News

Ontario court spells out bought deal requirements

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For the first time in a Canadian court, the enforceability of a bought deal engagement letter has been tested.

In *Stetson Oil & Gas Ltd. v. Stifel Nicolaus Canada Inc.* [2013] O.J. No. 1058, Justice Frank J.C. Newbould of the Ontario Superior Court of Justice, Commercial List, held that the engagement letter of the bought deal was a binding agreement requiring the underwriter, Thomas Weisel (the name was changed to Stifel Nicolaus Canada Inc. near the end of the trial), to close the bought deal.

Stetson was awarded damages of $16-million, representing the shortfall between the proceeds it would have received under the Thomas Weisel bought deal and the proceeds it received under subsequent financing (based on the number of shares that Thomas Weisel offered to purchase).

"Because of this case, a bought deal is a bought deal," said Arthur Hamilton, a partner with Cassels Brock & Blackwell, who represented the plaintiff along with partner Lara Jackson. "It says that if an investment bank is going to take the risk, which is what a bought deal does, they had better be confident that they can close on the terms that they have announced to the public."

Toby Allan, a Fraser Milner Casgrain partner who practices securities and corporate law in Calgary, said that out of the decision, "It's important that underwriters ensure that their bought deal letters contain appropriate termination rights and conditions that provide protection for them during that interim period until a formal underwriting agreement is actually executed."

A "bought deal" is when an investment bank buys a securities offering and assumes the risk (that securities may lose value or not sell at all) in return for a negotiated discount.

Stetson began in 2008 when Stetson Oil & Gas Ltd., a TSX Venture Exchange-listed junior oil and gas exploration company, wanted to raise $25-million to buy land in the Bakken formation in North Dakota. Thomas Weisel Partners Canada Inc. offered to purchase the issuer's securities at a fixed price and take the risk of selling them in the market at a profit. When the offering was not well received, the underwriter backed out of the deal and Stetson, going through another dealer, managed to raise only $12-million. Stetson sued for breach of the bought deal engagement letter.

Thomas Weisel argued that it didn't have to complete the deal because the engagement letter was merely an "agreement to agree," and even if it was binding, their obligation to complete the financing was subject to a number of "outs," including a "material adverse change out" and a "disaster out," which would rely on circumstances.

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"[Bought deals] are expected to sell in the first few days and the underwriting agreement is negotiated closer to the closing," Jackson said. "So I don't think it was unusual that the determination rights weren't specifically defined in the bought deal engagement letter. But what happened here was that Thomas Weisel…didn't place the deal in the ordinary course, and when it went to rely on the termination rights, none of them had been negotiated."

Allan explained that the court determined that the underwriter wasn't entitled to have those rights [outs] because they weren't spelled out in the engagement letter itself. "In a typical transaction," he said, "even if you did have those termination rights in your letter or entered into an underwritten agreement that had them, in the context of what the industry refers to as a 'bought deal,' it's generally intended and understood that the number of options and termination rights are relatively limited and intended to deal with specific items that the court said don't relate to ordinary changes in market price."

Hamilton said the case has drawn a very clean distinction between a material adverse change (or "MAC clause") — often found in mergers and acquisitions that can nullify a deal because of adverse changes such as, in this case, a fall in the price of oil — and a market out clause, which simply lets the underwriter get out of a deal penalty-free.

"The market out clause cannot and should never be part of a bought deal, because then you don't have a bought deal," he said. "This decision brings some balance back that a bought deal's terms must be respected. So with no market out clause *ever* coming into a bought deal situation, what an underwriter is left with is the MAC clause, and Justice Newbould has done a very good job delineating what constitutes MAC considerations."

In another wrinkle to the case, Allan points out that Stetson was a private placement, and that with a public bought deal, securities law requirements themselves would see the bought deal letter as a binding obligation. Nevertheless, he sees the *Stetson* decision as a cautionary tale for every bought deal. "The lesson is that your obligation arises at the time of the letter, so you want to make sure you have the appropriate protections built into the letter itself."

Stifel Nicolaus Canada Inc. says it plans to appeal.

Heat: Schmidt case fallout sparks anger, disappointment among MPs

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when they are not provided complete constitutional information with respect to proposed legislation," Cotler argued. "Members are impeded in the performance of their constitutional functions and responsibilities as holders of the public purse when they pass bills that invite costly and lengthy constitutional challenges against which the government must then defend at taxpayers' expense."

Nicholson defended how he carries out his statutorily-imposed obligations to inform MPs about constitutional flaws in proposed legislation. "This government has never introduced any legislation that I believe was inconsistent with the *Canadian Charter of Rights and Freedoms* or the *Canadian Bill of Rights*," he assured MPs.

Scheer ultimately dismissed the complaints of both Cotler and Martin, asserting it wasn't the Speaker's role to determine if "the government is meeting its obligations under the law."

The issue is before the Federal Court in a high-profile action against the Attorney General of Canada launched last December by Department of Justice general counsel Edgar Schmidt. He is seeking a declaration that Nicholson and his officials are applying an unduly lax standard in discharging the Minister's responsibilities under s. 4.1 of the *Department of Justice Act* and s. 3 of the *Canadian Bill of Rights* to examine bills and proposed regulations for *Charter* and *Bill of Rights* compliance and report any inconsistencies to the Commons.

Said Scheer: "Given the chair's limited scope to consider legal matters, and based solely on what is within my purview to consider, I cannot comment on the adequacy of the approach taken by the government to fulfill its statutory obligations. I can therefore find no evidence that [Mr. Martin's] privileges have been breached, and cannot see how this rises to a matter of contempt."

Martin expressed disappointment with the Speaker's ruling. "I still think our argument has merit, and the evidence that something is amiss is in the sheer volume of legislation that is being challenged," he told *The Lawyers Weekly*.

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> **Irwin Cotler**
> Liberal MP

He predicted that "it will become a routine question in any piece of legislation to ask the [justice] minister what advice he received from DOJ officials pertaining to constitutionality."

Cotler and Nicholson appeared to take different views of the scope of the Minister of Justice's statutory examination responsibilities.

"We are speaking about statutory directives, those which engage the responsibilities of members of this House," Cotler stressed. "It is not a matter simply between the Minister and the Crown. It is not simply a matter of what the Minister believes; it is the effect that accrues from the constitutional responsibilities with respect to these statutes."

Nicholson acknowledged to MPs that "my statutory duty is owed to the House of Commons."

However, in his March 21 statement of defence to Schmidt's case, he told the Federal Court that "the Minister and his officials are legal advisers to the executive branch of government, not to Parliament."

"As legal advisers to the executive," he elaborated, "the Minister may answer questions in the House and he and his officials may appear before Parliamentary committees and respond to written questions to explain the government's legal position on the legislation that it has introduced. However their role is not to provide legal advice to Parliament."

Parliament can rely for legal advice on its own lawyers, as well as law professors and members of the bar who testify before committees, says the statement of defence.

Moreover, the Minister's statutory obligation to alert MPs to *Charter* inconsistencies "does not require that there be disclosure any time there is a risk, only that I ascertain that there is inconsistency," Nicholson told the Commons. "I must stress that the approach I have described is not new. It originates from the earliest days following the enactment of section 4.1."