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OSC Reasons in HudBay Raise Questions About Independence of Financial Advisers

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The Ontario Securities Commission has released its reasons for the recent ruling that led to the withdrawal of HudBay Minerals' proposed acquisition of Lundin Mining.

While the reasons deal mainly with procedural and administrative law issues, they include comments from the OSC about potential conflicts of financial advisers who are compensated on the basis of the success of a transaction. In our bulletin on top M&A trends for 2007, we noted this as an area of concern for directors, who have become increasingly vigilant regarding the potential for conflicts among their advisers.

It is common practice, though not legally required, for a board of directors or special committee to obtain a fairness opinion from financial advisers to support their judgment in approving a transaction and to evidence the discharge of their fiduciary duties. Except when securities laws specifically require the use of an independent adviser, directors in Canada have been comfortable relying upon opinions of financial advisers in M&A transactions even though the advisers may have other roles or relationships with other parties in the transaction. For example, special committees often obtain a fairness opinion from the financial adviser retained to oversee the sale process, who may be entitled to a success fee on completion of the transaction. The multiple roles played by advisers in some transactions reflect the practical reality that retaining advisers who are familiar with the company and the transaction is often the most efficient way for special committees to obtain the advice they need.

In the reasons, the OSC states that large success fees "create a financial incentive for an advisor to facilitate the successful completion of a transaction when the principal focus should be on the financial evaluation of the transaction from the perspective of shareholders." The OSC goes on to say that a fairness opinion prepared by an adviser who is paid a success fee "does not assist a special committee of independent directors in demonstrating the due care they have taken in complying with their fiduciary duties in approving a transaction." In practice, advisers' fees are negotiated, and there are commercial reasons why boards and their advisers tend to prefer a success-based fee structure. Directors take into account the potential conflict created by those fee structures in assessing how much weight they should give to the opinion, and they disclose the potential conflict so that shareholders can do the same. In the face of the OSC's categorical statement that special committees cannot rely on a fairness opinion given by an adviser who is paid a success fee, we expect that directors will more frequently require a fairness opinion from a second firm of financial advisers that is not entitled to a success fee on the transaction. **1**

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