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Success Fees in Advisory Agreements: Financial Advisers (and Their Clients) Take Note

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Read the complete report.

The decision of the Ontario Court of Appeal in *RBC Dominion Securities v Crew Gold Corporation* underscores the importance of clearly delineating the circumstances in which a financial adviser is entitled to a success fee. The decision also suggests that the courts will be loath to find that the financial adviser is entitled to a success fee for transactions unrelated to the work it performed. In particular, parties should consider specifying whether or not a "causal link" between the adviser's activities and the transaction must be present in order for a success fee to be payable.

The Advisory Mandate in *Crew Gold*

In 2009, Crew Gold Corporation (Crew) engaged RBC to assist it in evaluating strategic alternatives. Under the engagement agreement, RBC was entitled to a success fee for a "Transaction" that was completed during the term or within 12 months thereafter, whether or not the purchaser was solicited by RBC.

The agreement defined "Transaction" as a potential transaction involving the direct or indirect sale or disposition of Crew and stated that a Transaction may involve (i) a sale of all or a substantial portion of the shares, business or assets of Crew to a third party; (ii) an investment by a third party in Crew that resulted in its change of control; or (iii) an amalgamation, arrangement or other business transaction involving Crew and a third party to effect such sale or disposition.

Pursuit of the Strategic Transaction

During the course of RBC's mandate, Crew restructured its outstanding debentures, and Crew's board considered several strategic alternatives presented to it by RBC. Following the debenture restructuring and while the board was considering the strategic alternatives presented to it by RBC, a shareholder of Crew (that had obtained its shares as a result of the debenture restructuring) sold its block of shares to Endeavour Financial Corporation (Endeavour) without the involvement of either Crew or RBC. As a result of the transaction, Endeavour's stake in Crew increased to 43%. Following this transaction, RBC was "shunted to the side" as Crew focused on a potential transaction involving Endeavour.

Battle for Control of Crew

Within days of Endeavour's purchase of the shares, OAO (Severstal), a Russian mining company, began to increase its interest in Crew. The race was on for the ultimate control and ownership of Crew, and the focus turned to the battle between Endeavour and Severstal. Crew engaged a different financial adviser to advise it with respect to the brewing takeover battle and terminated RBC's advisory engagement. Endeavour ended up selling its 43% stake in Crew to Severstal approximately two months after the termination of the RBC engagement agreement. Severstal took Crew private several years later under a plan of arrangement. RBC claimed that it was entitled to a success fee for the Endeavour/Severstal transaction, which Crew declined to pay, notwithstanding that the transaction was, on its face, clearly contemplated as a Transaction in respect of which a success fee was payable under RBC's engagement agreement.

No Causal Link, No Fee?

At trial, the court held that RBC and Crew intended that RBC receive a success fee only if there was a "causal link" between RBC's activities and the transaction in question. This is somewhat surprising given that the success fee was expressly payable even if RBC had not introduced the purchaser to Crew or if RBC's involvement was not a material cause of the transaction. The court also found that the engagement agreement was not intended to broadly apply to any sale of shares by a Crew shareholder, even though the definition of Transaction included the sale of a significant portion of Crew shares by either Crew or one of its shareholders.

The Ontario Court of Appeal upheld the lower court's decision. The Court of Appeal held that notwithstanding the plain language in the engagement agreement, the trial judge did not fail to apply proper contractual interpretation principles in interpreting the engagement agreement. The Court of Appeal found that the trial judge's interpretation – that the parties intended the success fee to be linked to some action on the part of RBC – was reasonable based on the engagement agreement in question. With respect to the tail provision in the engagement agreement, the Court of Appeal found that the trial judge correctly interpreted the tail provision as simply providing for payment of a success fee if the "mandate" was carried out after the termination of the engagement agreement. In other words, the transaction for which a success fee was payable must relate to work performed by the adviser before the termination of the engagement agreement.

Lessons from the *Crew Gold* Decision

Financial advisers and their clients alike would be well-advised to take a thoughtful and careful approach to tail provisions and related key definitions in their engagement agreements:

- Financial advisers should consider including express language in their standard form engagement agreements to the effect that no causal link is required for a success fee to be payable during the tail period. They should also consider proposing a detailed and expansive definition of "Transaction" if they want to be entitled to a success fee for a broad range of transactions executed during the tail period.
- Courts will continue to apply a contextual approach to contractual interpretation and will not necessarily render decisions on the basis of the express language in an engagement agreement; however, express language addressing the causal link requirement may help demonstrate to a court that the parties intended the success fee to be payable to a financial adviser in a broad set of circumstances, including where there is no causal link between the transaction and the advisory services provided.
- Although the courts have demonstrated an unwillingness to broadly construe a financial adviser's entitlements during the tail period, parties that engage financial advisers should consider proposing a more limited definition of "Transaction" or excluding certain types of transactions from the definition.

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