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Court rejects deal price as indicator of fair value in dissent decision

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Introduction

In an extraordinary decision, the Supreme Court of Yukon (the Court) in *Carlock v. ExxonMobil Canada Holdings ULC* (*ExxonMobil*) [PDF], awarded dissenting shareholders a 43% premium to the negotiated deal price in ExxonMobil's 2017 acquisition of InterOil. The Court's US$71.46 per share award is particularly surprising given ExxonMobil's price of US$45 plus a contingent resource payment valued at just under US$5.00 per share was itself a topping bid to a prior board-supported transaction with Oil Search, and the fact that the transaction was approved by a significant majority of shareholders not once but twice due to disclosure-related litigation.

If the decision is not successfully appealed, the award of such a significant premium to the negotiated purchase price puts market participants on notice that the process undertaken by transaction participants in negotiating a merger may come under scrutiny by courts in the context of a shareholder dissent. The decision also diverges from recent authority on the issue in Delaware, where deal price has been accorded deference as an indicator of fair value. If the decision stands, it may encourage increased levels of shareholder dissent.

Dissent rights in Canada

There are several types of transactions and corporate changes in which shareholders have a right to dissent. Where shareholder approval is required for a corporation to effect a fundamental change, such as an arrangement, shareholders are entitled to formally dissent and to be paid the fair value of their shares. This ensures that a shareholder that opposes the transaction or corporate change is not required to accept the consequences of that change simply because other shareholders voted in favour. The dissenting shareholder and the corporation must follow a prescribed statutory process to attempt to agree on the fair value of the shares. If they do not, application may be made to the court to determine fair value.

There has been relatively limited Canadian jurisprudence regarding the exercise of dissent rights to date, particularly as compared to the United States. Canadian cases have typically focused on valuation issues as opposed to examining the governance and process that resulted in the outcome that triggered the dissent.

The decision

The Court rejected ExxonMobil's expert's determination of the fair value of InterOil shares in favour of the fair value as determined by the dissenting shareholders' expert. The dissenting

shareholders argued, based on an optimistic view of future market demand and pricing, that InterOil should be valued at US$71.46 per share under a discounted cash flow approach. ExxonMobil argued fair value should be viewed as US$49.98 per share based on a transaction price of US$45 per share and a contingent resource payment of US$4.98, supported by both asset-based and discounted cash flow valuations.

The Court noted that several factors supported the proposition that the transaction price represented fair value – for example, that InterOil was known to individual and institutional investors and traded on the NYSE; multiple sophisticated parties were interested in partial transactions; it was "no secret" that InterOil and its principal asset (a petroleum license in Papua New Guinea) were on the market; there was a bidding and negotiation process that led to the price of US$45 per share; and bidders included insiders (including ExxonMobil). However, in rejecting the transaction price as the indicator of fair value, the Court noted there was no planned sales process in which InterOil attempted to solicit the highest possible market price for a sale of the whole company, and that another bidder's decision to not match ExxonMobil's final bid (which was itself a topping "superior proposal" in respect of an agreed upon transaction) was not evidence of an auction. The Court also noted that, despite substantial changes to the state of the market since ExxonMobil's initial offer in June 2016, the transaction price of US$45 per share remained constant.

Most importantly, the Court observed that although InterOil made significant enhancements to its corporate governance process in response to the Yukon Court of Appeal's rejection of the original arrangement, the transaction price was still a result of the original, flawed process. As described in our earlier Osler update, the arrangement was initially 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. The arrangement was subsequently approved by the Court following corrective disclosure and a second shareholder vote where 91% of the votes cast were in favour of the transaction.

The Court further found that ExxonMobil failed to consider increases in the price of oil from March 2016 to February 2017 and failed to lead evidence regarding the country risk premium that informed its valuation. The Court accepted the valuation evidence of the dissenting shareholders and determined they are entitled to be paid US$71.46 for each share.

Delaware

The Court's judgment stands in contrast to the Delaware Supreme Court's decision in *Dell, Inc. v Magnetar Global Event Drive Master Fund Ltd.* (December 14, 2017), which supports the "efficient market hypothesis" and the principle that only compelling evidence of market failure will justify departing from the deal price in situations with arm's-length mergers. The Delaware Supreme Court unanimously questioned the reliability of valuations produced by an "expert witness who caters her valuation to the litigation imperatives of a well-heeled client."

Conclusion

In general, it would appear to be a sound rule that, absent manifest conflict or market failure, the results of a public sale process should be presumptive of fair value. A clear articulation of this in Canadian case law would provide helpful guidance to market participants. In the *ExxonMobil* decision, the Court was focused on process deficiencies and therefore did not defer to deal price as a proxy for fair value. This was a surprising conclusion: there was a board-supervised sale process with multiple bids and two credible

bids; a definitive agreement was reached with Oil Search only to be subsequently topped by ExxonMobil; the ExxonMobil arrangement was initially approved by over 80% of votes cast at the first shareholders meeting; following corrective disclosure and a slight enhancement to the value of the contingent right payment, shareholders approved the transaction a second time, with 91% of votes cast in favour; and the entire process took close to a year.

It remains to be seen whether the decision will be appealed and what the impact of this decision will be. Regardless of the outcome, the decision serves as a reminder of the importance of a well-designed sale process that can withstand judicial scrutiny.