SUPREME COURT OF YUKON

Citation: *Re: Interoil Corporation*, 2017 YKSC 16

Date: 20170301
S.C. No. 16-A0151
Registry: Whitehorse

INTEROIL CORPORATION

Petitioner

Before Mr. Justice R.S. Veale

Appearances:

Gregory A. Fekete , Alan Mark and Tom Friedland	Counsel for Interoil Corporation
Grant Macdonald, QC and Michael Dixon	Counsel for Exxon Mobil Corporation

REASONS FOR JUDGMENT
(Interim and Final Order)

INTRODUCTION

[1] Interoil Corporation ("Interoil") applies for approval of a new plan of arrangement (the "new Arrangement") whereby Exxon Mobil Corporation ("Exxon") acquires the common shares of Interoil.

[2] This is the second Interoil application for approval of a plan of arrangement with Exxon pursuant to s. 195 of the Yukon *Business Corporation Act*, R.S.Y. 2002, c. 20 (the *"YBCA")*.

[3] A previous plan of arrangement (the "original Exxon Arrangement") pursued by Interoil was approved by this Court in *Re Interoil Corporation*, 2016 YKSC 54, but rejected by the Court of Appeal in *InterOil Corporation v. Mulacek*, 2016 YKCA 14.

[4] The plan of arrangement has been enhanced and the procedure and corporate governance considerably improved as follows:

1. the plan of arrangement includes an independent fixed fee expert opinion for the entire resource being sold;
2. a Transaction Committee of four independent directors has overseen the procedure prior to the full Board approving the plan of arrangement; and
3. the Transaction Committee retained independent legal counsel and reviewed the past plan of arrangement, the present plan and the options available to Interoil.

[5] I have approved the plan of arrangement as being procedurally and substantively fair to Interoil and its shareholders for the reasons that follow.

BACKGROUND

[6] Interoil is a Yukon corporation with an independent oil and gas business focussed on Papua New Guinea. Its assets include one of Asia's largest underdeveloped gas fields, the Elk-Antelope Fields, in the Gulf Province, and exploration licences covering about 16,000 square kilometres.

[7] The resources covered by petroleum retention licence 15 ("PLR 15") are contingent resources with no certainty of commercial value or viability. The lack of any evaluation of this contingent resource was a factor in the rejection of the first plan of arrangement.

[8] However, the main reason for the Court of Appeal's rejection of the first plan of arrangement was the failure of fairness and corporate governance beginning with the Fairness Opinion obtained by the Board of Directors of Interoil which had the following deficiencies:

1. it failed to address the value of the Elk-Antelope asset and the impact of the cap on the Contingent Resource Payment ("CRP") so that shareholders could consider whether the Exxon Arrangement reflected that value;
2. it failed to disclose the details of Morgan Stanley's success compensation so that shareholders could evaluate whether the Fairness Opinion was influenced by the terms of the compensation;
3. it failed to provide the shareholders with an independent financial fairness opinion on a flat fee basis, particularly in the situation where the CEO had a financial incentive for the Exxon Arrangement to proceed.
4. it contained no reference to the specific documents that it reviewed:
5. it contained no facts or information to indicate what the opinion was based on; and
6. it contained no analysis of the facts or information so that a shareholder could fairly consider the merits of the Exxon Arrangement.

Interim Order

[9] As a result of these deficiencies, my Interim Order permitting the new plan of arrangement to proceed contains the following requirements:

1. an independent fixed-fee long form Fairness Opinion prepared by a reputable expert, in this case prepared by BMO, which included an updated valuation of Interoil's assets by GLJ Petroleum Consultants Ltd. ("GLJ").

2. the report of the independent Transaction Committee, consisting of the four independent members of the Board of Directors.

[10] 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.

[11] The new Arrangement provides that Interoil shareholders (including Restricted Shareholder Units granted to executive and board members) will receive:

(a) Exxon shares worth $45, calculated based on the volume weighted average price of shares of Exxon common stock on the NYSE for the ten (10) consecutive trading days ending on (and including) the second trading date immediately prior to the closing of the Arrangement; and

(b) a CRP to be paid into escrow and released upon satisfaction of certain conditions following closing of the proposed transaction in accordance with the Contingent Resource Payment Agreement (the “CRP Agreement”). The CRP is subject to a post-closing adjustment that is linked to the volume of the PRL 15 2C Resources. After taking into account such post-closing adjustment, Shareholders and RSU Holders would effectively receive, in respect of each Common Share (including each Common Share issued to RSU Holders pursuant to the Arrangement), a cash payment estimated to equal approximately $7.07 for each incremental tcfe of PRL 15 2C Resources that is above 6.2 tcfe, up to a maximum of 11.0 tcfe of PRL 15 2C Resources. If the Interim Resource Certification is completed prior to the Effective Date and the

volume of the PRL 15 2C Resources is greater than 6.2 tcfe, Interoil and Exxon will revise the definition of CRP to mean an amount equal to the amount that would have otherwise been released to Securityholders as the CRP Payout (as defined below) and provide for the payment of the CRP to each Securityholder at the Effective Time through the Depositary (as opposed to executing the CRP Agreement).

[12] In effect, the new Arrangement increases the potential value of the CRP by $7.07 if an additional 1 tcfe is realized.

Final Order

[13] The submission of Interoil for its Final Order that the new plan of arrangement was fair and reasonable was unopposed and included the following:

(a) BMO provided a long-form fairness opinion on a fixed-fee basis which states that based upon and subject to the assumptions, limitations and qualifications set out therein, as at December 14, 2016, the consideration to be received by Shareholders pursuant to the Arrangement is fair from a financial point of view to the Shareholders. The BMO Fairness Opinion, a copy of which was included in the Circular, outlined the facts and information upon which the opinion was based and included detailed analyses regarding the portion of the consideration comprised of Exxon shares, the portion of the consideration comprised of the CRP, the implications of the cap on the CRP, the Elk-Antelope Fields and the potential payments due to Interoil under the Total Sale Agreement;

(b) in his affidavit, John Armstrong, the head of BMO's Canadian Mergers & Acquisitions group, expressly adopted in its entirety the content of the BMO Fairness Opinion. Mr. Armstrong's affidavit provides detailed expert evidence with respect to the substantive fairness of the Arrangement to Interoil's Shareholders;

(c) the Transaction Committee and the Board (voting both with and without directors who are members of management) unanimously recommended the Arrangement and believe that the Arrangement is in the best interests of Interoil, considering the interests of all affected stakeholders;

(d) the Circular fully disclosed the nature and details of the Arrangement so as to enable Securityholders (consistent with the decision of the Yukon Court of Appeal) to make an informed choice as to the value they would be giving up and the value they would be receiving under the Arrangement;

(e) the Arrangement Resolution received overwhelming approval from the Securityholders who voted at the Meeting. Specifically, of the shares that were voted at the Meeting, 91.24% voted in favour of the Arrangement Resolution. The Arrangement Resolution therefore received approximately 10% more support than the original Exxon Arrangement which had received 80% approval from the shares that were voted;

(f) dissent rights were provided and were exercised by 0.5% of Shareholders, down from approximately 10% of the original Exxon Arrangement;

(g) two leading proxy advisory firms recommended that Shareholders vote in favour of the Arrangement;

(h) The Arrangement is the result of both thorough bid solicitation process and a subsequent bidding process among knowledgeable and sophisticated parties; and

(i) the Arrangement provides Shareholders with certainty of value now through the share consideration (at a 42% premium) and also enables Shareholders to participate, through the CRP, in the potential upside of the resource volume of the Elk-Antelope Fields at the Interim Resource Certification stage (at a maximum aggregate premium of 149%), without the risk and uncertainty of having to see the project through to development in order to share in this upside.

The Law of Plans of Arrangement

[14] The test for final approval of a plan of arrangement is based upon the requirements of s. 195 of the *YBCA* and meeting three criteria established by the Supreme Court of Canada in *BCE Inc. v. 1976 Debentureholders,* 2008 SCC 69 ("*BCE Inc.*"), as follows:

a) there has been compliance with all statutory and court-mandated requirements;

b) the Arrangement has been put forward in good faith; and

c) the Arrangement is fair and reasonable.

[15] The Court of Appeal in *InterOil* provided a summary of the general guidance given to a judge in *BCE Inc.* relevant to the case at bar.

a) The court should consider whether the arrangement, objectively viewed, is fair and reasonable and "looks primarily to the interests of the parties whose legal rights are being arranged". (Para. 119);

b) The court should focus on the "terms and impact of the arrangement itself, rather than on the process by which it was reached. What is required is that the arrangement itself, viewed substantively and objectively, be suitable for approval." (Para. 136);

c) The "business judgment test" – whether an intelligent and honest business person, as a member of the voting class concerned and acting in his or her own interest would reasonably approve the arrangement – does *not* constitute "a useful or complete statement of what must be considered". (Para. 139);

d) The reviewing judge must "delve beyond whether a reasonable business person would approve of [the] plan." (Para. 141);

e) There must be a "positive value to the corporation to offset the fact that rights are being altered". In other words, the court must be satisfied the "burden imposed by the arrangement on security holders is justified by the interests of the corporation… as an ongoing concern." (Para. 145);

f) The "valid purpose inquiry" is fact-specific. One important factor is the "necessity" of the arrangement to the continued operation of the corporation. Indicia of necessity include the existence of alternatives and market reaction to the plan. (Para. 146);

g) If the arrangement is not mandated by the corporation's financial or commercial situation, courts will be more cautious and strive to ensure that it is not in the sole interest of a particular stakeholder. (Para. 146);

h) Generally, the arrangement must strike a "fair balance, having regard to the ongoing interests of the corporation and the circumstances of the case. Often this will involve complex balancing, whereby courts determine whether appropriate accommodations and protections have been afforded to the concerned parties." (Para. 148);

i) Other indicia include whether a majority of securityholders have voted to approve the arrangement; whether an intelligent businessperson might reasonably approve of the plan; the "proportionality of the compromise" between various security holders; the securityholders' positions before and after the arrangement; whether the plan was approved by a special committee of independent directors; the presence of a fairness opinion from a reputable expert; and the access of shareholders to dissent and appraisal remedies. (Para. 152);

j) The foregoing list is not exhaustive and the court should not insist on a "perfect arrangement." As stated at para. 155:

> The court on a s. 192 application should refrain from substituting their views of what they consider the "best" arrangement. At the same time, the court should not surrender their duty to scrutinize the arrangement. Because s. 192 facilitates the alteration of legal rights, the Court must conduct a careful review of the proposed transactions. As Lax J. stated in *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.* (2002), 214 D.L.R. (4th) 496 (Ont. S.C.J.), at para. 153: "Although Board decisions are not subject to microscopic examination with the perfect vision of hindsight, they are subject to examination."
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> [Emphasis added.]

[16] In considering these factors, I find that:

a) the shareholder approval increased from 80% for the original Exxon Arrangement to over 90% for the new Arrangement. In addition, Interoil provided the shareholders with considerable information on the value of the new Arrangement and the value of the contingent resources;

b) the Transaction Committee was independent, examined and endorsed the arrangement;

c) the Fairness Opinion was independent and addressed the deficiencies of the previous fairness opinion;

d) the shareholders had access to dissent and appraisal remedies and those who indicated they wished dissent rights were reduced from 10% on the first plan of arrangement to 1% on the new plan of arrangement.

[17] As a result of the deficiencies of the previous Fairness Opinion, which frankly provided no reliable opinion at all, I wish to set out the following factors which distinguish the BMO Fairness Opinion and provide the Court with the comfort that the new Arrangement is fair and reasonable:

(a) The Fairness Opinion was prepared by one of Canada's most distinguished and reputable investment banks;

(b) It was provided to the Transaction Committee on an independent fixed-fee basis (payable regardless of whether the Arrangement Agreement was ultimately entered into and regardless of whether the Arrangement was ultimately completed), and the amount of the fee was disclosed to Securityholders in the Circular;

(c) It set out in detail the materials reviewed and assumptions made;

(d) It explained the valuation methodologies used;

(e) It contained BMO's analysis of the consideration to be paid to Shareholders under the Arrangement, including both the ExxonMobil share consideration and the CRP, the implications of the cap of the CRP, the Elk-Antelope Fields and the potential payments due to Interoil under the Total Sale Agreement; and

(f) It ultimately concluded that the new Arrangement is fair to Shareholders from a financial point of review.

[18] This Fairness Opinion provides a useful template for the detail that Fairness Opinions should provide to shareholders and to courts. I particularly endorse the practice of appending the Fairness Opinion to the affidavit of an expert from the BMO Mergers and Acquisitions group in order to comply with this Court's expert evidence rule.

[19] I conclude that the new plan of arrangement is in compliance with s. 195 of the *YBCA* and the Interim Order. It has been put forth in good faith and is fair and reasonable.

VEALE J.