Fairness Opinions — Is There A New Interoil Standard?

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In gaining final approval of the Court for its proposed plan of arrangement, InterOil took a number of steps not commonly used before now. Whether these steps, and the court decision that approved them, will be followed in future plans of arrangement remains to be seen.

The Supreme Court of Yukon recently issued a final order approving the plan of arrangement whereby ExxonMobil Corporation would acquire all of the outstanding shares of InterOil Corporation. This was the second attempt by InterOil to obtain court approval in connection with the arrangement with ExxonMobil, its first attempt having been denied by the Yukon Court of Appeal, which found that the arrangement as originally proposed had not been shown to be fair and reasonable (for the reasons discussed in our December 9, 2016 publication, available here).

A key reason cited by the Court of Appeal in denying InterOil's original application was the fact that the Fairness Opinion provided by Morgan Stanley was, in the view of the Court, deficient for a number of reasons, including the failure to disclose the success-based compensation that Morgan Stanley would receive in connection with the transaction, the failure of the Fairness Opinion to attribute any value to InterOil's Elk-Antelope asset, for which shareholders of InterOil were receiving a contingent resource payment (CRP) subject to a cap, and the failure to provide any discussion of the valuation process undertaken by Morgan Stanley. In addition, certain other governance matters were cited by the Court of Appeal, including the apparently passive role that the board's Transaction Committee took in considering the arrangement.

Following the Yukon Court of Appeal decision, the plan of arrangement was amended, leaving the base consideration per share payable to the InterOil shareholders unchanged at $45 per share, but increasing the cap on the CRPs which may, in certain circumstances, be payable to the InterOil shareholders. InterOil also retained BMO Capital Markets to provide an independent, fixed-fee, long form Fairness Opinion. In connection with the BMO Fairness Opinion, InterOil obtained an updated resource report in respect of its Elk-Antelope asset. After obtaining shareholder approval of the revised plan, InterOil then made a new application to the Supreme Court of Yukon for approval.

The Supreme Court of Yukon's written decision approving the plan of arrangement was released on March 1, 2017. Where the Court of Appeal's decision in denying the original application raised the question of whether an independent long form Fairness Opinion would be required in respect of future plans of arrangement, the Supreme Court of Yukon in its written decision has gone even further. The judge noted that the revised plan of arrangement had included two elements, the first being an independent fixed fee long form Fairness Opinion prepared by a reputable expert, which contained an updated valuation of InterOil's assets, and the second being the report of the Transaction Committee, consisting of four independent members of the board of directors. He then went on to state:

"In my view, these requirements provide a minimum standard for interim orders of any plan of arrangement. It is not acceptable to proceed on the basis of a Fairness Opinion which is in any way tied to the success of the arrangement."

He also noted that the BMO Fairness Opinion, among other things, outlined the facts and information upon which the opinion was based and included detailed analysis regarding the portion of the consideration comprised of ExxonMobil shares, the portion of the consideration comprised of the CRP, and the implications of the cap on the CRP in relation to the Elk-Antelope asset.

The idea that the independent fairness opinion and independent committee report are now a "minimum standard" is a significant departure from the current legal requirements applicable to plans of arrangements as well as current industry practices. The legislation governing plans of arrangement does not require companies to obtain Fairness Opinions at all (although most boards do obtain such opinions to assist them in evaluating the transaction and fulfilling their fiduciary obligations) and, if a Fairness Opinion is obtained, it is not unusual to have the company's financial advisor, which may be entitled to receive a success-based fee in connection with the transaction, provide such an opinion. Further, there may be cases where there may be no reason to strike a separate committee to evaluate the transaction, for example where there are no conflict or independence issues at play.

Where related party or unequal treatment issues do arise, Multilateral Instrument 61-101 – *Protection of Minority Shareholders in Special Transaction* imposes certain requirements related to obtaining independent valuations and the establishment of an independent committee. However, these rules would generally not be applicable to arms' length plans of arrangement such as the InterOil and ExxonMobil transaction.

It is also interesting to note that the decision refers to an affidavit provided to the Court by the head of BMO's Canadian Mergers & Acquisitions group in which he expressly adopted in its entirety the BMO Fairness Opinion and provided detailed "expert evidence" with respect to the substantive fairness of the arrangement to Interoil's shareholders. The judge stated that, "I particularly endorse the practice of appending the Fairness Opinion to the affidavit of an expert from BMO Mergers and Acquisitions group in order to comply with this Court's expert evidence rule". This step appears to have been taken in response to the Court of Appeal's statements that the Morgan Stanley fairness opinion did not constitute evidence of fairness and the only evidence of fairness in the matter consisted of the report and testimony provided by parties opposing the arrangement. The Morgan Stanley fairness opinion was likely given to the board to help it discharge its fiduciary duties and not for the purpose of a court proceeding. However,

once proceedings began, this distinction may have been lost, and InterOil may have tried to put more weight on the Morgan Stanley opinion than was appropriate. In any case, the decision of the Yukon Supreme Court seems to suggest that a Fairness Opinion should be entered as evidence in support of the application – not something generally done in the past. It will be interesting to see if other companies adopt this approach in respect of Fairness Opinions, or if courts will require it.

In any event, if this decision is followed by other courts it has the potential to significantly increase transaction costs for companies looking to complete plans of arrangements. In the case of InterOil, BMO was paid a fixed fee of US$4 million to provide a long form Fairness Opinion.

Whether this decision will, in fact, be followed by other courts remains to be seen. The Yukon Court of Appeal decision noted a number of reasons specific to InterOil as to why an independent fixed fee Fairness Opinion would be appropriate, and it appears to be a significant stretch by the Supreme Court to impose a requirement that such an opinion be required for every plan of arrangement. Companies should always consider issues of conflict and independence and ensure that they have adequate processes in place to deal with such issues. However, a blanket rule requiring an independent fixed fee long form Fairness Opinion for every plan of arrangement, regardless of the specific circumstances of the parties or the value of the transaction, may be overly broad and result in significant transaction costs that may add little value to the shareholders. It will be interesting to see if this decision results in any changes to how Courts consider plans of arrangement or if it has a significant effect on industry practice.

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