March 3, 2017

InterOil Take 2: Yukon Court Doubles Down on Requirement for Fixed-Fee Financial Adviser Engagements

Authors: Alexander Moore, Patricia L. Olasker and William Ainley

On February 20, 2017, the Yukon Supreme Court approved ExxonMobil Corporation's second attempt to acquire InterOil Corporation through a plan of arrangement. This is the second iteration of the acquisition transaction following the Yukon Court of Appeal's rejection of the initial transaction proposal. In its reasons released on March 1, 2017, the Yukon Supreme Court laid out a new "minimum standard" that requires plans of arrangement to be supported by an independent, long-form fairness opinion prepared by a reputable expert who is compensated on a fixed-fee basis without any success fee.

Among the objections that the Yukon Court of Appeal cited in rejecting the arrangement as first proposed were the facts that Morgan Stanley, InterOil's financial adviser, was receiving a large, undisclosed success fee contingent on the closing of the transaction, and the lack of financial analysis provided to shareholders in the meeting circular and the fairness opinion. For a more detailed discussion of the Yukon Court of Appeal's decision in the first arrangement application, see our December 2, 2016 article, *Yukon Appeal Court's InterOil Decision Based on Cold, Hard and Questionable Facts*. In our article we noted that the faults cited by the Court regarding the financial adviser's success fee and the absence of analysis in the fairness opinion were based on uncontroverted evidence regarding best practices that was inconsistent with established Canadian market practice; we also questioned whether long-form fixed-fee fairness opinions would be required for all plans of arrangement in the future.

In the aftermath of the Yukon Court of Appeal's rejection of the initial transaction, InterOil and ExxonMobil negotiated a modest contingent increase in the transaction price and resubmitted the transaction to shareholders, receiving an even greater level of shareholder approval from the 80% received from the original transaction. In addition, InterOil had retained a new, independent financial adviser, BMO Capital Markets, on a fixed-fee basis not linked to the transaction's success. InterOil also provided substantially enhanced disclosure to shareholders, including the entire text of the long-form fairness opinion from BMO that included BMO's analysis of the value of the transaction and the company's assets. The disclosure also provided a detailed account of the work and analysis performed by an independent Transaction Committee of the InterOil board that was struck to review and recommend the revised transaction.

The steps taken by InterOil in resubmitting the transaction succeeded in winning the Yukon Supreme Court's approval and overcame the issues that had troubled the Yukon Court of Appeal. In approving the transaction, the Court stated:

> In my view, these requirements [that is, an independent fixed-fee long-form fairness opinion and a report of the independent transaction committee] 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.

This statement is more emphatic and more widely applicable than we would have expected was called for by the Yukon Court of Appeal's decision. That Court's objections to the transaction had included several other "red flags" in addition to the concerns about the fairness opinion. These included concerns about the significant role of a conflicted CEO in negotiating the transaction, particularly in view of the size of the accelerated payout of the CEO's equity compensation; doubts about whether the board's special committee had duly informed itself regarding the value of InterOil's assets and the value of the contingent value payments offered as consideration in the transaction; and the lack of sufficient disclosure to enable shareholders to compare the likely payout of contingent payments under the ExxonMobil transaction with the potentially higher payout in an earlier proposed transaction. In the absence of these other red flags, it is possible that the Yukon Court of Appeal would not have rejected the arrangement solely on the basis of the lack of a long-form fairness opinion prepared by an independent financial adviser on a fixed-fee basis.

Nevertheless, it now seems clear that independent committees and long-form fairness opinions from independent financial advisers whose fees are not tied to success of the transaction are a prerequisite to court approval of a plan of arrangement – at least for any plan of arrangement proposed in the Yukon. Previously, such measures have only been required for transactions having related party elements, where Multilateral Instrument 61-101 specifically requires a valuation prepared by an independent financial adviser and supervision of that adviser by an independent committee.

This is a radical departure from long-standing, customary practice and these new requirements will increase transaction costs at the expense of shareholders, even in circumstances in which a fixed-fee opinion provides little additional value to shareholders. We will follow with interest how courts in other Canadian jurisdictions apply the Yukon Court of Appeal's decision.