BIDDERS CAN STRUCTURE OFFERS TO DISCOURAGE THE USE OF RIGHTS OF FIRST REFUSAL

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A recent decision of the Ontario Court of Appeal considers the duty of good faith and honest contractual performance in the context of an asset sale involving rights of first refusal ("ROFR"). In *Greta Energy Inc. v. Pembina Pipeline Corporation*,[1] the Court rejected the plaintiffs' (who held ROFRs over two wind farm assets) allegations that the defendants (the vendor of the assets and the bidder) had manipulated the purchase price allocation between the assets in a bad faith attempt to prevent them from exercising their ROFRs.

The Court confirmed that vendors and bidders may act in their self-interest in a competitive bidding process. In doing so, the Court provides useful guidance on the obligations vendors and bidders owe to holders of ROFRs, particularly in situations where a package of assets are being sold *en bloc*.

Facts

In 2016 the defendant, Veresen (now Pembina), announced its desire to sell its indirectly held majority interests in three wind farm assets, known as GV1, GV2 and SCELP, as well as certain other of its assets on an *en bloc* basis (it was advised that a better price could be realized that way). The plaintiffs, Greta Energy Inc. ("Greta") and Great Grand Valley 2 Limited Partnership ("GG2", the general partner of which being a company solely owned by Greta), indirectly owned minority interests in GV1 and GV2, respectively, and held identical ROFRs with respect to Veresen's interests in each asset. Veresen owned 90% of SCELP and a numbered company owned 10%. Unlike Greta and GG2, the numbered company did not have a ROFR, but it had the unilateral right to block Veresen's sale of its interests in SCELP.

The defendant, BluEarth Renewables Inc. ("BluEarth"), submitted a bid to purchase a portfolio of Veresen's assets, including the three wind farms, for $599 m. Veresen accepted the bid and thereafter began negotiating a purchase and sale agreement that, among other things, required BluEarth to provide a *bona fide* price allocation for each of the assets (to permit Veresen to provide the required ROFR notices to Greta and GG2). During their negotiations, BluEarth provided Veresen with a preliminary price allocation for the assets (which valued GV1 at $55.7 m, GV2 at $151.2 million and SCELP at $172.7 m). A few days later, BluEarth provided Veresen with its final price allocation, which reallocated $5 m from SCELP to GV2 (thereby valuing GV2 at $156.2 m and

SCELP at $167.7 m). BluEarth and Veresen then signed the purchase agreement and Veresen sent ROFR notices to Greta and GG2. Greta waived its ROFR on GV1 and GG2 exercised its ROFR on GV2.

BluEarth's acquisition of Veresen's interests in GV1 was conditional on a corporate reorganization of GV1 (necessitated by the fact that BluEarth's majority shareholder is a pension fund). However, Greta refused to consent to the reorganization unless BluEarth paid its associated legal fees and explained, to its satisfaction, that the purchase price allocation between GV2 and SCELP had not been "gamed" (Greta believed the price allocated to GV2 was too high).

Veresen responded by setting out why it believed BluEarth's price allocation to be reasonable, but Greta refused to consent to the sale. As a result, the sale of Veresen's interests in GV1 did not close. BluEarth purchased Veresen's interests in SCELP and some other assets, and (significantly) GG2 purchased Veresen's interests in GV2 for the price BluEarth had agreed to pay after exercising its ROFR.

Greta and GG2 then commenced an action against Veresen and BluEarth, alleging that Veresen breached the duty of good faith by allowing BluEarth to reallocate the pricing between GV2 and SCELP in an attempt to prevent GG2 from exercising its ROFR (by artificially inflating the price of GV2). They also alleged that Veresen and BluEarth conspired with one another to mislead them about the price allocation, that Veresen breached its fiduciary duties and that BluEarth induced Veresen to breach the terms of the ROFRs.

Greta and GG2 moved for summary judgment seeking damages, and Veresen and BluEarth responded with a cross-motion dismissing their claim. The motion Judge granted Veresen's and BluEarth's cross-motion and dismissed the plaintiffs' claims in their entirety. Greta and GG2 appealed, and the Ontario Court of Appeal unanimously dismissed the appeal.

The Motion Decision

At first instance, Justice Gilmore found that Veresen had set up a legitimate process to sell its assets, that BluEarth engaged in that process and that it was not commercially unreasonable for BluEarth to pay a price for any or all of the assets that would pressure ROFR holders not to exercise their rights.

No Breach of Good Faith

With respect to the allegation that Veresen breached its duty of good faith, Justice Gilmore accepted that Veresen was required to act in good faith towards the ROFR holders when soliciting and accepting offers and negotiating the terms of sale.[2] However, she found no breach of that duty.

First, she found it was not unfair for Veresen to require bidders to bid on the entire package of assets and defer pricing allocation until after the bid process concluded. BluEarth only allocated prices to the various assets so

as to permit the ROFR notices to be issued.

Second, her Honour found that Veresen did not encourage BluEarth to inflate the price allocated to GV2 and had no obligation to object to its proposed reallocation of the price. Notably, she held BluEarth's reallocation was done for legitimate reasons, including the fact that Veresen's co-owner in SCELP had the unilateral right to block its sale (increasing the risk of it not being sold to BluEarth) and that GV2 required different financing.

Third, Justice Gilmore accepted Veresen's argument that there is no "correct" price for a ROFR, only what the vendor offers and the purchaser is willing to pay. So, while a ROFR holder must be given the opportunity to pay the price offered by a third party, this does not mean that the price must accord with the ROFR holder's view of its fair market value. Citing to *Chase Manhattan Bank of Canada v. Sunoma Energy Corp.*[3] her Honour noted that a wide range of values could be attributed to a ROFR-encumbered property by different parties, based on their different assessment of its upside potential.

Finally, her Honour held that Veresen did not engage in misleading behaviour designed to dissuade the plaintiffs from exercising their ROFRs. While Veresen did not give the plaintiffs documents related to BluEarth's reallocation of the purchase price, it did provide the plaintiffs with all documents they had requested. Relying on *C.M. Callow Inc. v. Zollinger*[4], Justice Gilmore noted that the duty of honest performance does not impose a positive duty of disclosure so long as a party does not mislead their counterparty. Veresen was obligated to provide a price allocation in its ROFR notices, which Veresen did by providing the plaintiffs with the prices BluEarth was willing to pay for each of GV1 and GV2. Her Honour accordingly rejected the plaintiffs' argument that Veresen mislead them by not disclosing the change in price allocation.

No Breach of Fiduciary Duty, Conspiracy or Inducing Breach of Contract

Justice Gilmore went on to reject the remainder of the plaintiffs' claims. With respect to their allegation that Veresen owed them a fiduciary duty, her Honour found that there was no implied or express undertaking requiring Veresen to act in their best interests.

Justice Gilmore rejected the plaintiffs' conspiracy claim because she found that the pricing reallocation was not predominantly intended to harm the plaintiffs or to frustrate the exercise of their ROFRs. She did observe, however, that a Court could find a conspiracy to "eviscerate" the exercise of the ROFR if Veresen and BluEarth initially allocated prices in a way to discourage Greta/GG2 from exercising it, and then adjusted the price downward after they had waived the ROFR.

Lastly, Justice Gilmore held that BluEarth did not induce breach of contract. Her Honour found that, while BluEarth was at least in part trying to price the assets in a way that discouraged exercise of the ROFRs, there is

nothing nefarious about that so long as the strategy is not unreasonable (meaning, no bad faith price manipulation as noted above) and does not "eviscerate" the rights of the ROFR holders.

Court of Appeal Decision

The Court of Appeal found no palpable and overriding errors in Justice Gilmore's decision and dismissed the plaintiffs' appeal in its entirety.

The Court confirmed that BluEarth was entitled to act in its self-interest and structure its bid to discourage the exercise of the ROFR. Significantly, the Court noted (as Justice Gilmore did) that "the dynamic between the ROFR holder and the third party is a competitive one: the respondents were entitled to attempt to discourage the exercise of the ROFR and did not "eviscerate" the appellants' rights".[5]

Key Takeaways

The *Greta* decision articulates some important principles about the duty of good faith and honest contractual performance in the context of a sale of a package of assets bound by ROFRs:

1) Unless the terms of the ROFR expressly provide otherwise, vendors:

   a. may sell assets *en bloc* (vendors are not required to solicit separate bids for each asset bound by a ROFR);[6]
   b. may accept a bidder's price allocation for a package of assets without requiring evidence of their fair market value;[7] and
   c. are not required to disclose their discussions about price allocation with bidders to ROFR holders, so long as the pricing was an amount the bidder is willing to pay and the vendor is willing to accept (the duty of honest contractual performance does not impose a duty of disclosure, unless the lack of disclosure involves dishonesty or an attempt to mislead);[8]

   (consequently, one might expect to see counsel attempting to insert additional language into ROFRs in an attempt to address the above-noted points);

2) Bidders can structure offers in such a way that discourages the exercise of a ROFR, provided the price allocation is *bona fide* (not deliberately manipulated to ensure the ROFR is not exercised) and the rights provided in the ROFR are not eviscerated.[9] This means, among other things, that vendors and bidders may not initially allocate prices in a way to discourage ROFR holders from exercising their rights, and then adjust the price of the ROFR-bound asset down after the ROFR holders waive their rights; and

3) The ROFR holder's perception of what the fair market value is of a particular asset is not particularly relevant or determinative of whether there has been a breach of good faith. There is no such thing as a

"correct" price for a ROFR – only what the bidder is willing to offer and what the vendor is willing to accept.[10]

Greta recognizes that asset sales involve a competitive bidding process in which bidders and vendors may act in their own commercial self-interest. Where a bidder commits to paying a *bona fide* amount for a package of assets, even if a ROFR holder believes the price allocated to a ROFR-encumbered asset is overvalued, the ROFR holder will be forced to either pay that price or waive the ROFR.

Future cases will have to grapple with where the line exists between permissible bid structuring (so as to discourage the exercise of a ROFR) and impermissible, bad faith, price manipulation (that eviscerates the ROFR holder's rights).

[1] 2022 ONCA 783 ("*Greta*").
[2] Justice Gilmore referred to the leading case on the duty of good faith with respect to ROFRs, being *GATX Corp. v. Hawker Siddeley Canada Inc.*, 1996 CANLII 8286 (Ont. S. C.), in which the Court held that the grantor of a ROFR "must not act in a fashion designed to eviscerate the very right which has been given" at para. 71.
[3] 2001 ABQB 142, aff'd 2002 ABCA 286.
[4] 2020 SCC 45.
[5] *Greta, supra*, at para 29.
[6] *Greta Energy Inc. v. Pembina Pipeline Corporation*, 2021 ONSC 7579 (*Greta ONSC*), at paras. 45-46, 60-61, *Greta, Supra*, at para. 14.
[7] *Greta ONSC, Ibid*, at paras. 63-64, 68, 93, and 111, *Greta, Ibid*, at para.25
[8] *Greta ONSC, Ibid*, at paras. 67-70 and 109, *Greta, Ibid*, at para 26.
[9] *Greta ONSC, Ibid*, at paras. 100, 109, *Greta, Ibid*, at para. 29 and 32
[10] *Greta ONSC, Ibid*, at paras. 63-64, 68, 87 and 93, *Greta, Ibid*, at para. 25.

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A Cautionary Note