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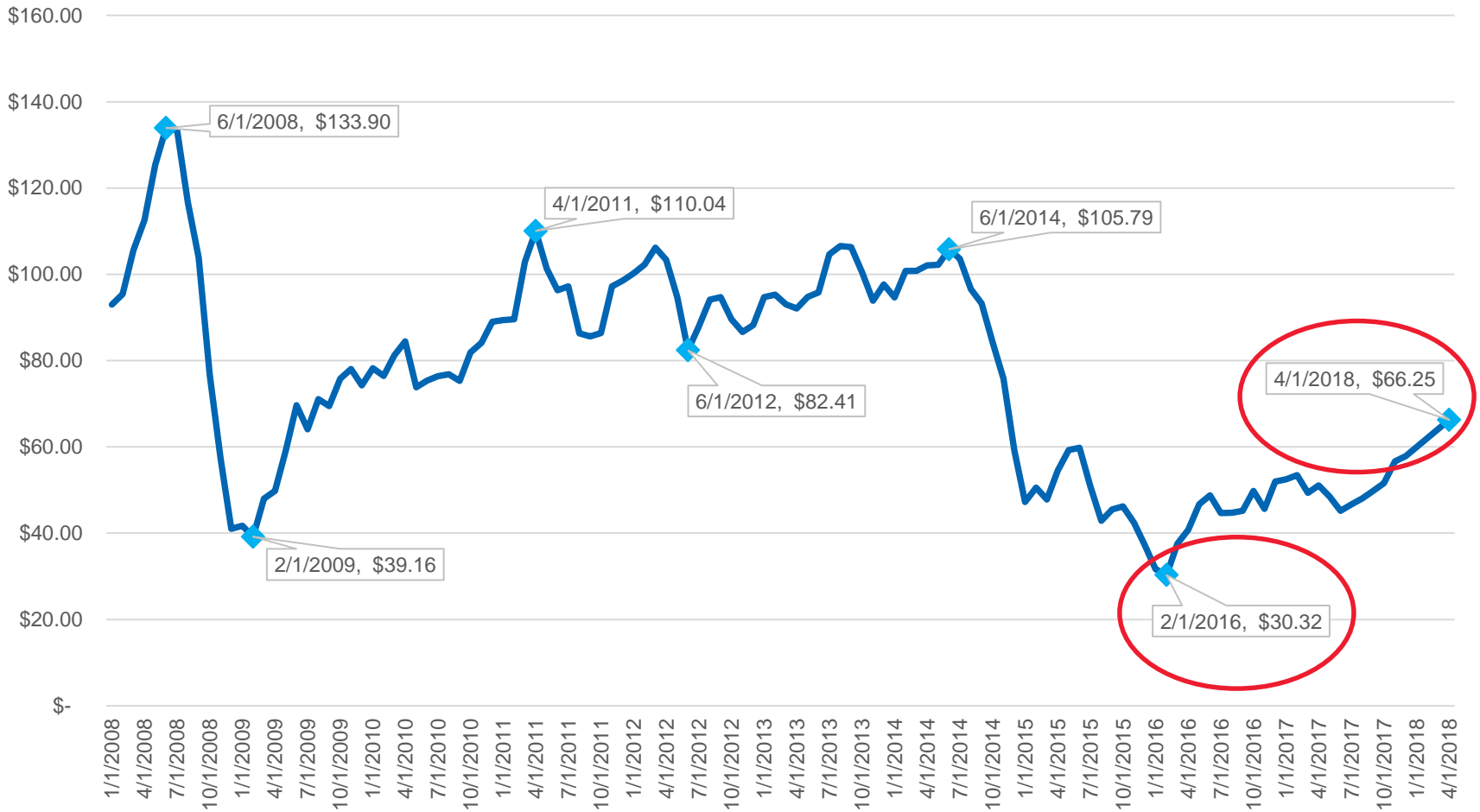
Specific Performance, Mitigation and Valuation Issues in a Rising (or Falling) Market

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WTI Spot Prices Over the Last 10 Years*

(in USD)



*Data taken from eia.gov

Northrock v. ExxonMobil Canada (EMC)

- *Northrock v ExxonMobil Canada Energy*, 2016 SKQB 188
- *Northrock v ExxonMobil Canada Energy*, 2017 SKCA 60

Northrock v. EMC (Facts)

The Bids



- In August 2005, ExxonMobil Canada (EMC) commenced a competitive bid process to divest PNG rights in Saskatchewan.
- Northrock and Husky collectively held ROFR rights over ~10% of the applicable assets.
- The bid process contemplated “share” bids or “asset” bids.
- Crescent Point Income Trust submitted the winning “share” bid, valued at ~ \$250M.

Northrock v. EMC (Facts)

The Transaction



- The sale (January 2006) was structured as a two-step “busted butterfly.”
- Step 1: EMC transferred assets to newly incorporated / wholly-owned companies.
- Step 2: Crescent Point redeemed the shares of the newly incorporated companies.
- There was an affiliate transfers ROFR exception in the agreement between EMC, Northrock & Husky.
- The sale was structured to maximize after tax sales proceeds. Northrock alleged, in part, that the sale was structured to avoid the ROFR.

Northrock v. EMC (Decision)

The Result



- Prior to closing (Jan 2006), Northrock sued, seeking (1) injunction; (2) specific performance; and (3) alternatively, **\$2.5M in general damages**.
- Trial was heard in September 2015 (7 lay witnesses, 6 expert witnesses).
- Expert Valuation Damages Evidence:
 - Northrock: **\$60.8M -- \$74.1M**.
 - EMC: **\$0 and \$15.0M**
- Court found ROFR not triggered. Did not address damages. Decision upheld on appeal.

ROFRs, and Busted Butterfly Transactions



“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)?”

-Nigel Banks, “Of Busted Butterflies and the Duty of Good Faith,” June 22, 2016 (Ablawg.ca)

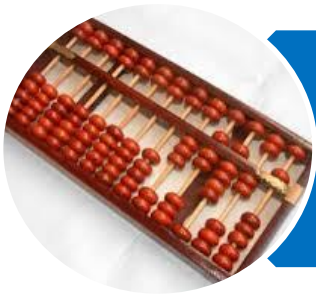
Outline



1. Specific performance or damages?



2. If not specific performance, what is the appropriate valuation date?



3. How to address mitigation & other selected topics

Specific Performance or Damages?

Recent Canadian Trends

Pre-Semelhago
(1996)

“Blackacre has no readily available equivalent...”

Semelhago
(1996-2012)

“Evidence that the property is unique...”

Southcott
(2012)

“Only where money cannot compensate fully...”



Specific Performance or Damages?

Post *Southcott* Analytical Approach



- Specific performance = judicial discretion (flexible remedy)
- Test = specific performance available where money cannot compensate for the loss, due to some peculiar or special value of asset
- Given rationale, SP less likely in commercial matters (vs. residential or personal property)
- Business rationale test (*Walton*, ABCA, 2007)
- The claimant has the onus at trial, BUT onus on moving party at prelim stage.

Specific Performance ~ Oil & Gas Context

Oil Isn't Unique, but the Opportunity Might Be

TITLE DEED PARK PLACE	
RENT	\$35.
With 1 House	\$ 175.
With 2 Houses	500.
With 3 Houses	1100.
With 4 Houses	1300.
With Hotel	\$1500
Mortgage Value	\$175.
Houses cost	\$200. each
Hotels, \$200. plus 4 houses	
<small>If a player owns ALL the lots of any Color - Group, the rent is Doubled on Unimproved Lots in that group.</small>	

TITLE DEED BOARDWALK	
RENT	\$50.
With 1 House	\$ 200.
With 2 Houses	600.
With 3 Houses	1400.
With 4 Houses	1700.
With Hotel	\$2000
Mortgage Value	\$200.
Houses cost	\$200. each
Hotels, \$200. plus 4 houses	
<small>If a player owns ALL the lots of any Color - Group, the rent is Doubled on Unimproved Lots in that group.</small>	

BOARDWALK	LUXURY TAX	PARK PLACE
PRICE: \$100	PRICE: \$100	PRICE: \$100
PAY \$75.00		

BOARDWALK	LUXURY TAX	PARK PLACE
PRICE: \$100	PRICE: \$100	PRICE: \$100
PAY \$75.00		



Adjacency – Is the property contiguous with another owned property?

Synergy – Would this property create synergistic benefits?

Majority – Would this property create majority control?

Specific Performance or Damages?

The *Canlin* Decision



- *Canlin Resources v Husky*, 2018 ABQB 24
- Natural gas facility, owned by Husky, Canlin and CNRL, operated as joint venture.
- Husky, as operator, shut down and decommissioned part of the property, preventing Canlin from processing gas.
- Husky arranges sale of certain assets, including interest in facility, to Ikkuma.
- Canlin sues, seeking declaration of a ROFR, and for specific performance of the ROFR.

Specific Performance or Damages?

The *Canlin* Decision



- ROFR issued in September 2017. Decision issued on January 11, 2018.
- Specific performance granted:
 - Facility creates critical link between Canlin wells and infrastructure.
 - Canlin asserted its claim early and often.
 - Canlin led evidence of the benefit to purchasing majority interest in the facility.
 - Ikkuma was aware of Canlin claim before closing balance of transaction.

Specific Performance or Damages?

Practical & Strategic Considerations



Act quickly to assert claim – time is of the essence.



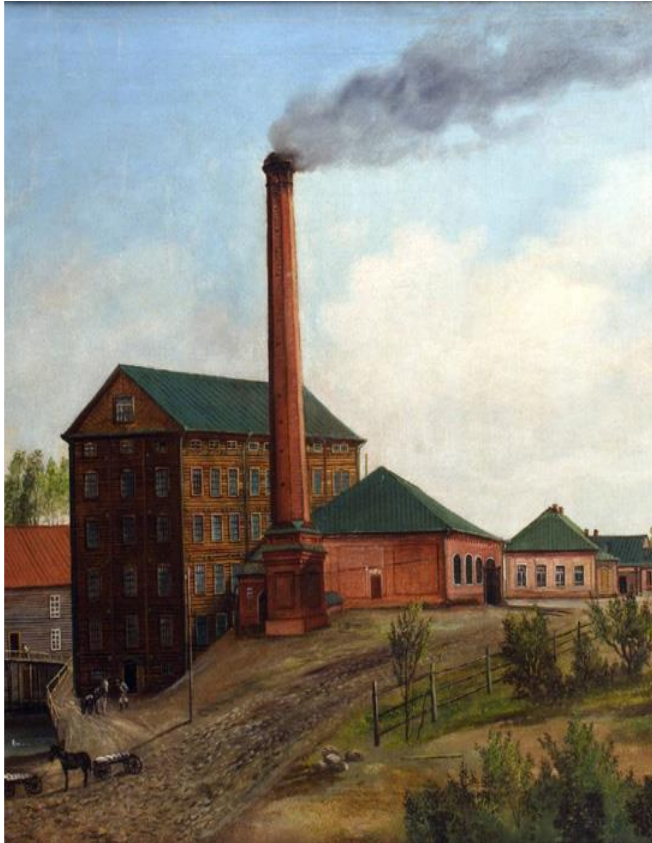
Lead evidence of uniqueness – synergies, business plans, adjacent property, operatorship, availability of similar assets,



Notice is key – informal / formal notice (land titles, injunction, etc.), minimize third party prejudice

Valuation Date

Valuation and Remoteness



- *Hadley v Baxendale*, (1854) 9 Ex 341
- Damages for breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach.

Valuation Date

Valuation, mitigation, and market risk

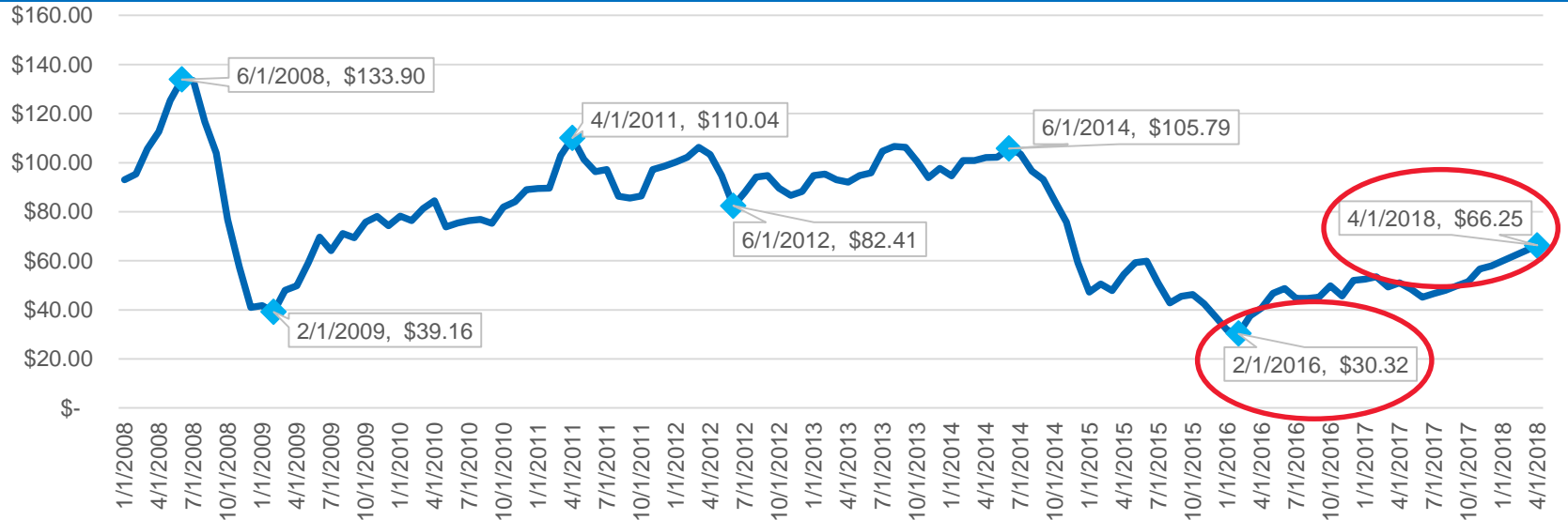


- *Asamera Oil Corporation Ltd. v Sea Oil & General Corporation*, [1979] 1 SCR 633
- “It is inappropriate in my view simply to extend the old principles applied in the *detinue* and conversion authorities to the non-return of shares with the result that a party whose property has not been returned to him, could sit by and await an opportune moment to institute legal proceedings, all the while imposing on a defendant the substantial risk of market fluctuations between breach and trial which might very well drive him into bankruptcy. Damages which could have been avoided by the taking of reasonable steps in all the circumstances should not, and indeed in the interests of commercial enterprise, must not be thrown onto the shoulders of a defendant by an arbitrary although neatly universal rule for the recovery of damages on breach of the contract for redelivery of property.”

Valuation Date

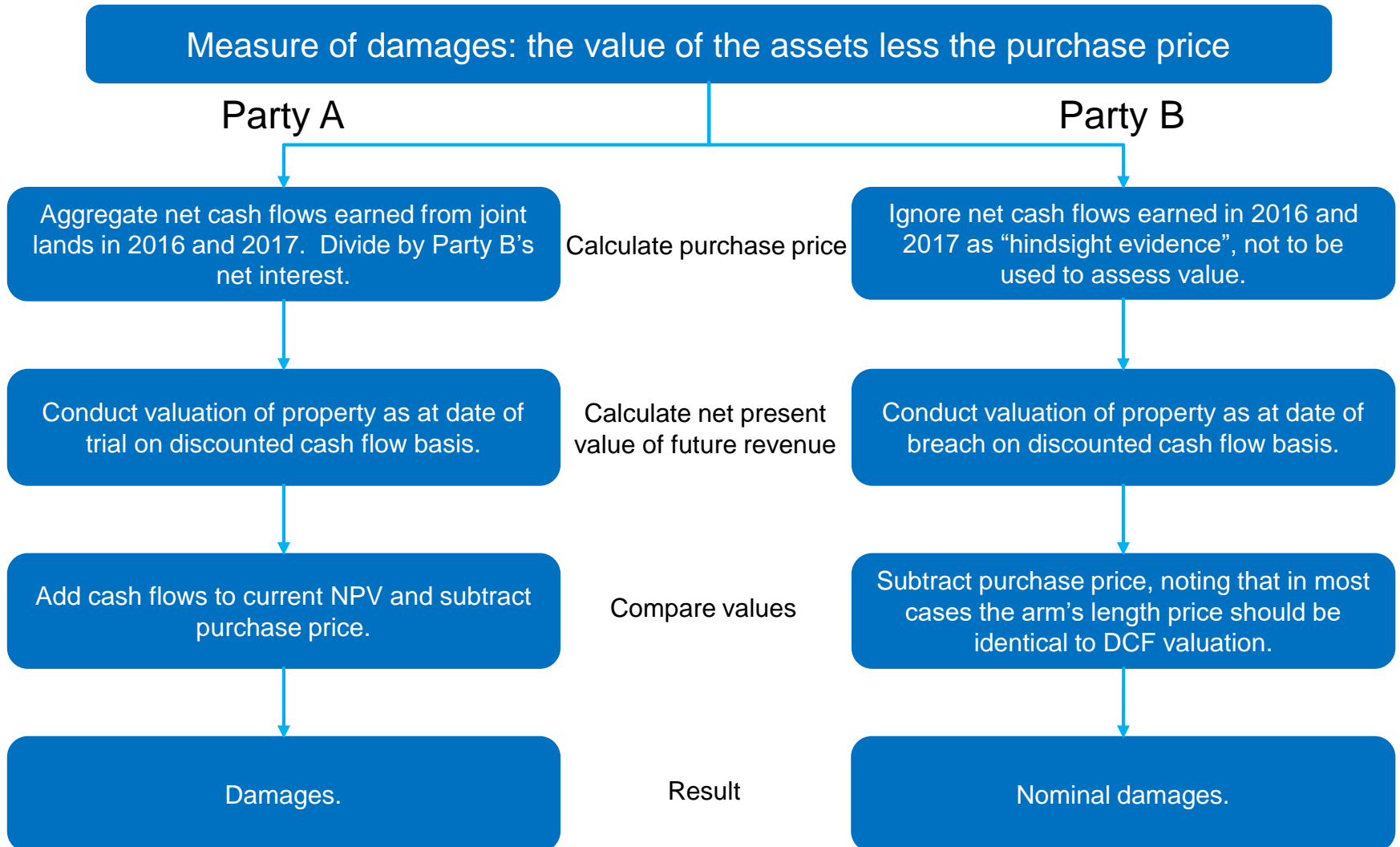
A Hypothetical

- Party A and Party B are parties to a contract for purchase and sale of oil and gas interests.
- January 1, 2016: Party B breaches the contract, depriving Party A of asset ownership.
- Party A commences action for damages; trial concludes in January, 2018.
- Party A's expert calculates the value of the property at the date of trial, and then adds cash flows earned from the property beginning on the date of breach.
- Party B's expert calculates value of the property using reserves values based on WTI futures strip as at breach date.



Valuation Date

Approach to damages determines valuation conclusion



Valuation Date

The “Limited Hindsight” approach: expectation damages discounted for market risk



- Ideal Result: compensate the plaintiff for expectation damages flowing from breach but adjust damages to account for the fact that an increase (or a decrease) in the value of the underlying asset occurring after the breach should not form part of the plaintiff’s loss.
- Under this approach, the plaintiff’s loss is notionally measured at date of breach,. Thereafter, discounted cash flow rate is applied to actual returns earned, ensuring that damages account for actual occurrences subsequent to breach.
- Future cash flows after the date of trial are based on discounted cash flow analysis using current reserves.

Valuation Date

Damages in Lieu of Specific Performance



- Damages “in lieu” of specific performance require finding that specific performance would be available and that damages are inadequate; they are not automatically available simply because the complaint involves a preferential right.
- Damages in lieu may be assessed at breach, or at trial.
- “Damages “in substitution” for specific performance must be a substitute, giving as nearly as may be what specific performance would have given.” (*Wroth v Tyler*, [1973] 1 All ER 897)
- As such, Courts must be flexible in selecting a valuation date that reflects the actual value of specific performance.

Valuation Date

Practical and Strategic Considerations



Short-term market risk is arguably foreseeable; long term changes in benchmark pricing may result in a remoteness problem.



Plaintiff must litigate promptly and diligently to avoid suggestion that it is timing the market.



Develop a robust and defensible damages theory, and instruct expert witnesses appropriately

Mitigation

When can specific performance insulate a claimant from the duty to mitigate?



- *Southcott Estates Inc.*, 2012 SCC 51
- “Specific performance is an equitable remedy that is difficult to reconcile with the principle of mitigation.” (para. 31)
- General rule: Claimant must take all “reasonable” steps to mitigate loss.
- Inaction may be justifiable / reasonable, where there is “some fair, real, and substantial justification” for the claim or “a substantial and legitimate interest” in seeking specific performance.

Mitigation

To Litigate or Mitigate?



To make peace, or go to war?

“A party who pursues a claim for specific performance faces greater uncertainty and more serious risk than a party who chooses to mitigate his/her losses and seek damages.” (Moore, A Tale of Two Remedies)



Who bears the burden?

To obtain specific performance, the plaintiff must establish that damages would be an inadequate remedy. To prove failure to mitigate, the defendant must prove reasonable steps were not taken. (*Southcott*, para. 24)

Mitigation

Practical & Strategic Considerations



Pleading requirements (Lau v. Geo-X, ABQB, 1988)

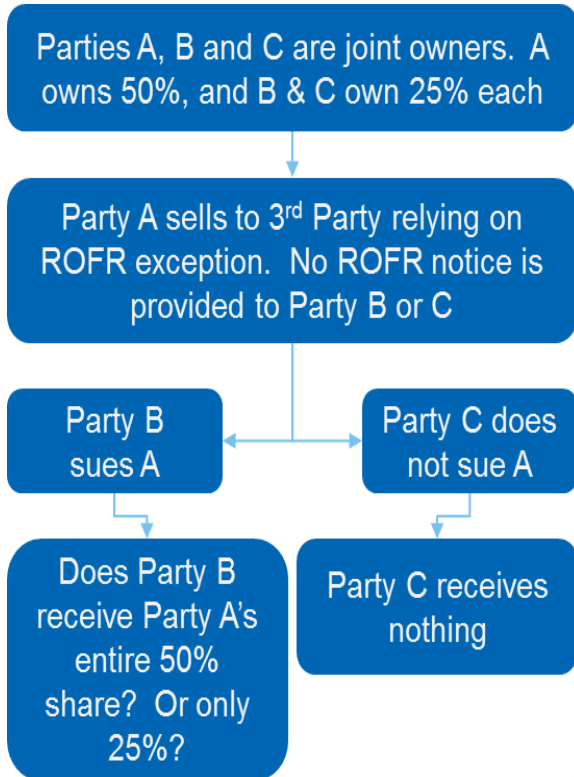


Cross Exam & Discovery Evidence : Were other opportunities available / pursued? Did the claimant have capacity to pursue other opportunities? How were the transaction funds spent (did money sit idle)? Was litigation pursued quickly? Did the claimant periodically evaluate other opportunities?



Expert Evidence: test with expert how to address mitigation *from a valuation perspective*; test whether expert has specialized knowledge re market or industry (relevant for other opportunities)

Multi-party Rights & “Loss of Chance”



- *Strategic Acquisition Corp. v Starke Capital Corp.*, 2017 ABCA 250
- Three Part Test: (1) is the claim for lost opportunity real, or fanciful; (2) what is the value of the opportunity; and (3) what is the discounted likelihood the opportunity would have been realized?



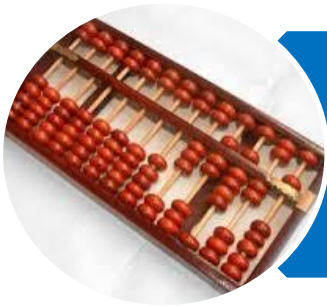
Conclusion



1. Specific performance or damages?



2. If not specific performance, what is the appropriate valuation date?



3. How to address mitigation & other selected topics

Acknowledgements

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Thank you