Goodmans LLP Update

Court of Appeal Endorses Reliability of Transaction Price in Dissent Proceedings

In *Carlock v. ExxonMobil Canada Holdings ULC, 2020 YKCA 4*, the Yukon Court of Appeal (comprised of judges from British Columbia's Court of Appeal) provided guidance about the weight to be given to the transaction price as evidence of the "fair value" of a company's shares in dissent proceedings.

Most significantly, the decision stressed that objective market evidence of fair value is preferable to theoretical attempts to derive a value based on subjective assumptions, such as discounted cash flow analyses, and that significant (in this case, determinative) weight should be given to the transaction price where the evidence demonstrates it was the highest price available in an open and unrestricted market between informed and prudent parties, acting at arm's length and under no compulsion to act. Nonetheless, the Court of Appeal maintained it was not establishing a rigid rule, and the weight to be given to the transaction price (and other evidence of value) will continue to be guided by the circumstances and evidence in each case.

Background

Before ExxonMobil acquired it, InterOil Corporation was a Yukon corporation whose principal asset was a minority stake in an early stage oil and gas project in Papua New Guinea. Its shares were widely held and publicly traded on the New York Stock Exchange. To develop the project, InterOil would have required significant financing.

Beginning in 2015, InterOil initiated a process to evaluate various alternatives to finance its obligations. While this process did not involve a public auction, InterOil's advisors canvassed virtually every institutional investor with the capacity to complete a transaction of this scale. While InterOil received numerous bids for both partial and whole company transactions, the board ultimately chose to pursue the transaction that provided the highest value for InterOil's shares – a sale of the whole company to Oil Search for $40.25 per share plus a contingent resource payment.

After InterOil announced the Oil Search transaction, ExxonMobil made an unsolicited superior proposal to acquire InterOil for $45 per share plus a contingent resource payment, which Oil Search declined to match. As a result, the InterOil board exercised its fiduciary out and terminated the Oil Search transaction. InterOil recommended the ExxonMobil transaction to its shareholders and the requisite majority approved it.

The Yukon Supreme Court initially approved the transaction over the objections of certain InterOil shareholders. However, the Yukon Court of Appeal overturned the Supreme Court's decision. It found that InterOil had not established that the transaction was "fair and reasonable" primarily as a result of concerns about the level of disclosure provided to InterOil's shareholders about the fairness opinion InterOil obtained and the "success fee" paid to the financial advisor who provided the opinion.

Following the Court of Appeal's decision, InterOil's board undertook a number of steps to address the Court of Appeal's concerns. It obtained a so-called "fixed fee" fairness opinion from an independent financial advisor and sent a new information circular to shareholders with extensive disclosure about the financial analysis underlying the fairness opinion. Following overwhelming shareholder approval, the Supreme Court once again

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approved the transaction, this time without objection. The final price received by InterOil's shareholders (including the final contingent resource payment) was $49.98 per share.

InterOil shareholders holding approximately 0.5% of InterOil's outstanding shares prior to closing exercised their statutory dissent rights, alleging the transaction price was an unreliable indicator of fair value in the circumstances.

The Dissent Proceedings

The Supreme Court concluded that the concerns that led the Court of Appeal to initially reject the ExxonMobil transaction prevented it from affording any weight to the transaction price as evidence of fair value. After considering the valuation evidence presented by both parties' valuation experts, the Supreme Court relied exclusively on the dissenting shareholders' expert opinion and set the fair value of InterOil's shares at $71.46 per share.

The Court of Appeal overturned the Supreme Court's decision and set the fair value of InterOil's shares at the per share transaction price of $49.98. The Court of Appeal held that its initial rejection of the transaction due to procedural concerns did not preclude the Supreme Court from considering the transaction price as evidence of fair value in the subsequent dissent proceedings. The Court of Appeal then concluded that, in the circumstances of this case, the transaction price represented the highest price available in an open and unrestricted market between informed and prudent parties, acting at arm's length and under no compulsion to act. In reaching this conclusion, the Court of Appeal relied primarily on these factors:

- InterOil's shares were highly liquid and widely held by institutional investors,
- InterOil was well covered by the analyst community,
- the deal price represented a significant premium over the recent trading price of InterOil's shares,
- every potential purchaser knew InterOil was available for purchase,
- the deal protection measures in the Oil Search and ExxonMobil transaction agreements were within market norms, and
- Oil Search declined to exercise its contractual right to match the superior ExxonMobil offer.

As a result, the Court of Appeal relied exclusively on the transaction price in determining fair value. In doing so, the Court held:

> "Objective market evidence, in the absence of evidence of market failure, is more reliable than theoretical analysis that attempts to derive a value based on assumptions about what a real market would disclose, if there were one. The behaviour of a real market is better evidence of value than a theoretical market."

The Court of Appeal also noted that accepting a fair value of $71.46 would mean ExxonMobil underpaid for InterOil by over $1 billion, which was not a reasonable possibility given the circumstances described above.

In its analysis, the Court of Appeal was clear it was not establishing a rigid rule that the transaction price will be determinative in any particular situation. However, the Court of Appeal's comments about the reliability of objective market evidence of fair value compared to theoretical valuation techniques, such as discounted cash flow analyses, may cause other courts to afford greater weight to the transaction price, absent factors that undermine its objective reliability.

For further information about this case and its implications, please contact any member of our Corporate Finance and Securities Group.