatory uncertainty brought about first by the election of an NDP majority in Alberta and then by the Liberal majority federally, Energy East stands to benefit from the changing political tides. We expect it will be approved and built within a reasonable timeframe. In fact, its odds have improved with the rejection of Keystone XL. If approved, TransCanada anticipates that the pipeline could be in service for deliveries in Québec and New Brunswick in 2020.

The Northern Gateway project was approved subject to 209 conditions when in June 2014, the federal cabinet accepted the Joint Review Panel's recommendation and ordered that the NEB issue Certificates of Public Convenience and Necessity. The election of the Liberals, who are opposed to Northern Gateway, does not bode well for the future of this project.

The final nail in the coffin for Keystone XL came on November 6, 2015: a resounding and not unexpected "no" from President Obama. Presidential Permit denied. First proposed in 2005, TransCanada's Keystone XL Project was an 1897 km crude oil pipeline beginning in Hardisty, Alberta and extending to Steele City, Nebraska. It would have delivered up to 830,000 bbls/d of WCSB and Bakken oil to Gulf Coast and Midwest refineries. President Obama stated that shipping "dirtier oil" into the US would "not increase America's energy security", and approving the project would have "undercut" America's global leadership on climate change. How President Obama came to the conclusion that Keystone XL would not increase America's energy security is entirely murky. While domestic oil production in the US has grown significantly, the US will continue to rely on substantial imports for the foreseeable future. A reduction in imports from Canada necessarily means an increase in imports from OPEC countries. Such a result seems antithetical to energy security; but then, this decision was not about energy security so much as President Obama's credibility in respect of the issue of climate change. Whether bitumen actually remains in the ground as a result of his decision, or whether greater emissions arise from increased rail transport while other pipeline projects seeking access to tidewater navigate the regulatory process, is unclear at this time. TransCanada has stated that it remains committed to building Keystone XL and is reviewing its options to potentially file a new application for a Presidential Permit. The results of the 2016 US presidential election will certainly influence whether the project is resurrected in the future.

9 | Decrease in crude shipped by rail will stabilize

The amount of crude oil exported from Canada by rail sharply decreased in 2015. In 2014, as many as 165,998 bbls/d of crude oil were exported by rail, but that number fell to 83,605 bbls/d in the second quarter of 2015 (a decrease of nearly 50%) before rising in the third quarter to 116,215 bbls/d. The main reason for the decrease from 2014 was the drop in the price of oil. That has made it less economic to ship crude by rail, particularly from the oil sands in Alberta, which generally requires diluent to be mixed with the oil to reduce its viscosity.

Costs for shipping crude by rail also increased in 2015. Contributing was the coming into force of Bill C-52, part of the federal government's response to the increase in shipments of crude by rail and recent accidents, such as the Lac-Mégantic disaster in Québec. Bill C-52 established:

- minimum insurance levels for freight railway operations;
- that a railway company is liable, without proof of fault or negligence, subject to certain defences, for damages resulting from an accident involving crude oil, up to the level of the company's minimum liability insurance coverage; and
- a fund that is financed by levies on shippers to cover the damages resulting from a railway accident involving crude oil that exceed the minimum liability insurance coverage.

In 2016, we expect the decrease in shipments of crude by rail to stabilize to around 2015 levels as the industry adapts to the current market conditions. If oil prices recover in the medium term, there may be an increase in shipments of crude by rail. However, we do not expect the quantities shipped by rail to recover to the levels seen in 2014. By the time oil prices recover, the pipeline capacity bottleneck – which is the main reason for the historic levels of crude being shipped by rail – may be at least partly relieved.

That being said, some of the proposed pipeline projects that will ship crude oil from Alberta are encountering regulatory challenges, which may play in rail's favour. President Obama's recent rejection of the Keystone XL pipeline and Prime Minister Trudeau's call for a moritorium on crude oil tanker traffic on the north coast of British Columbia, which may be the end for Northern Gateway, are examples referred to elsewhere in this publication. However, even if the pipeline bottleneck does ease significantly, despite the regulatory challenges, we expect that the shipment of crude oil by rail is here to stay.

10 | B.C. LNG: one step forward, one step back

A number of B.C. LNG projects are approaching – or at least appear to be approaching – a Final Investment Decision ("FID") to proceed with construction. Usually, there are two important factors that determine whether and when a FID is made: the economics of the project and the status of its required regulatory approvals.

In the past, the economics for B.C. LNG projects appeared promising, while obtaining regulatory approvals was the main obstacle in the way of development. However, over the last 12 to 18 months, it seems the opposite has become true.

The economic prospects for B.C. LNG have dimmed, at least in the medium term. Expected demand for LNG has fallen with the slowing economic growth of the world's leading LNG consuming nations, which are principally in Asia. Worldwide supply of LNG is also increasing. Over 100 MTPA of new capacity is in the process of coming into service, principally from Australia and the US Gulf Coast. This is expected to result in a global over–supply of LNG capacity through to 2022. Prices for LNG, which are traditionally linked to the price of oil, have also fallen recently. The price of oil is less than half of what it was 18 months ago and there are no signs of a quick recovery. The spot price of Asian LNG is now around US$6.60 per mmBtu, about one-third of peak prices in February 2014, which were US$20.50 per mmBtu at that time.

Progress is being made, albeit slowly, on the regulatory front. Some of the leading B.C. LNG projects now hold all of the material regulatory approvals needed to make a FID and the projects still facing the most significant regulatory challenges have at least managed to narrow the outstanding issues requiring resolution.

Project sponsors also usually want to be satisfied that sufficient consents have been obtained from affected First Nations, or at least that sufficient consultation has been undertaken and accommodations have been made. This mitigates the risk of regulatory approvals being overturned by the courts.

Kitimat LNG and LNG Canada hold sufficient regulatory approvals to permit a FID to be made now, if they wished. However, in each case, market conditions are the key consideration and constraint in making a FID. The other projects - Douglas Channel, Pacific Northwest and Woodfibre - now generally hold all material provincial regulatory approvals but each awaits at least one key federal approval. Given the recent election of a new majority federal government, it would not be surprising to see some or all of those regulatory approvals result in some further delays in FIDs.

In April 2015 Shell announced its proposed US$80 billion merger with British Gas. If completed, the BG merger would make Shell the world's largest producer of LNG, with export and regasification facilities on multiple continents, operating the biggest fleet of LNG tankers and holding extensive LNG production or off-take rights in new material projects in some of the largest and most significant new LNG plays, including in the US Gulf Coast and East Africa. The BG merger, to be sure, would have specific and material impacts on BG's proposed LNG projects including, most notably, that a proposed BG LNG facility in Prince Rupert, adjacent to Pacific Northwest's proposed Lelu Island facility would be unlikely to proceed in the foreseeable future, or at all. It would be fair to say that, since the BG merger was first announced, Shell has made it ever clearer that a key rationale, and maybe even the basic rationale, for the transaction was to help make Shell a market leader in global LNG. Shell has a view that the global market for LNG is one of the most important and strategically promising commercial opportunities in the world. Shell has noted that gas-fired power plants are less carbon intensive then coal or oil while being fully despatchable and are capable of providing base-load or peaking power – unlike virtually all renewables. Moreover gas carries with it few of the accident, liability and capital cost risks that have dogged nuclear power generation. This profile gives gas a long term (20-50 years) strategic advantage over other fuel sources. As a result gas has the possibility of emerging as the most widespread "transitional fuel" as the world moves from carbon intensive to carbon free, or at least less carbon intensive, power production. LNG is a critical component of this global gas story: pipelines can make gas a regional, national or even continental product – but only LNG can make it a global one.

This last year also saw the first year of operations of the Chevron/Woodside partnership – which now constitutes the Kitimat LNG syndicate. Chevron and Woodside are also partners on the larger and substantially more advanced Wheatstone LNG project in Australia, a 15 MPTA LNG facility with an estimated capital cost of around US$30 billion. In 2015 they clearly gave Wheatstone higher priority rather than proceeding immediately with Kitimat LNG.

In late January 2015 a new syndicate was unveiled by AltaGas to develop the much smaller Douglas Channel LNG. EDF and Enmar joined Alta Gas and Idemitsu, as they bought the Douglas Chanel project out of bankruptcy and re-launched it.

Looking forward, it is well known that some members of existing syndicates are looking to adjust their current holdings. Several years ago Petronas was widely reported to be looking to reduce its interest in Pacific Northwest LNG from 62% to just over 50%. Moreover, KOGAS has also been widely reported to have been looking, from time to time, to sell down some of its interest in Shell's LNG Canada syndicate. If the developments in the US Gulf Coast are any guide, these kind of syndicate changes or adjustments will only tend to increase as FIDs loom or start to be implemented and funding or guarantee obligations arise. It would not be surprising to see much the same dynamic play out with B.C.'s LNG projects in 2016.

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