SUPREME COURT OF YUKON

Citation: *Re: Interoil Corporation*, 2016 YKSC 54

Date: 20161007
S.C. No. 16-A0082
Registry: Whitehorse

INTEROIL CORPORATION

Petitioner

Before Mr. Justice R.S. Veale

Appearances:

Gregory A. Fekete and Tom Friedland	Counsel for Interoil Corporation
Wendy Berman, Lara Jackson and Derek Ronde	Counsel for Philippe E. Mulacek
Grant Macdonald, QC	Counsel for Exxon Mobil Corporation

REASONS FOR JUDGMENT

INTRODUCTION

[1] Interoil Corporation ("Interoil") has entered into an Arrangement Agreement dated July 21, 2016 (the "Exxon Arrangement") to sell all its issued and outstanding common shares to Exxon Mobil Corporation ("Exxon"). Interoil is an oil and gas company with assets in Papua New Guinea. Interoil now applies for a Final Order approving the Exxon Arrangement.

[2] Section 195 of the Yukon *Business Corporations Act*, R.S.Y. 2002, c. 20, as amended ("*YBCA*") sets out the process for court-approved arrangements which requires an Interim Order setting out the procedural and voting requirements to be followed by this application for a Final Order approving the arrangement.

[3] The test for approval is set out in *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69 ("*BCE Inc.*") as follows:

1. the corporation bears the onus of satisfying the court that there has been compliance with all statutory and court-mandated requirements;
2. the application has been put forward in good faith; and
3. the arrangement is fair and reasonable.

[4] To approve a plan of arrangement as fair and reasonable, courts must be satisfied that (a) the arrangement has a valid business purpose, and (b) the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way.

[5] The application is opposed by Philippe E. Mulacek ("Mulacek") under the fair and reasonable test which will be the focus of this judgment. There is no dispute that the application is in compliance with statutory and court-mandated requirements and in good faith.

BACKGROUND

[6] The Arrangement is being sought pursuant to s. 195 of the *YBCA* because Interoil considers it to be the only efficient means of completing the transaction that involves an exchange of securities. Court approval permits Exxon and Interoil to avail themselves of an exemption from the otherwise applicable securities registration requirements of the United States *Securities Act* of 1933 which entails substantial costs.

[7] Interoil's main assets are interests in the Elk and Antelope gas fields which are in the process of development. Petroleum Retention License 15 ("PRL15") which encompasses the Elk and Antelope gas fields is a joint venture with Interoil's net license

interest at 36.5%. The other licence interests are held by Total, S.A. ("Total"), a French oil and gas company (40.1%) and Oil Search Limited ("Oil Search") which has a 22.8% interest. Mr. Mulacek and other holders have a 0.5% interest. Total S.A. operates PRL15.

[8] Interoil also has a future revenue stream arising from the sale of an interest in PRL15 to Total in 2014.

[9] The Exxon Arrangement is the second arrangement brought before this Court. The first arrangement was for the sale of Interoil's shares to Oil Search, dated May 20, 2016 (the "Oil Search Arrangement"). As I understand it, the Oil Search Arrangement valued the equity of Interoil at approximately $2.1 billion or $40.25 per common share plus the value of a Contingent Value Right ("CVR") which was linked to the volume of PRL15 2C Resources (2C refers to a 50% certainty). The CVR would have delivered a contingent cash payment of approximately $6.044 for each 1 tcfe (1 trillion cubic feet equivalent) of PRL15 2C Resources above 6.2 tcfe without a cap. All figures are in US dollars.

[10] Interoil had obtained an Interim Order from this Court and was proceeding to the voting procedure.

[11] However, on June 30, 2016, before the vote on the Oil Search Arrangement, Interoil received an unsolicited bid from Exxon and entered into the Exxon Arrangement at issue. Interoil terminated the Arrangement with Oil Search and Exxon paid the $60 million break fee to Oil Search so Interoil could proceed to the Exxon Arrangement.

[12] The Exxon Arrangement, is the following:

(a) a payment of $45 per share paid in Exxon shares; and

(b) a contingent resource payment ("CRP") of approximately $7.07 for each 1 tcfe of PRL15 2C Resources above 6.2 tcfe, up to a maximum of 10.0 tcfe of 2C resources.

[13] Thus, the Exxon Arrangement provides an additional $5 per Interoil share and an increased CRP relative to the CVR in the Oil Search Arrangement, but capped at 10 tcfe. It is also important to note that certain Restricted Share Units ("RSU") were granted pursuant to Company Incentive Plans. As of August 2016, the directors of Interoil owned an aggregate of 404,302 RSUs representing 51.9% of the issued and outstanding RSUs. The CEO owns 329,825 of these RSUs. It is estimated that the CEO stands to earn approximately $35 million if the Exxon Arrangement proceeds. The RSUs are accelerated, thereby not required to satisfy certain performance metrics normally necessary for the issuance of common shares to the RSU holders. Each director has entered into a Voting Agreement requiring him or her to vote the common shares issued pursuant to the RSUs in favour of the Exxon Arrangement.

[14] If all CRP payments were made up to the cap of 10 tcfe, the value of the Exxon Arrangement is approximately $72 per Interoil share. The Oil Search Arrangement would have provided a similar value at 11.5 tcfe. Interoil indicates it is possible that the CRP could be 0, although Mr. Mulacek would disagree. He expresses the opinion that the CRP could account for up to 37% of the compensation to shareholders under the Exxon Arrangement. I make no finding of fact in that regard.

[15] At the Special Meeting held on September 21, 2016, the Exxon Arrangement Resolution received the following approval from the Security holders who were entitled to vote and who voted at the meeting:

(a) of the 36,108,796 votes cast on the Arrangement Resolution by Shareholders present in person or represented by proxy at the Meeting (representing approximately 72.27% of the outstanding common shares of InterOil entitled to vote at the Meeting), 80.57% were cast in favour of the Arrangement Resolution;

(b) of the 36,880,325 votes cast on the Arrangement Resolution by Securityholders (voting as a single class) present in person or represented by proxy at the Meeting (representing approximately 72.59% of the outstanding common shares, options and restricted share units on InterOil entitled to vote at the Meeting), 80.98% were cast in favour of the Arrangement Resolution; and

(c) of the 35,763,671 votes cast on the Arrangement Resolution by Shareholders present in person or represented by proxy at the Meeting, excluding the votes cast by such Shareholders that are required to be excluded pursuant to MI 61-101 (representing approximately 71.58% of such votes entitled to be cast at the Meeting), 80.38% were cast in favour of the Arrangement Resolution.

[16] Votes (a) and (b) clearly exceed the 2/3 threshold required by s. 195 of the *YCBA.* Vote (c) only requires a simple majority. No issue has been raised with these votes.

[17] Mr. Mulacek was chairman and a director of Interoil from 1997 to April 2013. He holds a 5.5% interest in Interoil. Mr. Mulacek has given notice to exercise Dissent Rights. Security holders purporting to exercise Dissent Rights hold approximately 10% of the outstanding Common Shares.

Management Information Circular

[18] The Management Information Circular (the “Circular”) consists of approximately 241 pages of information. It sets out a Summary of the Exxon and Oil Search

Arrangements and the reasons for the Board's determination that the Exxon Arrangement was a Superior Proposal, as defined in the Oil Search Arrangement. After determining that Oil Search did not intend to propose any revisions to its Arrangement, the Board met with Morgan Stanley who created the Fairness Opinion for the Exxon Arrangement. After considering a number of Reasons for Recommendation, the Board resolved to recommend that Shareholders vote in favour of the Exxon Arrangement.

[19] The Board considered, among other factors, the following which supported the Exxon Arrangement:

1. The Exxon Arrangement valued the equity of Interoil at $45 per share which represents a premium of 42.2% on the closing share price of Interoil on May 19. 2016, without considering the potential value of the CRP.
2. It provided Shareholders the ability to participate in the potential upside of the resource volume of the PRL15 Fields. If the CRP is paid, the aggregate consideration for a common share is approximately $72.
3. The Exxon shares provide immediate liquidity to those shareholders who wish to sell them.
4. The Exxon Arrangement provides certainty of value at $45 per common share.
5. Exxon agreed to pay the Oil Search termination fee of $60 million.
6. Under the heading "Review of Strategic Alternatives" the Board said that it "considered and actively pursued a wide range of potential strategic alternatives available to Interoil, including the potential shareholder value as assessed by Interoil and its financial advisors that could be expected to

be generated by remaining an independent company, as well as potential benefits, risks and uncertainties associated with such alternatives". No details were given.

7. Under the heading "Probe of Strategic Alternatives" the Board directed management to contact third parties to gauge their interest in a variety of different transactions involving Interoil and its assets. No details were given.

8. The Board also cited the benefits of participation in Exxon shares and their future growth.

9. The Board also found support in the Interior Resource Certification ("IRC") for the CRP to ensure that the PLR15 2C Resource Antelope well 7 would be drilled and tested before the IRC. However, this recommendation was tempered by the risk that the CRP payout, if any, will not be known for some time.

10. The Board relied on the Fairness Opinion and stated that "it did not constitute a recommendation as to how any Shareholder should vote" but nevertheless stated "Shareholders are urged to read the Fairness Opinion carefully and in its entirety".

11. The Rights of Dissent were carefully set out.

12. The interests of certain directors and officers were set out in their entirety and specifically the value of the CEO's RSUs at $32,252,855 and his termination payment of $2,646,000.

13. The Circular also set out a variety of risks that could influence the market value of shares and the risk that the $67 million termination fee would discourage other bids.

The Fairness Opinion

[20] The Information Circular, setting out the details of the Exxon Arrangement and the reasons for the Board of Interoil recommending it, contained a letter dated July 21, 2016, from Morgan Stanley & Co. LLC ("Morgan Stanley") to the Board giving its opinion that the Exxon Arrangement was fair from a financial viewpoint (the "Fairness Opinion"). I attach a copy to these Reasons.

[21] The Fairness Opinion sets out the Exxon Arrangement financial terms and states that the following matters were addressed:

1) Reviewed certain publicly available financial statements and other business and financial information of the Company and the Buyer, respectively;

2) Reviewed certain internal financial statements and other financial and operating data concerning the Company;

3) Reviewed certain financial projections regarding the Company prepared by the management of the Company;

4) Discussed the past and current operations and financial condition and the prospects of the Company with senior executives of the Company;

5) Reviewed the reported prices and trading activity of the Company Common Shares and the Buyer Common Stock;

6) Compared the financial performance of the Company and the Buyer and the prices and trading activity of the Company Common Shares and the Buyer

> Common Stock with that of certain other publicly-traded companies comparable with the Company and the Buyer, respectively, and their securities;
>
> 7) Reviewed the financial terms, to the extent publicly available, of certain comparable acquisition transactions;
>
> 8) Reviewed the Arrangement Agreement, the Plan of Arrangement, the CRP Agreement and certain related documents; and
>
> 9) Performed such other analyses, reviewed such other information and considered such other factors as we have deemed appropriate.

[22] No further details were set out under the nine categories, with the exception of the terms of the Exxon Arrangement.

[23] The Fairness Opinion contains the following statements:

> We have assumed and relied upon, and we have not attempted to verify independently, the accuracy, completeness and fair presentation of the information that was publicly available or supplied or otherwise made available to us by the Company and formed a substantial basis for this opinion.
>
> …
>
> Although we have included the CRP (as described in the CRP Agreement) in certain of our analyses, we express no opinion as to the likelihood of whether the certification of any particular resource size (as referenced in the CRP Agreement and upon which the contingent consideration that is to be received pursuant to the CRP is conditioned) will be achieved. <u>While we have considered the potential value of the CRP under different possible resource certification outcomes, with the permission of the Board of Directors, we have not attributed a specific value to the CRP for purposes of arriving at the conclusion expressed in this letter.</u>
>
> …

> We express no opinion with respect to the fairness of the amount or nature of the compensation to be received by any of the Company's officers, directors or employees, or any class of such persons, relative to the Consideration to be received by the holders of the Company Common Shares pursuant to the Arrangement. We have not made any independent valuation or appraisal of the assets or liabilities of the Company or the Buyer, nor have we been furnished with any such valuations or appraisals. Our opinion is necessarily based on financial, economic, market and other conditions as in effect on, and the information made available to us as of, the date hereof.
>
> …
>
> Our opinion does not address the relative merits of the Arrangement as compared to any other alternative business transaction, or other alternatives, or whether or not such alternatives could be achieved or are available. We have acted as financial advisor to the Board of Directors in connection with this transaction and will receive a fee for our services, a substantial portion of which is contingent upon the closing of the Arrangement. In the two years prior to the date hereof, we have provided financing services for the Buyer [Exxon Mobil] and have received fees in connection with such services.
>
> …
>
> Based on and subject to the foregoing, we are of the opinion on the date hereof that the consideration to be received by the holders of the Company Common Shares pursuant to the Arrangement is fair from a financial point of view to the holders of the Company Common Shares. (my emphasis)

[24] In addition to Morgan Stanley, the Board consulted other financial experts who did not provide opinions on fairness.

[25] Mr. Mulacek takes issue with the Fairness Opinion. Counsel relies upon the uncontradicted opinion evidence of Peter Dey, Chairman of Paradigm Capital Inc. ("Paradigm Capital"), an independent investment dealer, since 2005. No objection was raised to his expertise in corporate governance issues and I find that he is an expert in

corporate governance issues. He is a lawyer who practiced in corporate board issues, mergers and acquisitions from 1973 – 1983, 1985 – 1994 and 2001 – 2005. From 1993 – 1995 he was Chair of the Ontario Securities Commission and authored the Dey Report on Corporate Governance.

[26] In his letter dated September 22, 2016, he stated the following which I have summarized:

1. The Board was required to factor into its process the challenges of valuing the future production of a significant portion of the company's assets which was ostensibly reflected in the CRP.

2. A board engaged in a proper and robust review and consideration of a proposed transformative transaction should have obtained independent advice on the value of the CRP, the Elk-Antelope asset, and the 10Tcfe cap's impact on the CRP.

3. In circumstances where a financial expert's compensation depends in part on the success or failure of a transaction, shareholders must be in a position to evaluate whether the advice is influenced by these terms of payment. In the circumstances of this Transaction, the Board should have disclosed the details of the compensation payable to Morgan Stanley. It should also have engaged a second financial advisor whose compensation would not be dependent upon the success or failure of the Transaction.

4. There is another reason for the Board to have engaged a second financial advisor on a flat fee basis, a basis on which the advisor's compensation did not depend upon the success or failure of the Transaction. If the Transaction proceeded, the CEO stood to realize significant compensation through the change of control provision in his employment contract and conditions attached to the RSUs. The CEO therefore had a strong financial incentive for the Transaction to proceed. In these circumstances, the Board should have ensured that the Transaction negotiated by management did indeed reflect the fair value of the Company and should have sought independent advice as to the financial fairness of the Transaction.

[27] Mr. Dey concluded that "the process undertaken by this board in considering and recommending the Transaction in these circumstances was deficient, and failed to meet

current governance best practice and to ensure adequate safeguards of shareholder interests."

[28] Counsel for Mr. Mulacek provided the Court with three Fairness Opinions in unrelated matters for comparative purposes. They all set out the terms of engagement. The Scope of review sets out the specific documents and dates, in separate categories of information relevant to the transaction. They generally contained the headings of prior valuation, assumptions and limitations, overview of the seller with detailed financial and operational history, overview of the purchaser with detailed financial and operational history, a Fairness Analysis which included Approach to Fairness, Value of Consideration, Net Asset Value Approach, Selected Precedent Transaction Multiple Analysis, Comparable Public Company Analysis, Recent Trading Levels of Shares, Review of Alternatives and Fairness Conclusion. In summary, they contained significantly more information and analysis of the transaction than the Fairness Opinion provided in this matter.

[29] In addition to the opinion of Peter Dey, Mr. Mulacek filed an affidavit from John Booth, from the Investment Banking department at Paradigm Capital, containing an opinion as to whether the consideration to be received by the shareholders of Interoil from the Exxon Arrangement is adequate from a financial point of view. Again, no objection was taken to his expertise and the firm's, based on a 44-year history of providing reserve and resource estimates for the oil and gas industry. I find that John Booth is an expert in the valuation of reserves and resource estimates for the oil and gas industry.

[30] In an 8-page report, Paradigm Capital provided information under the headings of Engagement and Background indicating no contingent fee, Credentials and Independence of Paradigm Capital, Scope of the Review listing details of documents reviewed, Assumptions and Limitations, Interoil Overview Approach to Evaluation, Resource Estimate Evaluation, GLJ Credentials (the principal reserve consultant to Interoil), Precedent Transactions, Research Analyst Target Prices and a Comparable Companies Analysis. The Paradigm Capital report concludes with the following:

> **Opinion Considerations**
>
> In preparing our Opinion as to the adequacy, from a financial point of view, of the Consideration offered pursuant to the Transaction to the InterOil shareholders, Paradigm Capital has considered, among other things, the following factors:
>
> a) the appropriate estimate for the resource size, which, as per our assumptions outlined above, should be a minimum of 10 Tcfe; we note that:
>
> i) the structure of the Transaction, specifically the cap on the CRP at 10 Tcfe, significantly constrains potential InterOil shareholder value; and
>
> ii) the Consideration is below the floor implied by the lower range of the selected precedent transactions based on GLJ's resource estimate as at December 31, 2015;
>
> b) the completion of the Antelope 7 well, which can reasonably be expected to result in an increase to the Elk-Antelope 2C resource at the certification date; we note that:
>
> i) research analysts generally postulate that the completion of the Antelope 7 well could increase the Elk-Antelope 2C resource by an incremental 1.5 Tcfe (independent of any specific evaluator),

> which derives a Elk-Antelope 2C certification range of 10 Tcfe to 11.5 Tcfe.
>
> **Conclusion**
>
> Based upon and subject to the foregoing and such other factors as Paradigm Capital considered relevant, it is our opinion that, as of the date hereof, that the Consideration pursuant to the Transaction is inadequate, from a financial point of view, to the shareholders of InterOil.

[31] Counsel for Interoil did not respond to either Mr. Dey and Mr. Booth's opinions with contrary opinions.

THE LAW

[32] The Supreme Court of Canada in *BCE Inc.* requires the approval process applicable to change of control transactions to focus on whether the arrangement, viewed objectively, is fair and reasonable. In reference to the *CBCA*, the Court stated at para. 128:

> The purpose of s. 192, as we have seen, is to permit major changes in corporate structure to be made, while ensuring that individuals and groups whose rights may be affected are treated fairly. In conducting the s. 192 inquiry, the judge must keep in mind the spirit of s. 192, which is to achieve a fair balance between conflicting interests. …

[33] The Supreme Court goes on, at paras. 137 – 138, to establish:

a) the corporation bears the onus of satisfying the court that (1) the statutory procedures have been met; (2) the application has been put forward in good faith; and (3) the arrangement is fair and reasonable.

b) in reviewing the director's decision on the proposed arrangement, the court must be satisfied that (a) the arrangement has a valid business

> purpose; and (b) the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way.

[34] The Supreme Court states at para. 136 that the court must focus on the terms and impact of the arrangement itself, rather than on the process by which it was reached.

[35] The Court is also clear that there is no such thing as a perfect arrangement and what is required in a reasonable decision is light of the specific circumstances of each case. At the same time, the court should not surrender its duty to "scrutinize the arrangement".

[36] The BCE Inc. case dealt with an application by debenture holders who opposed an arrangement of approximately 52 billion as not being fair and reasonable, as upon the completion of the arrangement, their short-term trading value would decline by an average of 20% and could lose investment grade status. Thus, the BCE Inc. case is factually quite different from the case at bar. However, the Court said the following:

> [152] Other indicia of fairness are the proportionality of the compromise between various security holders, the security holders' position before and after the arrangement and the impact on various security holders' rights: see Canadian Pacific; Trizec. The court may also consider the repute of the directors and advisors who endorse the arrangement and the arrangement's terms. Thus, courts have considered whether the plan has been 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: see *Stelco Inc. (Re)* (2006), 18 C.B.R. (5th) 173 (Ont. S.C.J.); *Cinar; St. Lawrence & Hudson Railway; Trizec; Pacifica Papers; Canadian Pacific*.

[37] In *Magna International Inc. (Re)*, 2010 ONSC 4123, Magna obtained court approval of an arrangement to buy back the super-voting shares (which placed control

in the hands of one shareholder, Frank Stronach, who owned 0.6 per cent of the equity) at an 1,800 % premium to non-voting shares. To put it in perspective, the total market value of the consideration was $863 million at the date of the announcement. At the Special Meeting, 75.28 % of the Minority Class A shareholders voted in favour, 92.79% of the Class A and Class B shares voted together in favour and all Class B shares voted in favour. There was no Fairness Opinion.

[38] Wilton-Siegel J. approved the arrangement and placed significance on the shareholder vote in saying at para. 203:

> In addition, the position of the Opposing Shareholders disregards entirely the significance of the shareholder vote from the perspective of the implicit contract among shareholders of a public corporation. It is an important principle of corporate democracy that a shareholder is bound by an informed vote of all shareholders. It is relevant that, in acquiring shares in a public corporation, a shareholder must expect that the majority vote will prevail, except in circumstances of oppressive behavior by shareholder groups. Moreover, ratification of actions of directors by a vote of the affected shareholders is a recognized means of addressing controversial transactions.

The Position of Interoil

[39] Counsel for Interoil does not concede that the Fairness Opinion is deficient but emphasizes that other factors may be considered in balancing whether the Exxon Arrangement is a fair and balanced arrangement in light of its specific circumstances. Counsel submits that Interoil was in continuous review of funding for ongoing business development plans and began to explore an asset sale. Once the Oil Search Arrangement was in play and Exxon entered the fray, the Board was not faced with whether a sale transaction should occur, but rather which transaction maximized value for shareholders. Counsel submits that Mr. Mulacek will have an opportunity to establish

fair value for his shares through his dissent rights. In addition, counsel submits that Mr. Mulacek had many opportunities to convince other shareholders to vote against the Arrangement Resolution and could have issued a dissident proxy circular.

[40] Counsel for Interoil states that the Exxon Arrangement was the result of a bidding war and thus is the highest and best price available for shareholders. Counsel submits that the fact that Oil Search decided not to match the Exxon offer is a strong indicator of fairness. Counsel also submits that since no further bids were made after the announcement of the Oil Search Arrangement on May 20, 2016, it can be concluded that the Exxon Arrangement is the highest and best price available for shareholders.

[41] Counsel noted specifically that the Interoil Board considered the risk and uncertainty of the CRP payout which may be $0 if the PRL15 2C Resources is less than or equal to the 6.2 tcfe. The Board also considered that the CRP payout is capped at 10 tcfe and that the Board will have no direct control of the Interim Resources Certification Process. Counsel submit that Morgan Stanley attributed no specific value to the CRP but concluded that the $45 per share value alone resulted in a fair value.

[42] Counsel for Interoil submitted that the Board had six independent directors in addition to the CEO and Executive Director and that they conducted a robust and independent review of the Exxon Arrangement. On the basis that the Morgan Stanley Fairness Opinion was only one of the many factors taken into account, counsel submits that the Board concluded that the $45 per share price represents a 42% premium over the closing share price prior to May 20, 2016, before including a value of the CRP. Counsel submits that the Board’s exercise of its business judgment is within the range

of reasonableness and this Court should not substitute its own business judgment for that of the Board.

[43] Counsel submits that the shareholders were adequately informed and an approval of 80.57% of the shares voted at the meeting should be given considerable weight as stated in *BCE Inc.* He submits the shareholders chose certainty over speculation.

The Position of Mr. Mulacek

[44] Counsel for Mr. Mulacek submit that the transaction process has been marked by improper corporate governance and deficient disclosure as follows:

> (a) The board of directors allowed management and internal InterOil Board members who were financially incentivized to approve a sale to run the ExxonMobil Transaction process;
>
> (b) The InterOil Board permitted Morgan Stanley to provide a fairness opinion that omitted an analysis of a key part of the ExxonMobil Transaction, namely the contingent payment component;
>
> (c) The InterOil Board failed to provide shareholders with material information concerning Morgan Stanley's fairness opinion compensation, which was of the utmost importance given the presence of a "success fee";
>
> (d) The InterOil Board failed to obtain a second, independent fairness opinion from a financial advisor who was not incentivized to have the ExxonMobil Transaction proceed; and
>
> (e) The disclosure in the ExxonMobil Transaction Management Information Circular and the Fairness Opinion does not adequately describe the valuation of InterOil's assets in a manner that would enable shareholders to adequately determine whether the consideration (and the limitations to that

> consideration) offered by ExxonMobil is fair value for their shares.

[45] As a result, counsel submits that the compensation is inadequate and undervalued by billions of dollars, specifically in that:

> (a) contingent payments to shareholders are unfairly capped;
>
> (b) the process to determine the quantum of contingent compensation is inherently unfair to shareholders; and
>
> (c) certain streams of revenue from InterOil assets are not accounted for.

[46] Counsel for Mr. Mulacek submits that the improper corporate governance and deficient disclosure, which should be closely scrutinized by the Court, establishes that Interoil has failed to meet the onus that the Exxon Arrangement is fair and reasonable.

ANALYSIS

Did the Interoil Board Provide Improper Corporate Governance and Deficient Disclosure?

[47] I accept that the proposed arrangement has a valid business purpose and has been put forward in good faith. The issue is whether the Exxon Arrangement is fair and reasonable to the shareholders of Interoil.

[48] I am in agreement with the opinion of Mr. Dey to the extent that the process undertaken by the Interoil Board in considering and recommending the Exxon Arrangement demonstrates deficient corporate governance and inadequate disclosure.

[49] The Fairness Opinion, while only a part of the consideration by the Board of Directors, nonetheless plays a significant role in the assessment of any arrangement as

it signifies that the arrangement, to use the words of Morgan Stanley, is "fair from a financial point of view to the holders of the Company Common Shares". The Fairness Opinion was relied on by the Board of Directors and no doubt the shareholders.

[50] The Fairness Opinion obtained by the Board was deficient and indicative of a failure to discharge its fiduciary obligations in the following ways:

1. it failed to address the value of the Elk-Antelope asset and the impact of the cap on the 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 is 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.

[51] The Fairness Opinion was also remarkably deficient in the following ways:

1. it contained no reference to the specific documents that it reviewed:
2. it contained no facts or information to indicate what the opinion was based on; and
3. it contained no analysis of the facts or information so that a shareholder could fairly consider the merits of the Exxon Arrangement.

[52] That is not to say that the Information Circular did not provide information that could assist the shareholders, but rather that the Fairness Opinion was devoid of facts or analysis. Nor is it to say that Morgan Stanley did not provide that information to the

Board. It is simply to say that the shareholders did not receive the benefit of the analyses referred to in the Fairness Opinion and as a result had no real assistance in evaluating the Exxon Arrangement.

[53] Counsel for Interoil submitted that the form and content of the Morgan Stanley Fairness Opinion are consistent with the form and content of similar fairness opinions provided in other mergers and acquisition transactions. However, there is no comparison between it and the three Fairness Opinions provided to the court by counsel for Mr. Mulacek. The three Fairness Opinions provided offer facts and figures, analysis and comparative data that are not found in the Morgan Stanley Fairness Opinion. The Morgan Stanley Fairness Opinion provides less information than a residential real estate appraisal commonly filed in this Court.

[54] The issue of the value and content of Fairness Opinions has been commented on by courts in the past. The real issue is whether Fairness Opinions should be independent opinions or simply comfort letters that a Board of Directors enlists to support their decision.

[55] Counsel for Interoil submitted the Endorsement of Newbould J. in *Royal Host Inc. (Re)*, 2014 ONSC 3323, in making an interim order under s. 194(2) of the CBCA should be relied upon. The judge stated that the court does not approve the circular or engage in a detailed examination of the meeting material at the interim order stage. In that context, he observed the following at para. 6:

> 6 In this case, the board of directors of Royal Host obtained a fairness opinion from Trimaven Capital Advisors. As is typical in arrangements, the opinion states that the consideration under the arrangement is fair from a financial point of view to the shareholders of Royal Host, but it does not contain the analysis done by Trimaven leading to that

opinion. The opinion will be included in the notice of meeting and management information circular to be sent to the shareholders. The affidavit material in support of the interim order states that the fairness opinion will not be tendered at the final order hearing as evidence that the arrangement is, in fact, substantively fair. Rather, it will be used to show that the directors have put forward the arrangement in good faith and that the shareholder vote, when taken, will have been informed by, among other things, an independent opinion of a third party financial advisor.

7 This statement in the affidavit material is no doubt in response to the recent case of Re Champion Iron Mines Ltd (2014), 119 O.R. (3d) 339. In that case, there was also a similar fairness opinion considered by the board of directors and a special committee to the board, and it was sent to shareholders as well. In its factum on the hearing to approve the arrangement following a 99% vote in favour of the arrangement, the applicant apparently identified the fact of the securing of the fairness opinion, as well as its favourable content, as evidence in support of a finding that the application had been put forward in good faith. Brown J. refused to consider the fairness opinion and held it to be inadmissible because it did not comply with the rules of practice for an expert opinion in that the report did not contain the expert's reasons for the opinion, including, (i) a description of the factual assumptions on which the opinion is based, (ii) a description of any research conducted by the expert that led him or her to form the opinion, and (iii) a list of every document, if any, relied on by the expert in forming the opinion.

8 The position proposed to be taken by Royal Host regarding the fairness opinion appears reasonable, although ultimately it will be a matter for the court hearing the application for approval of the arrangement to consider, assuming the votes put forward support the arrangement. The purpose of a fairness opinion is a commercial one. It is an opinion to be considered by the board of directors and the shareholders in a commercial context. It is not an expert report in a litigation context. If the board or the shareholders are not satisfied with the report, they can vote with their feet and not proceed with or approve the arrangement.

9 Justice Wilton-Siegel had occasion to deal with this issue in Re Bear Lake Gold Ltd 2014 ONSC 3428 and

> concluded that a fairness opinion is properly included in the material as an indicia of the fairness and reasonableness of the proposed transaction. I agree with his analysis and opinion on this issue. (my emphasis)

[56] Brown J. in *Champion Iron Mines Ltd. (Re)*, 2014 ONSC 1988, where the judge approved a proposed arrangement on a number of factors but specifically excluded the Fairness Opinion of Canacord Genuity as inadmissible under the Ontario *Rules of Civil Procedures* and gave it no weight.

[57] The issue of whether a Fairness Report should meet the standard of an expert report under the Rules of Court was not argued before me. However, I find the comments of Brown J. particularly apt and applicable to the case at bar:

> 18 Accordingly, I concluded that the Fairness Opinion, as written, was inadmissible for purposes of the final order application and I ignored it. That said, ample other admissible evidence was filed by Champion Iron to support the granting of the final order.
>
> 19 The form of Fairness Opinion filed by Champion Iron closely resembled the form of such opinions typically seen these days on plan of arrangement applications. It would not be stretching the language too far to characterize the form of such fairness opinions as "cookie cutter" in appearance. That is not to say that any particular fairness opinion in that form lacked substantive supporting reasoning. Perhaps such reasoning existed. My simple point is that the supporting reasoning typically is not apparent on the face of the fairness opinions. From an evidentiary point of view, that renders them inadmissible for the purpose of asking the court to rely on their content in support of granting the application.
>
> **B. On plans of arrangements courts do not act as rubber stamps**
>
> 20 Which leads me to make a larger point. As a judge in front of whom a fair number of final order applications pass on a regular basis, one sometimes develops the feeling that corporate lawyers regard the role of courts in the whole plan

> of arrangement process as nothing more than one box to check off on a closing agenda. …. (bolding already added)

[58] I also notice that in *BCE Inc*., the Supreme Court of Canada was not specifically dealing with the adequacy of a Fairness Opinion when it stated at para. 152 that one indicia of fairness is "the presence of a fairness opinion from a reputable expert".

[59] I agree with the view that a third party financial advisor does not need to meet the requirements of an expert pursuant to the *Rules of Court* and that view was not argued in this case. However, I also agree that a Board of Directors must ensure that there will be an independent flat fee Fairness Opinion to assist shareholders and the Court if it wishes to comply with best practice corporate governance. A Fairness Opinion that simply follows the direction of the Board and is based on a success fee does not meet the standard of good corporate governance.

[60] I also adopt the view expressed by the Ontario Securities Commission in *HudBay Minerals Inc. (Re),* 2009 CarswellOnt 2219, at para. 264 that "a fairness opinion prepared by a financial adviser who is being paid a signing fee or a success fee does not assist directors comprising a special committee of independent directors in demonstrating the due care they have taken in complying with their fiduciary duties in approving a transaction."

[61] The point of all this is that Fairness Opinions, while only one indicia of fairness to consider, should be robust, rigorous and independent opinions from reputable experts to discharge the fiduciary duty of special committees of independent directors and to assist the shareholders in their evaluation of the fairness of an arrangement. A Fairness Opinion from an independent financial advisor retained on a flat fee is an important factor in assisting the court to scrutinize the arrangement.

Is the Exxon Arrangement Fair and Reasonable?

[62] I have no doubt that the Exxon Arrangement has a valid business purpose. That purpose is to sell the assets of Interoil for the highest price available rather than continue to be involved in the long game in the Elk-Antelope gas fields. Mr. Mulacek had his opportunity to persuade shareholders that the $45 plus the potential of $7.07 for each 1 tcfe of PRL15 2C Resources above 6.2 tcfe to a maximum of 10 tcfe, was not a reasonable or fair price for Interoil shares. He failed to persuade the 80% who voted in favour of the Exxon Arrangement.

[63] This Court should speak freely and independently about matters of corporate governance but at the end of the day it is the shareholders that have spoken in favour of the Exxon Arrangement. Judges are not business people and are not in a good position to judge these investments. See Edward Iacobucci, “Making Sense of Magna”, (2011) 49 Osgoode Hall L.J. 237-275 at para. 47.

[64] The shareholders of Interoil saw their share price increase at a premium of 42.2% after the Oil Search Arrangement, and, considering the price increase to $45 per share from Exxon, plus a CRP potential for a total value of $72 per share, they are entitled to make the decision approving the Exxon Arrangement.

[65] Any shareholder reading the Circular can discern the lack of detail regarding valuations and analysis as well as the interest of the CEO in voting for the Arrangement.

[66] While that may draw criticism from this Court in terms of corporate governance, it should not prevent shareholders from realizing substantive increases in value.

[67] From the shareholders’ perspective, they can realize their gain and Mr. Mulacek can pursue his Dissent Rights.

[68] Further, the Exxon Arrangement has clear advantages in receiving Exxon shares with immediate liquidity at a $45 per share value.

[69] The CRP provides a higher rate of return than the Oil Search Arrangement but is capped. While the Board did not provide detail on the value of Interoil's Elk-Antelope field nor the strategic alternatives, it reduced the speculative nature of the Interoil shares and provided a solid return.

[70] For these reasons, I approve the Exxon Arrangement as fair and reasonable.

_____

VEALE J.

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600 Travis Street
Suite 3700
Houston, TX 77002

Morgan Stanley

July 21, 2016

Board of Directors
InterOil Corporation
163 Penang Road
#06-02 Winsland House II
Singapore 238463

Members of the Board:

We understand that InterOil Corporation ("InterOil" or the "Company") and Exxon Mobil Corporation ("ExxonMobil" or the "Buyer") propose to enter into an Arrangement Agreement, dated July 21, 2016 (the "Arrangement Agreement"), which provides, among other things, for the acquisition of the Company by ExxonMobil (or its wholly owned subsidiary) pursuant to an arrangement (the "Arrangement") under the provisions of the Business Corporations Act (Yukon). Pursuant to the Arrangement, the Company will become a (direct or indirect) wholly owned subsidiary of ExxonMobil, and each outstanding common share of the Company (the "Company Common Shares") will be converted into the right to receive (a) shares of common stock, without par value, of ExxonMobil ("Buyer Common Stock") at an exchange ratio calculated to deliver a value of US$45.00 per Company Common Share based on the volume weighted average trading price per share of Buyer Common Stock for a ten-trading day period ending on (and including) the second trading day immediately prior to the closing of the Arrangement and (b) one contingent resource payment (the "CRP") entitling the holder to receive a cash payment from ExxonMobil pursuant to the terms of the Contingent Resource Payment Agreement (the "CRP Agreement"), substantially in the form annexed to the Arrangement Agreement (together, the "Consideration"). The terms and conditions of the Arrangement are more fully set forth in the Arrangement Agreement, the CRP Agreement and the Plan of Arrangement attached as Schedule "A" to the Arrangement Agreement (the "Plan of Arrangement").

You have asked for our opinion as to whether the Consideration to be received by the holders of the Company Common Shares pursuant to the Arrangement is fair from a financial point of view to the holders of the Company Common Shares.

For purposes of the opinion set forth herein, we have:

1) Reviewed certain publicly available financial statements and other business and financial information of the Company and the Buyer, respectively;

2) Reviewed certain internal financial statements and other financial and operating data concerning the Company;

3) Reviewed certain financial projections regarding the Company prepared by the management of the Company;

4) Discussed the past and current operations and financial condition and the prospects of the Company with senior executives of the Company;

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5) Reviewed the reported prices and trading activity for the Company Common Shares and the Buyer Common Stock;

6) Compared the financial performance of the Company and the Buyer and the prices and trading activity of the Company Common Shares and the Buyer Common Stock with that of certain other publicly-traded companies comparable with the Company and the Buyer, respectively, and their securities;

7) Reviewed the financial terms, to the extent publicly available, of certain comparable acquisition transactions;

8) Reviewed the Arrangement Agreement, the Plan of Arrangement, the CRP Agreement and certain related documents; and

9) Performed such other analyses, reviewed such other information and considered such other factors as we have deemed appropriate.

We have assumed and relied upon, and we have not attempted to verify independently, the accuracy, completeness and fair presentation of the information that was publicly available or supplied or otherwise made available to us by the Company and formed a substantial basis for this opinion. With respect to the financial projections prepared by management of the Company that have been provided to us, we have assumed that such financial projections have been reasonably prepared using the assumptions identified therein and on a basis reflecting the best currently available estimates and judgments of the management of the Company with respect to the future financial performance of the Company. Although we have included the CRP (as described in the CRP Agreement) in certain of our analyses, we express no opinion as to the likelihood of whether the certification of any particular resource size (as referenced in the CRP Agreement and upon which the contingent consideration that is to be received pursuant to the CRP is conditioned) will be achieved. While we have considered the potential value of the CRP under different possible resource certification outcomes, with the permission of the Board of Directors, we have not attributed a specific value to the CRP for purposes of arriving at the conclusion expressed in this letter. In addition, we have assumed that the Arrangement will be consummated in accordance with the terms set forth in the Arrangement Agreement and the Plan of Arrangement without any waiver, amendment or delay of any material terms or conditions. We have assumed that the conditions precedent to the completion of the Arrangement can be satisfied in due course, that in connection with the receipt of all the necessary governmental, regulatory or other approvals and consents required for the Arrangement, no delays, limitations, conditions or restrictions will be imposed that would have a material adverse effect on the contemplated benefits expected to be derived in the Arrangement and that the procedures being followed to implement the Arrangement are valid and effective. We are not legal, tax or regulatory advisors and are not providing legal, tax or regulatory advice to the Board of Directors. We are financial advisors only and have relied upon, without independent verification, the assessment of the Company and its legal, tax and regulatory advisors with respect to legal, tax and regulatory matters. We have not met separately with the independent auditors of the Company and, with the permission of the Board of Directors, we have assumed the accuracy and fair presentation of, and relied upon, the Company's audited financial statements and the reports of the auditors therein and the Company's interim unaudited financial statements. We express no opinion with respect to the fairness of the amount or nature of the compensation to be received by any of the Company's officers, directors or employees, or any class of such persons, relative to the Consideration to be received by the holders of the Company Common Shares pursuant to the Arrangement. We have not made any independent valuation or appraisal of the assets or liabilities of the Company or the Buyer, nor have we been furnished with any such valuations or appraisals. Our opinion is necessarily based on financial, economic, market and other conditions as in effect on, and the information made available to us as of, the date hereof. Events occurring after the date hereof may affect this opinion and the assumptions used in preparing it,

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and we do not assume any obligation to update, revise or reaffirm this opinion. Our opinion does not address the relative merits of the Arrangement as compared to any other alternative business transaction, or other alternatives, or whether or not such alternatives could be achieved or are available. We have acted as financial advisor to the Board of Directors in connection with this transaction and will receive a fee for our services, a substantial portion of which is contingent upon the closing of the Arrangement. In the two years prior to the date hereof, we have provided financing services for the Buyer and have received fees in connection with such services. In the two years prior to the date hereof, except for our current engagement, we have not been engaged on any financial advisory or financing assignments for the Company, and have not received any fees for such services from the Company during this time; however, during the six month period prior to July 2014, Morgan Stanley and its affiliates received fees for financial advisory services provided to the Company. The aggregate amount of such fees received from the Buyer and the Company, respectively (as identified and determined in accordance with Morgan Stanley's customary conflicts-related policies and procedures), has been disclosed to the Board of Directors. Please note that Morgan Stanley is a global financial services firm engaged in the securities, investment management and individual wealth management businesses. Our securities business is engaged in securities underwriting, trading and brokerage activities, foreign exchange, commodities and derivatives trading, prime brokerage, as well as providing investment banking, financing and financial advisory services. Morgan Stanley, its affiliates, directors and officers may at any time invest on a principal basis or manage funds that invest, hold long or short positions, finance positions, and may trade or otherwise structure and effect transactions, for their own account or the accounts of its customers, in debt or equity securities or loans of the Buyer, the Company, or any other company, or any currency or commodity, that may be involved in this transaction, or any related derivative instrument.

This opinion has been approved by a committee of Morgan Stanley investment banking and other professionals in accordance with our customary practice. This opinion is for the information of the Board of Directors of the Company only and may not be used for any other purpose without our prior written consent, except that a copy of this opinion may be included in its entirety in (i) the management information circular of the Company to be mailed to holders of the Company Common Shares in connection with the Arrangement and (ii) the materials to be filed with the applicable court in connection with seeking a final order approving the Plan of Arrangement. In addition, this opinion does not in any manner address the prices at which the shares of Buyer Common Stock will trade following consummation of the Arrangement or at any time and Morgan Stanley expresses no opinion or recommendation as to how the shareholders of the Company should vote at the shareholders' meeting to be held in connection with the Arrangement.

Based on and subject to the foregoing, we are of the opinion on the date hereof that the Consideration to be received by the holders of the Company Common Shares pursuant to the Arrangement is fair from a financial point of view to the holders of the Company Common Shares.

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Very truly yours,

MORGAN STANLEY & CO. LLC

By: _____

Name:
Title: