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Fairness Opinions after InterOil

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The Supreme Court of Yukon recently issued its reasons for approving Exxon Mobil's acquisition of InterOil [PDF], which closed on February 22, 2017. The original $2.3 billion arrangement was blocked by the Yukon Court of Appeal on the basis that it was not fair and reasonable, in large part due to the lack of disclosure of the financial analysis underlying the original fairness opinion in support of the transaction, leading to a concern that the shareholder vote approving the arrangement was not fully informed.

Under the amended arrangement, Exxon continued to offer US$45 per share of Exxon common stock and increased the maximum amount of consideration payable under the contingent resource payment. Responding to the criticism in the Court of Appeal decision, InterOil's revised proxy circular contained (i) a fixed fee long form fairness opinion that contained detailed financial analysis about the value of InterOil and the consideration payable under the arrangement, and (ii) a report of an independent committee of directors in support of the arrangement.

In approving the amended arrangement, the Court noted that the interim order of the Court required the above-noted disclosure in the proxy circular and observed that, in the Court's view, these two 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."

The Court's statement, if adopted more broadly, would result in a marked departure from existing practice, and does not reflect the law in jurisdictions other than the Yukon.

Fairness opinions are not legally required in Canadian public company sale transactions. The overwhelming market practice prior to *InterOil*, however, was for boards of directors to obtain a short form opinion from a financial advisor entitled to receive a success fee upon completion of the transaction. Obtaining a fairness opinion assists directors in satisfying their duty of care. Detailed financial analysis in fairness opinions has generally only been included in the case of related party transactions under Multilateral Instrument 61-101 – *Protection of Minority Security Holders in Special Transactions*.

Since the Yukon Court of Appeal's decision, there has been considerable debate in the legal and investment banking community as to whether Canadian practice relating to fairness opinions should change in response to the decision. So far practice has been mixed. Market participants have not, however, uniformly adopted the three practices suggested by the Court of Appeal: disclosure of financial analysis, disclosure of advisor fees, and fixed fee opinions.

For example, in Chemtrade Logistics Inc.'s proposed acquisition of Canexus Corporation (which is still pending), the Alberta Court of Queen's Bench granted a final order without a fixed fee fairness opinion. Neither Canexus nor its two financial advisors disclosed the

detailed financial analysis underlying the opinions. Both financial advisors were entitled to success fees, which were not disclosed.

The Alberta Court of Queen's Bench also approved Toro Oil & Gas Limited's arrangement pursuant to which it was acquired by Steelhead Petroleum Ltd. Toro obtained a typical short form fairness opinion that did not include the underlying financial analysis from its advisor, which was entitled to an undisclosed success fee. In addition, the British Columbia Supreme Court approved the acquisition of Merrex Gold Inc. by IAMGOLD Corporation, where Merrex obtained a short form fairness opinion for an undisclosed fixed fee that did not include the underlying financial analysis.

Perk Inc.'s acquisition by a subsidiary of RhythmOne plc was approved by the Ontario Superior Court of Justice. Perk obtained a fairness opinion from a financial advisor entitled to a success fee. The fairness opinion set out the valuation methodologies considered by the financial advisor, but did not disclose the financial advisor's detailed financial analysis or its fees.

Mettrum Health Corp.'s acquisition by Canopy Growth Corporation was also approved by the Ontario Superior Court of Justice. Mettrum obtained one fairness opinion for an undisclosed success fee and a second fairness opinion for an undisclosed fixed fee. Neither opinion included detailed financial analysis, although the fixed fee opinion disclosed the valuation methodologies considered by the financial advisor.

With respect to independent committees, where there is a true conflict transaction, an independent committee with independent legal and financial advisors should be, and may be required to be, established to review an acquisition proposal, supervise and direct any negotiations and make recommendations to the board.

An independent committee does not, however, need to be established in all cases. In an arm's-length sale transaction, the full board may want to be engaged, with each director participating in all deliberations. In other circumstances, a committee of convenience may be established, depending on the relative expertise of the directors and their differing time commitments.

In addition, where there are conflicts that are not acute — such as where there is a perception that management may be influenced by considerations relating to their continued employment or change of control payments — the conflict may be addressed by excluding management and any potentially conflicted directors from those portions of the board's deliberations as considered appropriate in the circumstances.

It is still too early to tell how fairness opinion practice will evolve following *InterOil*. A number of factors will need to be considered, including whether the transaction is structured as an arrangement, the jurisdiction of the arrangement, the process leading up to the transaction, and the likelihood of a shareholder challenge. Issuers and financial advisors, with the assistance of their legal counsel, should carefully consider the optimal approach to navigating the somewhat murky waters *InterOil* has left in its wake.