

## **Of Busted Butterflies and the Duty of Good Faith – A Saskatchewan Right of First Refusal Case**

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**Case Commented On:** *Northrock Resources v ExxonMobil Canada Energy*, [2016 SKQB 188](#)

What is the legal position if N has a right of first refusal (ROFR) in the event that E agrees to sell its interest, unless E's sale is to an affiliate; E transfers the interest to its wholly owned affiliate, NSCo and C then buys the shares of NSCo. Does the second transaction or the two transactions taken together (known in tax parlance – for reasons that, as with much of tax law, entirely escape me – as a “busted butterfly” trigger N's ROFR entitlement (perhaps on the basis that E should not be able to do indirectly what it cannot do directly)? Justice Currie of the Saskatchewan Court of Queen's Bench answered in the negative and as a result dismissed Northrock's (N's) claims which sounded in both contract and in tort (inducing breach of contract and conspiracy).

### **The Facts**

ExxonMobil (E) was interested in disposing of certain oil and gas producing assets in Saskatchewan. Some of those assets (the assets at issue here) were subject to a unit agreement and a unit operating agreement as well as another relevant agreement which provided Northrock (N) with a ROFR. In offering the properties for sale through an electronic data room, E indicated that it was interested in entertaining tax effective offers for the assets involving either a sale of the assets or a busted butterfly structured as above, under which E would transfer the assets to a Nova Scotia corporation (NSCo) (E's affiliate) following which the purchaser would buy the shares in NSCo. Most interested purchasers submitted alternative offers using both structures. E disclosed that the relevant properties were subject to ROFRs. E eventually selected the offer of Crescent Point (C) with the deal to be structured as a busted butterfly. E procured N's consent to the transfer to NSCo but in giving its consent N indicated that it objected to any transfer of the shares of NSCo to a third party without new ROFR notices. Neither E nor NSCo provided additional ROFR notices to N and the transaction closed with C acquiring the shares of NSCo.

N commenced this action suing E, C, and NSCo, alleging breach of contract, breach of a duty of a good faith, and the torts of inducing breach of contract and conspiracy. N sought a series of remedies including a declaration of trust, specific performance, damages, and punitive damages.

### **The Judgment**

#### ***Breach of Contract***

Justice Currie concluded that there was no ambiguity in the documents before him. The relevant agreements expressly exempted transfers to an affiliate from the ROFR obligations and did not address any subsequent sale of the shares of that affiliate. The parties could have bargained for such a provision but had not done so, and the Court was not prepared to read any such obligation

into the agreements. The same reasoning applied even where N was a successor in interest to the original agreement.

[54] ... an examination of the ROFR provisions reveals that the parties to the agreements did not intend that every circumstance of a party divesting itself of an interest would trigger a ROFR. In negotiating the ROFR provisions they chose which divestitures would be singled out for a restriction on the right of a party to deal with its own property.

[55] The parties have used clear language in the agreements. They said what they intended to say in the agreements, having chosen and identified what they were prepared to agree to. Since the meaning of the parties' words is clear, this is not a case of that meaning constituting an interpretation that defeats the intentions of the parties. Rather, those clear words communicate the intentions of the parties.

[56] The transaction, structured as it was to involve the transfer of interests to the NSULCs [Nova Scotia unlimited liability corporations] and the sale of the shares of the NSULCs, did not trigger the ROFR provisions of either agreement. ExxonMobil did not breach its agreements with Northrock by failing to provide ROFR notices.

### ***Breach of the Duty of Good Faith***

Neither was there a breach of the duty of good faith (and the Court considered this as a separate head rather than as part of the contractual analysis). The case law cited by the court (*GATX Corp. v Hawker Siddeley Canada Inc.* (1996), 27 BLR (2d) 251 (Ont Ct J), *Glimmer Resources Inc. v Exall Resources Ltd.* (1997), 35 BLR (2d) 297 (Ont Ct J) and *Chase Manhattan Bank of Canada v Sunoma Energy Corp*, 2002 ABCA 286, 317 AR 308) established that there might be breach of a duty of good faith in a ROFR context if a transaction were structured for the sole purposes of avoiding triggering a ROFR or (at para 66) "where a party is shown to have lied or misled, thereby breaching the duty of honest performance", but not when it is structured in such a way for other legitimate reasons such as tax reasons or, in the case of a sale by a receiver, to maximize values. The evidence in the case supported the conclusion that E adopted the busted butterfly structure for tax reasons and was not motivated to elect this structure so as to avoid its ROFR obligations. E's good faith in making this determination was not compromised by the fact that E's employee handling the matter sought a series of legal opinions on the general question of whether a butterfly transaction might trigger a ROFR, even though those opinions expressed some uncertainty as to the precise legal position. Justice Currie reasoned as follows (at paras 80 & 83):

A decision can be a *bona fide* business decision, even in the face of some risk or uncertainty. Many business decisions involve risk and uncertainty. They involve weighing the risk and uncertainties. That is the nature of business. The element of uncertainty about the legal opinions does not affect my acceptance of Mr. Graham's testimony that ROFRs were a detail that did not affect the decision, because the decision was driven by the concern for the tax pools.

In this case, the essence of the decision was that the busted butterfly structure could result in a benefit to ExxonMobil of \$29 million, with a negligible related cost.

....

Further, I am not persuaded of the validity of the proposition that a client may *bona fide* follow legal advice only if that advice ultimately proves correct. Such a proposition is entirely impractical, given the complexities of the law and of the wide range of circumstances to which it applies. Similarly, it strikes me that following legal advice is an indication of, if anything, *bona fide* conduct rather than the opposite.

Neither was this conclusion affected by evidence in which E's tax expert acknowledged that the tax advantages that might accrue to E were also not certain.

Finally, the evidence showed that C itself was neutral as to how to structure the deal (although one employee, not the relevant decision-maker, did advert to structuring so as to "circumvent the ROFR" (at para 71)) given that it was organized as a trust but that it was happy to accommodate E's preference in terms of structure. C was focused on the value of the assets and winning the bidding competition rather than avoiding the ROFR.

Given that there was no breach of the duty of good faith it was unnecessary for the Court to decide (at para 105) whether all the defendants had such a duty or whether such a duty might only be owed by those (E in this case) in a privity relationship.

### ***Tort***

Finally, since there was no breach of contract there could be no tort of inducing breach of contract; neither could N establish a conspiracy to deny Northrock its ROFR since, as already held, that was not the predominant purpose of the conduct of the relevant parties and neither was the defendants' conduct unlawful (since it was not in breach of contract).

### **Conclusion**

The relationship between ROFRs and busted butterflies (or more prosaically inter-affiliate transactions) has long been a source of considerable uncertainty for transactional lawyers in the oil and gas industry. This decision offers some guidance to parties but we need further endorsement from an appellate court in order to deliver any real certainty. Furthermore, the decision does not answer all of the potential questions surrounding the relative weighting of the structuring drivers i.e. the relative importance of ROFR avoidance as a motivating driver versus the importance of other factors which might drive the structuring of the transaction.

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