

**Natural Gas Exchange Inc. ("NGX")  
Canadian Insolvency Law**

**Would NGX's Counterparty's Agreement (the "CPA") and Specific Transactions carried out thereunder ("Transactions"), be considered to be "eligible financial contracts" ("EFCs") in an insolvency of NGX or of a Counterparty (a "CP")?**

**The EFC Statutory Provisions**

In Canada, provisions regarding EFCs have been enacted in a number of Federal statutes: the *Companies' Creditors Arrangement Act* (the "CCAA"), the Proposal sections of the *Bankruptcy and Insolvency Act* (the "BIA") and the *Winding-up and Restructuring Act* (the "WURA").

Currently, in a debtor's proceedings under the CCAA, WURA or in Proposal proceedings under the BIA, counterparties of the debtor enjoy the following rights (despite the existence of a Court-ordered or statutory stay of proceedings that would otherwise prohibit all creditor action) if their contract with the debtor is an EFC:

- (a) if a provision in the EFC allows such counterparties to terminate or amend the EFC, or claim an accelerated payment under the EFC upon the insolvency of the debtor, the counterparty cannot be stayed from doing such things;
- (b) the counterparty cannot be stayed from exercising its set-off rights granted in the EFC; and
- (c) if the EFC provides for the calculation of a net termination value upon the contract's termination, the counterparty is entitled to rely upon such net termination value and if the net amount is owed to it by the insolvent, the counterparty is a creditor of the insolvent person, with a claim in the proceedings for that net termination value.

On November 17, 2007, a new statutory definition of EFCs came into force. EFCs are now defined in Regulations to the CCAA, the BIA and the WURA as follows:

1. The following definitions apply [refers to relevant Regulations].

"derivatives agreement" means a financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities or other ownership interests, credit or guarantee obligations, debt securities, climatic variables, bandwidth, freight rates, emission rights, real property indices and inflation or other macroeconomic data and includes

- (a) a contract for differences or a swap, including a total return swap, price return swap, default swap or basis swap;

- (b) a futures agreement;
- (c) a cap, collar, floor or spread;
- (d) an option; and
- (e) a spot or forward. (*contrat dérivé*)

“financial intermediary” means

- (a) a clearing agency; or
- (b) a person, including a broker, bank or trust company, that in the ordinary course of business maintains securities accounts or futures accounts for others. (*intermédiaire financier*)

2. The following kinds of financial agreements are prescribed for the purpose of the definition “eligible financial contract” in [refers to relevant section in relevant Act]:
- (a) a derivatives agreement, whether settled by payment or delivery, that
    - (i) trades on a futures or options exchange or board, or other regulated market, or
    - (ii) is the subject of recurrent dealings in the derivatives markets or in the over-the-counter securities or commodities markets;
  - (b) an agreement to
    - (i) borrow or lend securities or commodities, including an agreement to transfer securities or commodities under which the borrower may repay the loan with other securities or commodities, cash or cash equivalents,
    - (ii) clear or settle securities, futures, options or derivatives transactions, or
    - (iii) act as a depository for securities;
  - (c) a repurchase, reverse repurchase or buy-sellback agreement with respect to securities or commodities;
  - (d) a margin loan in so far as it is in respect of a securities account or futures account maintained by a financial intermediary;
  - (e) any combination of agreements referred to in any of paragraphs (a) to (d);

- (f) a master agreement in so far as it is in respect of an agreement referred to in any of paragraphs (a) to (e);
- (g) a master agreement in so far as it is in respect of a master agreement referred to in paragraph (f);
- (h) a guarantee of, or an indemnity or reimbursement obligation with respect to, the liabilities under an agreement referred to in any of paragraphs (a) to (g); and
- (i) an agreement relating to financial collateral, including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to an agreement referred to in any of paragraphs (a) to (h).

### **Judicial Interpretation of the New EFC Definition**

As of the date hereof, no Canadian Court has yet interpreted the new EFC definition.

Under the new definition, the CPA or Transactions will be found to constitute EFCs if they are characterized as "derivatives agreements" (whether settled by payment or delivery) that either "trade on a futures or options exchange or board, or other regulated market"; or are "the subject of recurrent dealings in the derivatives market or in over-the-counter securities or commodities markets".

To be found to be "derivatives agreements", the CPA and Transactions must be "financial agreement[s] whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as . . . commodities and includes . . . a futures agreement . . . and a spot or forward".

We will first discuss the characterization of Transactions, since the new EFC definition stipulates that any master agreement in respect of an EFC is also an EFC. We believe that the CPA would be found to be a master agreement in respect of Transactions. Therefore, if Transactions are found to be EFCs, the CPA will also be an EFC.

We are of the view that financially-settled Transactions should be found by Canadian courts to constitute EFCs without difficulty. The balance of this memorandum will therefore discuss only physically-settled Transactions.

Given that the new EFC definition relies heavily on financial market terminology, it is quite likely that Canadian Courts (as they did in previous cases when called on to interpret the old EFC definition) will rely on evidence from financial markets experts, in determining whether or not an agreement constitutes an EFC. We have not commissioned an opinion from such an expert. However, NGX has advised us that, in its experience, financial market participants and experts would hold the following opinions about the CPA and Transactions:

- (a) they are derivatives agreements, as that phrase is defined in the new provisions;
- (b) Transactions are futures agreements or forwards; and
- (c) Transactions "trade on a futures or options exchange or board, or other regulated markets" or are "the subject of recurrent dealings in the derivatives market or in over-the-counter securities or commodities markets".

We have assumed for the purposes of this Memorandum that financial market participants and experts would hold these views about the CPA and Transactions.

"Financial agreement" is not defined in the new EFC definition, although examples of financial agreements (including futures agreements and forwards) are listed. As noted, we have assumed that Transactions fall within this list of examples.

We note as well that the decision of the Alberta Court of Appeal in *Re: Blue Range Resource Corp.* 2000 ABCA 239 would likely support the characterization of Transactions as one of the listed financial agreements, specifically "physically-settled forward commodity contracts". This is because Transactions involve either natural gas or electricity, both of which satisfy the *Blue Range* test as commodities capable of being the subject of forward contracts (*i.e.* both are fungibles that are interchangeable and capable of being traded on futures exchanges or as the underlying assets of over-the-counter derivative transactions, and both trade in volatile markets with sufficient trading volumes to ensure competitive trading prices, such that Transactions can be "marked to market" to determine their value).

Even if we are incorrect in the assumption that Transactions are included in the list of example financial agreements, we believe that Canadian courts should find Transactions to comprise financial agreements, in substance.

The Ontario Court of Appeal, in *Re: Androscoggin Energy LLC* (2005), 8 C.B.R. (5<sup>th</sup>) 11 (for the purpose of interpreting the old EFC definition) considered the types of contracts that serve "financial purposes". Essentially, the Court held that contracts can be "financial" in substance (*i.e.* involving an element of financial risk management or hedging) if, properly interpreted as a whole, they include the "hallmarks" of financial contracts, such as termination, set-off and net termination value rights exercisable in the face of a counterparty's insolvency. While the presence or absence of the hallmarks will not be determinative, their presence will be indicative that the contract in question is or can be financial in nature. It is not unreasonable to assume that Canadian courts, when they interpret the new statutory term "financial agreement", will take guidance from the *Androscoggin* decision.

Transactions, which incorporate the provisions of the CPA, grant to both NGX and CPs, termination, set-off and net termination value rights, in the face of the insolvency of the other party. Transactions are also capable of serving a financial purpose. We therefore believe that Canadian courts should find that Transactions, in substance, are financial agreements.

As noted above, we have also assumed that Transactions are derivatives agreements that "trade on a futures or options exchange or board, or other regulated markets" and that are also "the subject of recurrent dealings in the derivatives market or in over-the-counter securities or commodities markets". The wording of this requirement in the new definitions is somewhat awkward, as it is not clear whether it is the derivatives agreements themselves, or the underlying reference items on which they are based (such as commodities), that are required to trade on exchanges, etc. or be the subject of recurrent dealings, etc. We believe that Canadian courts should find the better interpretation to be that the exchange/dealing requirement refers to the underlying reference items, not to the derivatives agreements themselves. To hold otherwise would arguably limit the EFC protections to derivatives agreements that are commonly assigned and reassigned, which is not in accordance with the stated intention of the new enactments (to, among other things, ensure that Canadian financial market participants are provided with expansive protection and that Canadian financial markets remain competitive internationally).

Based on the assumptions and reasoning set out above, we believe that Canadian courts should come to the conclusion that Transactions and the CPA are EFCs and that NGX and CPs would therefore be entitled, in proceedings under the CCAA, the WURA and Proposal proceedings under the BIA, to exercise all their rights under the CPA to terminate, accelerate, set-off and determine net termination values.

**This Memorandum relates solely to matters of Alberta law and Canadian law applicable in the Province of Alberta, as of the date hereof. The relevant legislation can be amended or repealed altogether and new legislation enacted. The Courts can also effect significant changes to the interpretation of the legislation and alter the practices followed to this date. We do not undertake to update this Memorandum in the event of a change in law or practice.**

**This Memorandum is given for the sole benefit of NGX and may not be relied upon by any other person unless we otherwise specifically agree with that person in writing, except that we consent to a copy of this Memorandum being shown to the CFTC and posted on the CFTC's internet website in connection with NGX's application to be registered as a DCO, and solely on the basis that we accept no responsibility or liability to any person other than NGX. Any person other than NGX who has an interest in the subject of this Memorandum should obtain their own legal advice with respect to issues addressed in this Memorandum.**

Bennett Jones LLP

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