InterOil – Latest decision upholds importance of market prices in valuation

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The ExxonMobil (Exxon) acquisition of InterOil has produced some interesting court decisions and, in the process, caused participants in the M&A markets to re-evaluate various common practices, including in relation to fairness opinions (as discussed in our earlier article, "Fairness Opinions - Is there a new InterOil Standard?"). The most recent (and presumably last) decision is that of the Court of Appeal of Yukon in *Carlock v. ExxonMobil Canada Holdings ULC*, issued on February 7, 2020. In its decision, the Court of Appeal dealt with the claim made by dissenting shareholders of InterOil to be paid the fair value of their shares, by confirming that the price offered pursuant to the acquisition agreement constituted fair value, and not the much higher price that the lower court had awarded. The decision is important because it emphasizes the importance of market prices in determining fair value after the lower court had based its decision on expert opinion.

InterOil History

To briefly recap, Exxon's acquisition of InterOil had been the subject of court proceedings, which had criticized certain elements of the process and led to fresh disclosure and a new shareholder meeting. Importantly, however, the basis of the deal changed only slightly - the cash price payable by Exxon remained the same and the contingent payment increased marginally. The shareholders of InterOil approved the acquisition as did the Yukon Supreme Court. However, certain shareholders holding less than 0.5 per cent of the shares exercised dissent rights, which led to further court proceedings.

Like most plans of arrangement, the InterOil plan allowed shareholders to exercise a statutory right of dissent and be paid the "fair value" of their shares. Obviously, shareholders would only exercise this right if they believed the payment they would receive under the plan did not reflect fair value.

Supreme Court Hearing

At the initial court hearing, the Chief Justice of the Supreme Court of Yukon held in favour of the dissenting shareholders, that the acquisition price of $49.98 payable under the plan of arrangement did not reflect fair value and that, in fact, fair value was $71.46.

He did so based on expert testimony that calculated value based on a discounted cash flow (DCF) analysis.

The Chief Justice's reasoning primarily arose from his view that, because the original process to approve the plan of arrangement had been criticized and set aside in the previous court decisions, he was precluded from giving any weight to the transaction price which, as noted above, had never really changed. Accordingly, he found it necessary to determine fair value based on other evidence, namely the DCF analysis.

Court of Appeal Decision

The Court of Appeal held the Chief Justice erred "by relying entirely on a speculative DCF evaluation in the face of reliable and objective market evidence of fair value". There was no reason not to look at the transaction price and market price as being persuasive indicators of fair value. The governance issues which had tainted the original process had been corrected. In fact, when the process was reviewed, there were good reasons to think the transaction price did reflect fair value, including:

- the extensive sales process that had been undertaken (even if it was not quite a formal public auction);
- the fact that a competing bidder had refused to top Exxon's bid even though it had a right to do so;
- the transaction price represented a significant premium to the pre-announcement market price of InterOil's shares over an extended time, and not just a "snapshot" premium; and
- the fact that InterOil's broad and sophisticated shareholder base had voted in favour of the transaction.

In a telling point, the Court of Appeal noted that a purchaser who acquired InterOil at the Chief Justice's price of $71.46 would have had to pay $1 billion more than Exxon had agreed to pay. Such a value gap made no sense in the real world, the Court said: "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."

The decision includes a number of statements supportive of market prices being persuasive indicators of value. The Court also disagreed with the dissenting shareholder's argument that Exxon should have provided evidence of its own internal valuation work: "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."

Finally, in statements that should comfort dealmakers, the Court of Appeal rejected the argument that one could not rely on the deal price as being indicative of fair value because there had been no auction and InterOil was restricted from soliciting new bids. The lack of an auction and the "no shop" provision did not mean the deal price did not reflect fair value since all prospective purchasers were informed of the opportunity anyway and were free to make bids.

Conclusion

In the result, the Court of Appeal allowed Exxon's appeal and held that the transaction price was the fair value of the dissenters' shares. This certainly appears to be the correct result, no less so for having taken so long to arrive.

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