COURT OF APPEAL OF YUKON

Citation: *Carlock v. ExxonMobile Canada Holdings ULC*, 2020 YKCA 4

Date: 20200207
Docket: 18-YU841

Between:

Charles A. Carlock

Respondent
(Petitioner)

And

ExxonMobil Canada Holdings ULC

Appellant
(Respondent)

And

**Dissenting Shareholders as Defined in
Paragraph One of the Order of June 20, 2017**

Respondents
(Respondent)

SEALED IN PART

Before: The Honourable Madam Justice D. Smith
The Honourable Mr. Justice Harris
The Honourable Madam Justice Shaner

On appeal from: An order of the Supreme Court of Yukon, dated February 18, 2019 (*Carlock v. ExxonMobil Canada Holdings ULC*, 2019 YKSC 10, Whitehorse Docket 16-A0193).

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Place and Date of Hearing: Whitehorse, Yukon
November 12, 2019

Place and Date of Judgment:	Vancouver, British Columbia February 7, 2020

Written Reasons by:
The Honourable Mr. Justice Harris

Concurred in by:
The Honourable Madam Justice D. Smith
The Honourable Madam Justice Shaner

Summary:

This appeal is from an order setting the fair value of shares owned by dissident shareholders under s. 193 of the Yukon Business Corporations Act, R.S.Y. 2002, c. 20. Pursuant to a court-approved Plan of Arrangement, ExxonMobil Canada Holdings ULC agreed to acquire InterOil Corporation for $49.98 per share, paid in Exxon shares. A small number of InterOil shareholders invoked their dissent and appraisal rights. The court appraised the fair value of the dissidents' shares at $71.46 per share. Exxon appeals from this order.

Held: Appeal allowed, fair value of the dissidents' shares set at $49.98. Prior to this Plan of Arrangement, Exxon and InterOil had previously agreed to a different Plan of Arrangement on similar terms. This Court held, on the record then before it, that the Supreme Court erred in approving the first Plan of Arrangement. In making the order currently under appeal, the Chief Justice erred in principle by reasoning that this Court's previous judgment meant the transaction price initially agreed upon in the first Plan of Arrangement could not be resurrected as fair value in the second Plan of Arrangement. As a result, the Chief Justice failed to give weight to objective market evidence of fair value and instead relied on a theoretical valuation. This Court is satisfied on the facts of this case that fair value is equivalent to the transaction price. The facts surrounding the transaction show that the transaction price 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.

Reasons for Judgment of the Honourable Mr. Justice Harris:

Introduction

[1] This is an appeal from an order of the Supreme Court of Yukon, with reasons indexed at 2019 YKSC 10, setting the fair value of shares of certain dissident shareholders, including Mr. Carlock, in InterOil Corporation ("InterOil") as of February 22, 2017. The application followed the approval of a Plan of Arrangement through which ExxonMobil Canada Holdings ULC ("Exxon") agreed to purchase the shares of InterOil by means of an exchange of InterOil shares for Exxon shares, leading to InterOil becoming a wholly owned subsidiary of Exxon.

[2] The Exxon/InterOil Plan of Arrangement involved an agreed price of $45 per InterOil share paid in Exxon shares plus a contingent resource payment ("CRP") estimated at $7.07 per share (all values in USD). The actual CRP of $4.98, which appears to have been calculated after February 22, 2017, led to a total transaction price of $49.98 per share. This transaction was endorsed by over 90% of the voting

shareholders, and less than 0.5% of shareholders exercised their dissent rights. Exxon contended on the underlying application that the transaction price was fair value. The Chief Justice rejected that position and found the fair value to be $71.46 for each InterOil share.

[3] Exxon contends that the Chief Justice fell into a series of errors of principle in assessing the fair value of InterOil's shares. In broad terms, the alleged errors are threefold. First, the Chief Justice failed to place proper weight on objective market evidence of value. Second, the Chief Justice misinterpreted the significance of earlier comments by this Court in its reasons for concluding that a first Plan of Arrangement involving the sale of InterOil shares to Exxon had not been demonstrated to be fair and reasonable. Those comments focused on flaws in the process leading to that first Plan of Arrangement. The second Plan of Arrangement — which was approved and executed, leading to the fair value application at issue in this appeal — was at substantially the same price as the first Plan of Arrangement. The Chief Justice's misinterpretation of the significance of this Court's comments caused him to err in concluding that he could not rely on the rectification of those process flaws to find the transaction price was probative of fair value, even though he had approved the second Plan of Arrangement based on that transaction price as fair and reasonable. Third, resulting from the first two alleged errors in principle, the Chief Justice placed undue emphasis on the discounted cash flow method of analysis without properly weighing the effect on value of flawed assumptions underlying the resulting valuation. Exxon argues that on the record this Court can conclude that the actual transaction price represents the fair value of each share.

[4] For their part, the dissident shareholders argue that this Court should defer to the discretion exercised by the Chief Justice. In short they say that exercise of discretion was properly rooted in an assessment of the evidence and facts found by the Chief Justice that were open to him on the record. They argue that he did not misinterpret the effect of this Court's earlier decision and that he committed no error in how he applied its reasoning. They say the process leading to the transaction was irretrievably flawed and the Chief Justice was entitled to discount its probative value.

Ultimately, the Chief Justice relied on the best evidence of value available to him and committed no error in principle in so doing. In short, Exxon is attempting to reargue the case below as if this were a new hearing.

[5] For the reasons that follow, I would allow the appeal and confirm the transaction price as fair value of the shares held by the dissident shareholders. Respectfully, I have concluded that the Chief Justice misinterpreted the implications of this Court's earlier criticisms of the process as disclosed by the then existing record. The process flaws were capable of correction and the record capable of clarification. I agree with Exxon that the Chief Justice placed insufficient weight on objective market evidence and correspondingly too much weight on an inherently frail valuation technique. These were errors in principle. The objective market evidence disclosed by the record supports the transaction price as fair.

The legal framework and outline of proceedings

[6] Arising out of the approval of the Plan of Arrangement, the dissident shareholders invoked their right to dissent under s. 193(3) of the Yukon *Business Corporations Act*, R.S.Y. 2002, c. 20, which provides:

> 193(3) … a shareholder entitled to dissent under this section and who complies with this section is entitled to be paid by the corporation the fair value of the shares in respect of which the shareholder dissents, determined as of the close of business on the last business day before the day on which the resolution from which the shareholder dissents was adopted.

[7] The meaning of "fair value" is not in dispute. Fair value is related to fair market value. Fair market value means "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": 2019 YKSC 10 at para. 57; see also Kevin P. McGuinness, *Canadian Business Corporations Law*, 3rd ed. (Toronto: LexisNexis, 2017) at 1016, §25.468.

[8] The terms are not, however, always equivalent: see *Nixon v. Trace*, 2012 BCCA 48 at paras. 10–13; *Grandison v. NovaGold Resources Inc.*, 2007 BCSC 1780 at para. 152.

[9] First, as Justice Pitfield explained in *Grandison*, “it is not the market value of the dissenter’s shares that is the center of attention”: at para. 152. Instead, the focus is “the determination of the en bloc value of all shares in the company, and the allocation of a proportionate share thereof to the dissenter”: *ibid*. Dissident shareholders are entitled to receive a proportionate share of the en bloc value of the company, rather than simply the fair market value of their own shares which might reflect, for example, a minority discount.

[10] Second, the use of the term “fair market value” might be confused with the “market value approach” to valuation. They are not always one and the same. As Madam Justice Newbury explained in *Nixon*, "a volume of case law construing ‘fair value’ has developed in Canada which is not tied to market value but considers all available methods and selects the most appropriate in the particular circumstances before the court”: at para. 12.

[11] With these points in mind, in this case, “it must be acknowledged that en bloc value is the fair market value of all issued shares of the company”: *Grandison* at para. 152. The parties’ definition of fair value is appropriate. Fair value in this case means the ratable portion of the en bloc fair market value of all shares in the company, where fair market value is defined as 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.

[12] The next question is how one determines fair value using this broad definition.

[13] The “one true rule”, originating in *Cyprus Anvil Mining Corp. v. Dickson,* [1986] 33 D.L.R. (4th) 641 (B.C.C.A.) at para. 51 is: “to consider all the evidence that might be helpful, and to consider the particular factors in the particular case, and to exercise the best judgment that can be brought to bear on all the evidence and all the factors.”

[14] As Justice Pitfield explained in *Grandison*:

> [5] On an application of this kind, the court's obligation is to consider all relevant evidence and to exercise judgment in the determination of fair value at … the date on which the special resolution adopting the plan of arrangement was passed …. The value attributed to the shares by the plan of arrangement is but one piece of evidence to be considered. Other evidence includes that pertaining to the history of [the acquiring company and target company], the trading price of the shares in the public market, the evolution and formulation of the plan of arrangement and the value of the shares specified in it, and the opinions regarding value expressed by expert witness[es] called by the petitioners and the respondents, respectively.

[15] It is common ground that, broadly speaking, value is approached drawing on five valuation methods: (a) the quoted market price on the stock exchange ("market value approach"); (b) the valuation of the net assets of the company at fair value ("assets approach"); (c) the capitalization of maintainable earnings ("earnings of investment value approach"); (d) the "discounted cash flow" ("DCF") method taking into account a capitalization of future profits; and (e) a combination of approaches.

[16] I pause to observe that viewing the market value approach simply as valuation based on stock market prices may be unduly restrictive where other objective market based evidence is available demonstrating the actual behaviour of market participants in a real market. Where the evidence supports the conclusion that the market is efficient, consisting of multiple informed participants capable of acting in their own self-interest, and there are no material market failures, the result of the market is likely the best and most objective evidence of value. It is rooted in reality and not based on assumptions, theory or predictions.

[17] As C. Hunter, Q.C. and C. Pearce explain in *"Fair Value" – A Common Issue With Surprisingly Sparse Canadian Authority*, (2011) Annual Review of Civil Litigation, the market value approach (approach (a) above) actually consists of multiple methodologies. One such methodology is to look at the quoted share price on the stock exchange. Another, however, is to look at a negotiated transaction price. In this case, while the quoted stock market price leading up to the transaction is relevant, the heart of the dispute focuses on the appropriate use of the transaction price. This is so because that price was the outcome of the behaviour of participants

in a real market. It is of immediate and direct probative value. It is not a theoretical derived value.

[18] Each of the approaches described above offer potentially probative evidence of value, depending on the particular circumstances of a case. Ultimately, a court has to apply its best judgment to all of the evidence: *Cyprus Anvil* at para. 51.

[19] Commonly, the determination of fair value in the reported cases occurs where there is no broadly based open market transaction because, for example, the transaction might not involve a disposition of shares or is not arms-length. In those kinds of circumstances, it is often necessary to resort to a theoretical search for value that attempts to estimate the value that would be the product of a hypothetical market. Where, however, there is an open market for shares or other evidence indicative of arms-length conduct of numerous market participants acting in their own self-interest and settling on a price, such evidence is particularly reliable as an indicator of fair value, as I have already explained. 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.

[20] Justice Burnyeat expressed this point well in *Robinson v. Realm Energy International Corporation,* 2015 BCSC 1437:

> [121] The stock market valuation approach is an examination of the trading prices at or leading up to the valuation date. As the approach presumes that the views of buyers and sellers will take into account the favourable and unfavourable aspects of the prospects of a transaction, the market value approach may provide the most objective and realistic assessment of the fair value of shares. The stock market prices become more persuasive of fair value where this approach is based on the validity of underlying assumptions such as the existence of a market with a free flow of information, numerous participants, no manipulative influences, shares that are not “thinly traded”, and shares that are widely held rather than dominated by a large majority shareholder or a group of shareholders who may effectively control a company.

[21] Theoretical analysis is often suspect because it is vulnerable to the assumptions on which it is based. This does not render such evidence irrelevant. It is commonly used to analyse values and prospective transactions. Indeed, discounted cash flow analysis was relied on in support of the transaction price in this case, as well as being the foundation of the dissenters' attack on the transaction price as reflecting fair value. Nonetheless, as pointed out in the majority judgment in in *Cyprus Anvil* at para. 73:

> [73] … But the discounted net cash flow method must always be viewed with care where there is no historical cash flow to use as the basis of the calculation, and the cash flow itself must be derived from a series of assumptions about gross receipts in a projected market for the product and hypothetical costs of production. A minor variation in assumptions about future metal prices, tonnage, metallurgy, mining plans or discount rates becomes magnified through the calculation into a gross distortion of the fair value.

[22] I do not take it that any of these principles are contentious. More importantly, the Chief Justice correctly identified the relevance of these principles. Moreover, he also correctly recognized certain other important principles relevant to his task at para. 11:

> [11] There are a number of general principles that are well established to determine fair value:
>
> 1. Neither party bears the burden of proof and the court itself must value the shares of the dissenting shareholders. In other words, the dissenting shareholders do not have to prove that the transaction price is too low, nor does the corporation have to prove that the transaction price is the fair value. See *Cyprus Anvil Mining Corp. v. Dickson*, [1986] 33 D.L.R. (4t) 641 (B.C.C.A.), at paras 102 – 103 ("*Cyprus Anvil*") and *Ford Motor Co. of Canada Ltd. v. Ontario Municipal Employees Retirement Board* (1997), 36 O.R. (3d) 384 (O.N.C.A.), at para. 19;
> 2. Any party that asserts a proposition for a value must prove it by a preponderance of evidence on a balance of probabilities;
>
> …

[23] In my opinion, the reversible errors underlying the order flow from the application of these principles to the facts of the case, not from an error in appreciating the proper approach to the valuation of the dissidents' shares.

The transaction

[24] InterOil was a Yukon corporation. It operated as an oil and gas company, exclusively in Papua New Guinea. Its primary asset was a 36.5% joint venture interest in an oil and gas field, known as PRL 15. PRL 15 was, at material times, in the early development stage. The long-term plan for PRL 15 was to build a liquid natural gas ("LNG") plant in Papua New Guinea from which LNG could be shipped worldwide. At the material time, PRL 15 was a contingent resource, not classified as a "reserve", and many years away from commercial production.

[25] InterOil's shares were widely held and publicly traded on the New York Stock Exchange.

[26] From June 2014, InterOil had no revenue-generating assets or oil and gas reserves. I will return to discuss the commercial circumstances of InterOil later in these reasons. In brief, InterOil required significant funds to finance its obligations in connection to PRL 15. Although under agreements it had a right to receive funding for a portion of its ongoing financing obligations, the timing and reliability of that source of funding was uncertain.

[27] InterOil canvassed a variety of alternative means of financing its obligations. Eventually InterOil's board of directors began to consider a whole company transaction as a means of meeting its financial obligations.

[28] InterOil received a number of bids for its shares beginning in March 2016. Again, I will return to some of the detail of the various bids later in these reasons. For current purposes, it is sufficient to note that on May 19, 2016, InterOil's board decided that a proposed whole company transaction with a company known as Oil Search was in the best interests of the company. On May 20, 2016, InterOil publicly announced the proposed arrangement with Oil Search.

[29] On June 23, 2016, Exxon made a bid for InterOil's shares on terms the Board determined were superior to Oil Search's terms. The Board terminated its agreement with Oil Search, as it had a right to do, and proposed to enter into an arrangement

agreement with Exxon. The basic terms of that arrangement were that Exxon would buy all of the shares of InterOil for $45 per share plus a contingent resource payment ("CRP") of approximately "$7.07 for each one tcfe of PRL 15 2C Resources above 6.2 tcfe, up to a maximum of 10.0 tcfe". Exxon paid the "break fee" of $60 million required under the Oil Search agreement so that InterOil could proceed with the Exxon deal.

[30] The arrangement with Exxon was approved at a special meeting of the shareholders, although a Mr. Mulacek and others holding approximately 10% of the common outstanding shares voted against the resolution. The Yukon Supreme Court approved the proposed Plan of Arrangement under s. 195 of the Yukon *Business Corporations Act*, finding that the arrangement was fair and reasonable: 2016 YKSC 54. That order was subsequently set aside by this Court in *InterOil Corporation v. Mulacek,* 2016 YKCA 14 on November 4, 2016.

[31] Notwithstanding this Court's judgment, the parties remained committed to the fundamentals of the proposed arrangement. The Board took a number of steps to address the deficiencies that had been identified by this Court in order to renegotiate and re-evaluate the arrangement with Exxon. I will return to the significance of these steps later.

[32] On December 15, 2016, the Board unanimously resolved to approve a second Exxon arrangement on substantially the same terms as the first. The arrangement differed slightly in that the so-called break fee was agreed to at $100 million, rather than $60 million and the CRP was increased by about 10%.

[33] The second Exxon arrangement was approved at a shareholder meeting on February 14, 2017. On February 20, 2017, Justice Veale (as he then was) approved the second Exxon Plan of Arrangement as fair and reasonable. That order was not appealed. The transaction closed on February 22, 2017. Less than 0.5% of shareholders exercised their dissent rights by the petition commenced February 28, 2017. The result of that petition is the subject of this appeal.

Reasons for judgment

[34] The Chief Justice analysed the respective positions of the parties, the history of the transaction, the evidence of value, and the history of court proceedings. He identified the principles he had to apply in determining the value of the dissidents' shares. He described steps taken by the Board to address the deficiencies identified by this Court in setting aside the first Plan of Arrangement. The material part of his judgment follows:

> [45] Both parties acknowledge that the corporate governance procedures were enhanced as a result of InterOil addressing the deficiencies identified by the Court of Appeal. While the corporate governance enhancements may be considered to be a factor on the road to establishing "fair value", they are by no means conclusive as they followed rather than preceded the establishment of the transaction price.
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> [46] The crux of this "fair value" dispute is the different conclusion reached by Mr. West for the dissenting shareholders and Mr. Doran for Exxon. …
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> …
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> [58] There are many factors to take into consideration in approaching the question of fair value in this case, which has a somewhat unique situation where corporate governance was heavily criticized by this Court and the Court of Appeal prior to November 4, 2016. After that date, best practices were incorporated into the process but by that time, the purchase price per share of $45 was already concluded and did not change but for the post valuation date calculation of the CRP, the most speculative aspect of the transaction. The effect then of the best practices was to better inform the InterOil shareholders reviewing the Information Circular for the second vote of approval. It is therefore a positive factor, albeit not conclusive, that the shareholder approval rose from 80% to approximately 90%. The fact that Philippe Mulacek, a very knowledgeable shareholder, first objected but then approved, is also important.
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> [59] In my view, considerable attention must be paid to the sales process prior to the Court of Appeal decision and the commercial or partial sale process which was followed by the whole company transaction.
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> [60] There are factors that support the proposition that the transaction price is fair value:
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> 1. InterOil shares were known to individual and institutional investors and traded on the NYSE;
> 2. There were many interested parties in partial transactions and three major players (Total, Exxon and Oil Search) who knew the Papua New Guinea gasfield scene;
> 3. It was no secret that InterOil and its significant asset, PRL 15, were on the market based on the parties expressing interest to partial or whole company transactions;

> 4. Although there was not an auction, there was a bidding and negotiations process that moved the InterOil share price from $34 to $45; and
>
> 5. The bidders included insiders like Oil Search and Total as well as Exxon.
>
> [61] Nevertheless there were other factors at play that must be taken into consideration:
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> 1. There had been no planned sales process in which InterOil attempted to solicit the highest possible market price for a whole company transaction. In fact, InterOil had been subject to non-solicitation agreements since May 19, 2016;
>
> 2. Oil Search's decision to not match Exxon's unsolicited bid is not evidence of an auction or the value of the Exxon bid;
>
> 3. The base price offered by Exxon had not changed since the initial binding offer of June 23, 2016. This is despite substantial changes to the state of the LNG market over this period; and
>
> 4. The Board process leading to the approval of the first proposed Exxon Transaction had been roundly criticized by the Yukon Court of Appeal. Although the Board of Directors had addressed and remedied the specific deficiencies identified by the Court, there was never even consideration of commencing a fresh process.
>
> CONCLUSION
>
> [62] I conclude that the transaction price was established in a flawed corporate governance process. The fact that the corporate governance process to establish a fair and reasonable arrangement was enhanced does not change the findings of the Court of Appeal on the original arrangement. These findings included a CEO in a position of conflict, an "independent" special committee that was not independent of management and the lack of necessity for the deal. In my view, the transaction price, borne of a flawed process, cannot be resurrected as the "fair value" as defined by the experts.

Discussion

[35] I conclude that the Chief Justice erred in his appraisal of the fair value of the dissidents' shares. Specifically, the Chief Justice erred in finding that this Court's previous judgment setting aside the first arrangement precluded him from effectively giving any weight to the transaction price in assessing the fair value of the shares. As a result, he erred by relying entirely on a speculative DCF evaluation in the face of reliable and objective market evidence of fair value. I also conclude, in this case, the record is sufficient to allow us to fix the fair value of the dissidents' shares at the transaction price.

Errors in the judgment below

[36] The Chief Justice recognized, in para. 60, certain objective market factors tending to support the transaction price as fair value. In para. 61 however, he describes four factors that he says must also be taken into account. In substance, he treats those four factors as depriving the factors described in para. 60 of any probative weight. This analysis, in part, underpins his conclusion in para. 62 that he cannot rely on the transaction price as evidence of fair value because it was established originally through a flawed corporate governance process. This explains, in turn, why the Chief Justice, in para. 46 of his reasons, treated the crux of the fair value debate as turning on the conflict between the differing expert opinions of value. After finding that the transaction price, “borne of a flawed process”, could not be relied upon as the fair value of the shares, the Chief Justice preferred the assumptions underlying one expert’s report over the assumptions underlying the other expert’s report, and ruled accordingly: at paras. 62–65.

[37] In short, the Chief Justice resolved the question of value by preferring one opinion to another. In doing so, he effectively gave no weight to objective market evidence and the history of the transaction, except to the extent that those matters were factored into the conflicting expert opinions. The Chief Justice’s decision to prefer one opinion over another was, it is apparent, driven by his view of the different assumptions underlying the opinions.

[38] A critical step in the Chief Justice’s analysis was the implications he drew from the previous decision of this Court. He treated that decision as implying that the flaws identified by this Court, on the record then before it, undermined any weight to be placed on the process leading to the original transaction price. For this reason, the transaction price could not be “resurrected”.

[39] With respect, I see two errors in that analysis. First, this Court’s reason for rejecting the first Plan of Arrangement was that it had not been demonstrated, on the record before the Court, to be fair and reasonable, not that it was in fact unfair or unreasonable. The problem arose because the Court could not be satisfied, in light

of the series of identified "red flags", that the shareholders were adequately informed of the necessary material facts to make an informed choice on whether to vote for or against the arrangement. As the Court pointed out at paras. 33 and 40:

> [33] It is of course for the shareholders, not the court, to decide between the conflicting views of the prospects of InterOil and its joint venture interest in the Elk-Antelope gasfields. It *is* the court's task to decide whether the proposed arrangement has been shown to be fair and reasonable. In the circumstances of this case, <u>that requires, in my respectful view, that the court be satisfied the shareholders were in a position to make an *informed choice*, both as to the value they would be giving up, and the value they would be receiving</u>. …
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> …
>
> [40] With respect, it seems to me that the chambers judge erred in principle in setting aside the identified deficiencies when he came to consider the fairness and reasonableness of the proposed arrangement. Instead of 'delving into' the question of value (see *BCE* at para. 141), he relied on the truism that the shareholders were "entitled to make the decision". Clearly, it *was* the shareholders' decision to make, but court approval was *also* required by the Act to ensure the decision was <u>fair and reasonable in the sense of being based on information and advice that was adequate, objective and not undermined by conflicts of interest.</u> Given the 'red flags' in this case – the absence of a fairness opinion from an independent expert, the failure of Morgan Stanley to assess the value of the CRP as compared with the value of the PRL prospects (again, the company's primary asset); the deficiencies pointed out by Mr. Dey; the unchallenged report of Mr. Booth; the fact the CEO was in a position of conflict; the probability the "independent" special committee was not independent of management; and the lack of "necessity" for the deal – the Court was required to do more than accept the vote of the majority as a "proxy" for fairness, or the cash amount of Exxon's offer as a proxy for reasonableness. As I say, this was an error of principle, if not law, in the sense that the correct 'legal test' was not brought to bear.
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> [Emphasis added by underlining, emphasis in italics in original.]

[40] This Court did not decide that a transaction involving the same parties at substantially the same price could not be fair and reasonable. Moreover, this Court said nothing about the openness or competitiveness of the bidding and negotiations leading up the transaction price. In response to the argument that the Plan of Arrangement was a "good deal" for the shareholders, this Court acknowledged that adequately informed shareholders are "perfectly entitled to make a decision to 'de-risk' their investments" and that a judge may "not be in the best position to assess investments like the InterOil shares": at para. 43. No less, the lower court had erred

in approving the arrangement by setting aside the deficiencies it had identified on the record before it, and simply deferring to the verdict of the majority of the shareholders. Simply put: “The evidence before the judge contained many deficiencies that were not answered by the fact that the arrangement was approved by a majority or that Mr. Mulacek had dissent rights available to him.”: at para. 43.

[41] It follows from this that it was open to InterOil to remedy the deficiencies identified by the Court in order to properly inform and advise shareholders of the merits of the transaction and to ensure that that advice was adequate, objective and not undermined by conflicts of interest. Steps to achieve precisely that were undertaken by InterOil, including amplifying the record to address deficiencies such as Mr. Booth’s uncontradicted evidence and other matters. It was an error in principle to conclude that the transaction price could not be resurrected as evidence of fair value, provided the flaws in the process and gaps in the evidentiary record were properly addressed. Those flaws related principally to the adequacy of information given to the shareholders to justify the fairness and reasonableness of the first proposed transaction. They also reflected some flaws in the decision-making process and the information flowing between the Transaction Committee and the Board. The evidence shows that each identified flaw was addressed and remedied. Indeed, the second Plan of Arrangement was found to be fair and reasonable and that decision was not appealed.

[42] The evidence before the Chief Justice demonstrated that governance issues were resolved and the transaction reassessed. The fairness and reasonableness of the transaction was re-evaluated by the Board. Shareholders were put in a position where they had the necessary information to properly evaluate the merits of the proposed transaction. In my view, the Chief Justice erred in putting no weight or inadequate weight on critical objective evidence as to value.

[43] Secondly, the prior conclusion of this Court was based on the record in that appeal. The record in this proceeding is materially different. Not only does that record address the way in which the Board remedied deficiencies in the information

available to shareholders and the other red flags identified by this Court, it also provided significant detail about the process and the market conditions leading to the first transaction. Respectfully, the Chief Justice does not grapple with the evidence capable of demonstrating that the original transaction price was objectively fair. In my view, nothing in this Court's previous reasons foreclosed a demonstration that the original transaction price was fair and, accordingly, that the transaction price in the second arrangement was also fair. The Chief Justice erred in the weight he attached to the previous findings of this Court which were based on the record as it stood then.

[44] In sum, the Chief Justice's misapprehension of this Court's reasons for rejecting the first arrangement and his failure to properly consider the distinct legal issue and factual record before him in this case led him, in error, to hold that he could not rely on the transaction price as objective evidence of fair value. This error in principle caused the Chief Justice to undertake his own assessment of the assumptions underlying the theoretical DCF analyses used by the two experts, without any consideration of the fact that the market price would reflect real market conduct, even though one would expect that conduct was influenced by market participants' consideration of those or similar assumptions. As I explain in what follows, on the facts of this case, proper consideration of the transaction price and the circumstances leading up to it results in the conclusion that the transaction price was an accurate reflection of fair value.

Proper assessment of fair value

[45] Having found that the Chief Justice's appraisal is in error, this Court must decide whether it can determine fair value or is compelled to send the matter back for a new hearing. The former option is preferable: see *Cyprus Anvil* at para. 63. On the record in this case, I am satisfied that we can determine that the fair value is the transaction price. The transaction price reflects a negotiated price in a competitive market consisting of well-informed and sophisticated parties. There is no indication that any other process could have led to a higher price. All potential purchasers or partial investors were fully informed. There was no impediment to other potential

purchasers outbidding Exxon. The deal price was at a substantial premium to the pre-deal stock price. The shares were widely traded and held by large and sophisticated investors, expert in assessing value, none of whom dissented. Share value was driven by an asset in the early stages of development, the future prospects of which were highly uncertain. Theoretical derivations of value were rife with uncertainty and speculation. Such assumptions were surely factored into the decision by institutional investors to accept the deal price.

[46] In *Deer Creek Energy Limited v. Paulson & Co. Inc.*, 2008 ABQB 326, at para. 549 Justice Romaine cited *M.P.M. Enterprises Inc. v. Gilbert*, 731 A.2d 790 (U.S. Del. S.C. 1999) at 797, in a passage I would endorse:

> [T]he fact that a transaction price was forged in the crucible of objective market reality (as distinguished from the unavoidably subjective thought process of a valuation expert) is viewed as strong evidence that the price is fair.

[47] It is helpful to explain why, on the record before us, objective market evidence compels the conclusion that, considering all approaches to value, the transaction price reflected the fair value of the shares.

[48] At the material times, InterOil's primary asset was its interest in PRL 15. InterOil only held contingent resources; it had no revenue generating assets. InterOil held a 36.5% interest in PRL 15. Other license holders held the remaining interests. Total S.A. held approximately 40.1% of PRL 15, which it had acquired from InterOil in March of 2014. The government of Papau New Guinea also had a state right of participation, which it was expected to exercise. Papau New Guinea's exercise of its right of participation would lower InterOil's interest in PRL 15 to 28.3%.

[49] The long term plan for PRL 15, <u>if</u> the resource proved capable of commercial production, was for a joint venture of the license holders to produce LNG and ship it worldwide. Total S.A. was the operator of the joint venture project. The interest holders, including InterOil, were responsible for their proportionate share of project development costs. The project was expected to cost up to $20 billion, and $13 billion would be covered by joint venture project financing. $7 billion would be

contributed by the parties to the joint venture in their proportionate shares, meaning that InterOil would be required to contribute close to $2 billion (assuming Papau New Guinea exercised its right of participation and lowered InterOil's share to 28.3%).

[50] By the summer of 2014, InterOil was projecting significant financial challenges, particularly with respect to its obligation to fund its share of the expected capital costs of the project. As mentioned, InterOil had no revenue-generating assets. Its primary source of expected cash flow consisted of contingent Interim Resource Certification Payments owed to it by Total S.A. The specifics of InterOil's finances at this point need not be explained in depth, other than to say that InterOil's ability to cover its contributions to the project was dependent on its ability to raise significant debt or equity financing.

[51] In March 2015, the Board requested that management take accelerated steps to identify strategic investors for InterOil, in consultation with the company's advisors, and to continue identifying and reaching out to institutional investors and funds to support and increase InterOil's share price.

[52] In a May 2015 Board meeting, management reported that it expected InterOil would need to raise $1.75 billion by the time of the final investment decision on the project in order to fund its share of the development costs.

[53] Following the March 2015 directions from the Board, management attempted two initiatives — both of which ultimately failed — to find a strategic partner to accept a placement of 19.9% of InterOil's shares, and to issue $500 million in convertible bonds.

[54] By August 2015, management was predicting a $1.9 billion funding shortfall by the time of the final investment decision. At a Board meeting, management reported that it had been approached by several parties who were interested in acquiring a stake in InterOil's asset holdings. To this end, management proposed to open a data room for potential counter-parties by September 2015.

[55] By November 2015, InterOil had set a goal of completing an asset or equity transaction by the first quarter of 2016. Management had identified approximately 30 potential partners, essentially every institutional investor (including sovereign funds) with the capacity to invest. By this time, a number of prospective deals were in active discussion, including prospective large transactions with Total S.A., Exxon, Oil Search, and one other major market participant. A physical data room had been opened to facilitate discussions with potential counter-parties. Exxon and Oil Search both indicated interest in accessing the data room for a significant transaction. There is no evidence of any realistic potential investor who was unaware of the opportunity to invest in or acquire InterOil.

[56] By March 2016, a number of parties were interested in deals with InterOil, either for a partial interest in PRL 15 or a whole company transaction. InterOil received two separate indicative bids for part of PRL 15 with implied share values of $35 and $27. Both bids, if accepted, were expected to downgrade InterOil's share price. InterOil also received informal or non-binding bids for whole company transactions from Exxon, Oil Search and Total S.A. Those bids valued InterOil shares at between $34 and $40 plus a contingent value right.

[57] It is important to note that no potential transactions contemplated an implied share value close to the ultimate transaction price. Put simply, no better deal was available to shareholders.

[58] At a Board meeting in mid-March 2016, the Board instructed management to continue discussions with all parties to see if any of the existing proposals could be improved. An independent Transaction Committee was also formed.

[59] In the months that followed, InterOil did not initiate a public auction process for the whole company. The record reveals that this was a considered decision based on professional advice. InterOil had already identified all possible counter-parties who had the requisite financial ability and expertise to enter a deal given the nature of InterOil's business and assets. The Board viewed it as unlikely that a public auction would attract any new parties, and doing so would indicate that

the company was in distress, resulting in lower bids. In short, with input from investment bankers, the Board decided a public auction would have negative results for InterOil's shareholders.

[60] In April 2016, Morgan Stanley and UBS were retained as financial advisors with respect to any whole company proposal. Morgan Stanley would ultimately provide a fairness opinion. Its retainer included a success fee.

[61] In late April 2016, Oil Search made a revised non-binding proposal valued at $40.25 per share plus a contingent value right. The Transaction Committee met to discuss this proposal on May 10, 2016.

[62] At this time, a number of other options remained on the table. One of the parties interested in a partial asset transaction had improved its previous bid to seek a 3% interest in PRL 15 at an implied value of $32 per share. A new player had provided a bid for a 2% interest in PRL 15 with an implied value of $32 per share. These partial asset transactions, however, were still expected to negatively impact InterOil stock.

[63] With respect to whole company transactions, Total S.A.'s bid worth $38–$40 per share was still on the table. Exxon had also provided a revised bid worth $38.50 per share, and indicated that this was not its last offer.

[64] The Transaction Committee recommended that the Board continue negotiations with Oil Search.

[65] On May 17 and 18, 2016, the Transaction Committee met to continue discussing the Oil Search offer. The Transaction Committee met with legal and financial advisors. Morgan Stanley concluded that the deal was fair to InterOil's shareholders, even without consideration of the contingent value right, which Morgan Stanley viewed as too uncertain to form part of its final conclusion on fairness. The price of $40.25 per share was a significant premium over InterOil's May 17, 2016 trading price of $32.29, and offered significantly better value to shareholders compared to the asset purchase offers.

[66] At a May 19, 2016 meeting, the Board voted unanimously that the Oil Search transaction was in the shareholders' best interest, was financially fair to the shareholders, and that the Board recommended the transaction to shareholders for approval. A public announcement followed on May 20, 2016.

[67] The Oil Search agreement allowed InterOil to consider unsolicited proposals prior to the completion of the transaction. If InterOil received a superior proposal, as defined by the agreement, Oil Search had a three-day window to match or beat the proposal, failing which InterOil could abandon the Oil Search transaction upon payment of a break fee.

[68] On June 23, 2016, Exxon approached the Chairman of the Board with an unsolicited, non-binding offer to acquire all InterOil shares for $45 per share plus a contingent resource payment. The contingent payment offered by Exxon was higher per unit of resource recovery, but was capped, whereas the Oil Search contingent resource payment was uncapped.

[69] On June 24, 2016, the Board met and received a presentation from Morgan Stanley concluding it was likely that the Exxon proposal was superior to the Oil Search transaction, as defined by the agreement. The base value of $45 a share was a 42% premium on InterOil's May 19, 2016 share price (pre-announcement of the Oil Search transaction).

[70] Over the next several weeks, the Transaction Committee and the Board met a number of times to discuss the Exxon proposal. The main issues considered by the Board were that the Exxon bid was higher in terms of base compensation and the unit price on the CRP, but that the CRP was capped, and that Exxon would pay the Oil Search break fee. On July 17, 2016, the Board unanimously resolved that the Exxon proposal was superior to the Oil Search transaction.

[71] On July 20, 2016, the Board met again. Oil Search had informally advised the Chairman of the Board that it would not submit a revised bid. Morgan Stanley provided a fairness opinion, and, as with its previous opinion, concluded that the

Exxon proposal was fair even if the value of the contingent resource payment was zero. The Board terminated the Oil Search transaction and recommended the Exxon transaction to its shareholders.

[72] After obtaining an Interim Order permitting InterOil to hold a shareholders' meeting to consider the Exxon transaction, a meeting was held on September 21, 2016. Of the shares voted, over 80% were in favour of the transaction, including 98% of institutional investors. Institutional investors held over 50% of InterOil shares, and consisted of a number of the world's most well-known and respected investment banks.

[73] On October 7, 2016, InterOil appeared in the Supreme Court for an order approving the transaction. Mr. Mulacek, the former CEO and a shareholder in InterOil, opposed the application. As explained earlier in these reasons, the transaction was approved by the Supreme Court but that decision was overturned on appeal with reasons indexed at 2016 YKCA 14.

[74] What followed from the Board is crucial. The implications to be drawn from the Board's actions following the Court of Appeal's decision formed a key point of disagreement between the parties on this appeal.

[75] As the respondent pointed out throughout its argument, InterOil issued a press release immediately following the Court of Appeal's decision, stating that it continued to believe that the Exxon arrangement represented compelling value for all InterOil shareholders, and that InterOil and Exxon were considering the Court's ruling and determining a path to closing the transaction. Notably, nothing about this announcement flouted the Court's decision nor was it inconsistent with the implications of the Court's reasoning. The Court had not concluded that the arrangement did not represent fair value for the shareholders. Nor had it suggested that, for InterOil to arrive at a fair and reasonable deal, it would need to abandon the transaction or start a new process.

[76] The Board took a number of steps to respond to this Court's decision. The Board approved a Charter for the Transaction Committee which gave the Transaction Committee authority to engage independent legal and financial advisors, and autonomy to review all aspects of the transaction and provide recommendations to the Board to address any identified deficiencies. The Transaction Committee retained independent legal advisors and an independent financial advisor, BMO Capital Markets ("BMO") to prepare a fresh fairness opinion on a fixed-fee basis without compensation tied to the outcome. The Transaction Committee also requested a fresh resource assessment report, and negotiated with Exxon for an increase in the contingent resource payment cap. Between November 12 and December 15, 2016, the Transaction Committee met a total of 13 times, including *in camera* meetings without InterOil management present.

[77] At one meeting, BMO advised the Transaction Committee that, in its view, InterOil had run a thorough and robust process that exceeded what BMO would typically see in North American markets. BMO noted specifically that many deals would not have had the same number of proposals and alternatives for the target to consider.

[78] Ultimately, BMO concluded that the transaction was fair to InterOil's shareholders and issued a long-form fairness opinion.

[79] After detailed discussions with BMO, the Transaction Committee resolved unanimously that the Exxon transaction was in the best interests of the shareholders and was fair from a financial point of view. It recommended that the Board approve the transaction and recommend it to its shareholders. On December 15, 2016, the Board voted twice — once with the executive members and once without — and unanimously approved the transaction as in the shareholders' best interests.

[80] Prior to the special meeting of the shareholders to consider the Exxon transaction, InterOil issued a new Management Information Circular, over 300 pages long, describing why management and the Board endorsed the arrangement, and specifically including the BMO fairness opinion, the updated resource assessment

report, a detailed summary of the negotiations and events leading up to the transaction, and the risks InterOil faced as a stand-alone company.

[81] On February 14, 2017, a special meeting of shareholders to consider the Exxon transaction was held. 70.86% of the outstanding common shares of InterOil voted. 91.24% of the votes cast were in favour of the resolution approving the Exxon Agreement. Proxy advisory firms had recommended shareholders vote in favour of the transaction.

[82] An order approving the transaction was entered, and not appealed, and the transaction finally closed on February 22, 2017.

[83] Dissent notices were received for 0.5% of InterOil's outstanding shares. Mr. Mulacek, who opposed the first Plan of Arrangement, did not dissent. None of the institutional shareholders dissented.

[84] From this history, a number of salient points can be extracted:

- InterOil engaged in a systematic process to canvas a variety of different ways in which the capital necessary to finance the development of its primary asset could be funded. This is what led it, ultimately, to a whole company transaction.
- Once the prospect of a whole company transaction became a reality, every potential purchaser was aware that InterOil was available for purchase. All interested potential purchasers had access to a data room and an opportunity to bid for the company, if it was in a potential purchaser's interest to do so. Numerous parties made and revised bids for partial or whole company acquisitions. In InterOil's circumstances, it fairly concluded a public auction would not have added value for shareholders.
- Even after InterOil acted on the Oil Search transaction, it was entitled to, and did, act on unsolicited superior proposals. The deal protection measures were within market norms.
- Oil Search, who had a clear interest in completing a whole company transaction, refused to meet or better the Exxon bid that led to the first transaction. Contrary to the Chief Justice's statement at para. 61, in the absence of evidence to the contrary, this must be taken as market evidence that the Exxon bid was not under value.
- Without any consideration of the CRP, the base value per share ($45) paid by Exxon was a 42% premium over InterOil's share price ($31.65) on

May 19, 2016, the last available share price prior to the public announcement of a whole company transaction. Including the CRP, the deal was a 58% premium on the May 19, 2016 share price. This factor is particularly important given that InterOil's shares were widely held and highly liquid, and that InterOil was well covered by the analyst community. I will return to this point below.

- The Exxon deal also represented a premium over previous whole company offers, and a significant premium on the implied share value involved in the asset purchase offers made by three interested corporations.
- Any conflicts or informational deficiencies were remedied prior to the shareholder vote on the second Exxon transaction.
- Mr. Mulacek, who was highly informed and experienced and had objected to the first Exxon transaction, endorsed the second Exxon transaction and did not exercise dissent rights.
- InterOil was widely held by highly sophisticated and self-interested institutional investors, the vast majority of whom voted in favour of the first and second Exxon transaction, and none of whom exercised dissent rights. Similarly, proxy advisory firms advised shareholders to vote in favour of the deal.

[85] These factors, taken cumulatively, strongly support the transaction price as fair value to the dissenting shareholders.

[86] Before closing some further comments are in order.

[87] First, as the appellant's counsel pointed out, acquiring all of InterOil at $71.46 per share — the fair value arrived at by the Chief Justice — would have cost a prospective purchaser a total of over $1 billion more than Exxon paid. This would imply that Exxon underpaid by $1 billion, and that no other market participant was prepared to step in to bid up the price. It is simply unreasonable, given the number of parties interested in a whole company transaction, and the number and sophistication of InterOil's shareholders, that $1 billion in value was left on the table.

[88] Second, although the transaction price was at a significant premium over the immediately preceding trading price, the stock had in the previous year exhibited considerable volatility. In July 2015, it had traded at a high of $58.47 but from there the trend was downward, although not uniformly. The stock price did not exceed the transaction price between July 2015 and May 2016, when the first announcement of

a whole company transaction was made. Between January and May 2016, the stock traded at between $22.37 and $34.45. From this I conclude that the transaction price reflected a settled premium over stock price over an extended time, and was not just a snapshot premium. The stock price can be taken to reflect the opinion of the market as to value, pricing in future prospects and any changes in the market for LNG during the material period.

[89] Third, it must be noted that institutional investors, just like the competing experts in this case, make their decisions using what they view as accurate assumptions. While a judge in a fair value case is entitled to prefer the assumptions of one expert over another, consideration ought to be given, where market forces are such that the market is reliable, to the fact that the market itself prices assumptions into its decisions. In this case, for example, it is unlikely that the institutional investors approving of the transaction wholly declined to account for increasing oil prices, country risk premium or other changes to in the market, contrary to the conclusion of the Chief Justice.

[90] Fourth, the respondents criticize the absence of evidence from Exxon of its own internal valuation of InterOil. With respect, in my opinion, that argument is without merit. Exxon's subjective valuation of InterOil is not evidence of market value. It is evidence of value to user. The fact that Exxon might have been prepared to pay more for the shares than it did, assuming that to be the case, is beside the point. Exxon is required only to pay the market price.

[91] Fifth, I respectfully disagree with the Chief Justice's conclusion that Oil Search's decision not to meet Exxon's bid was not evidence of fair value. Oil Search clearly had an interest in completing a whole company transaction. It had the option to match or better the first Exxon bid. It chose not to. In the absence of any evidence to the contrary, Oil Search's failure to meet or better the bid can only support the inference that it was not prepared to pay as much for InterOil as Exxon was. This is evidence of value.

[92] Sixth, the respondents argue that to rely on market evidence as determining fair value would eviscerate dissenting shareholder rights. I see no merit in that argument. Each case turns on its own facts. Most cases of this kind do not involve such compelling objective market evidence and other evidence of value is more probative. Nothing in these reasons detracts from the "one true rule" or minimizes the relevance of other evidence of value depending on the facts of the case.

[93] Finally, the Chief Justice's criticisms that there was no planned sales process or an auction, respectfully, miss the mark. There is no evidence that proceeding differently would have produced a higher price. Such an assertion is pure speculation, given that all prospective investors or purchasers were informed of the opportunity. Similarly, the fact that InterOil could not actively solicit new bids once it agreed to a transaction did not, to the knowledge of the market, inhibit improved bids by potential purchasers prepared to pay the break fee.

Disposition

[94] I would allow the appeal. I would declare the transaction price to be the fair value of the respondents' shares. Subject to any submissions on the questions of costs, I would order that the appellant is entitled to its costs. I would maintain the sealing order that is in place. Any submissions on either costs or the sealing order should be completed and filed with the Court within 45 days of the release of this judgment and should be restricted to no more than 3 pages on each issue. With

thanks to all counsel for the admirable assistance each of them provided to the Court.

"The Honourable Mr. Justice Harris"

I agree:

"The Honourable Madam Justice D. Smith"

I agree:

"The Honourable Madam Justice Shaner"