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COURTS CONSIDER "FAIR AND REASONABLE" TEST FOR ARRANGEMENTS

"Two recent decisions have shed light on how courts will apply the requirement confirmed by the Supreme Court of Canada in *BCE Inc. v. 1976 Debentureholders* that an arrangement be fair and reasonable in order to receive court approval. "

By Fraser McDonald
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Two recent decisions have shed light on how courts will apply the requirement confirmed by the Supreme Court of Canada in *BCE Inc. v. 1976 Debentureholders* that an arrangement be fair and reasonable in order to receive court approval.

In the first decision, *InterOil Corporation v. Mulacek*, the Yukon Court of Appeal considered the decision of a chambers judge in an application by InterOil to approve an arrangement under the *Business Corporations Act* (Yukon) which would have seen its shareholders exchange their shares for shares of Exxon Mobil Corporation plus a "contingent resource payment" capped at a certain level.

The chambers judge initially issue a final order approving the arrangement, but, nonetheless, highlighted a number of issues with the process followed by the directors of InterOil, including the following:

(i) the board committee established by InterOil to oversee the transaction did not take a sufficiently active role and allowed management, which had a conflict, to lead the negotiations; and

(ii) the fairness opinion was deficient in that it was provided by a financial advisor whose compensation was largely dependent on the success of the arrangement, which fact was not disclosed to shareholders, and provided very little by way of back up for its conclusion.

However, consistent with many other situations, the arrangement was approved by the judge on the basis of the overwhelming support (over 80%) of the shareholders.

The Court of Appeal, while acknowledging that it is for the shareholders to make a final decision, the court, in making a determination that the arrangement is fair and reasonable, must be satisfied that the shareholders' decision is based on information

and advice that is adequate, objective and not undermined by conflicts of interest. The Court of Appeal, based on the deficiencies identified by the chambers judge, found that the shareholder approval was not so informed and did not approve the arrangement.

The second decision, Smoothwater *Capital Corporation v. Marquee Energy Ltd.*, concerned an arrangement proposed by Marquee under the *Business Corporations Act* (Alberta) involving Marquee's shares being exchanged for shares of Alberta Oilsands Inc., which had been approved by the shareholders of Marquee. The arrangement was to be followed by a vertical short-form amalgamation of Marquee and Alberta Oilsands not requiring any shareholder approval. Smoothwater Capital, a shareholder of Alberta Oilsands, objected on the basis that, by virtue of Marquee proceeding by way of arrangement, shareholders of Alberta Oilsands were deprived of the vote that would have been required for an amalgamation and the resulting dissent rights.

In overturning a lower court decision, which granted the shareholders of Alberta Oilsands a vote on the arrangement and the right to dissent, the Court of Appeal confirmed that "the choice of structure of the transaction should not be taken from the directors without an express statutory provision to that effect". This deference will be given to the directors notwithstanding that another structure may have provided additional safeguards to shareholders and the standard of fairness and reasonableness is to be judged from the perspective of the corporation being arranged, in this case, Marquee.

While it is difficult to generalize from judicial decisions on plans of arrangement as they tend to be very fact specific, these decisions are instructive in a number of respects. Firstly, they highlight the advantages of proceeding by way of arrangement of:

(i) a one-step M&A transaction offering maximum transactional structuring flexibility and enhancing "transactional certainty"; and

(ii) court approval, meaning that securities issued to U.S. shareholders pursuant to the arrangement will be exempt from registration pursuant to U.S. securities law, and providing some level of comfort to directors.

Secondly, *InterOil* highlights the importance of the board approval process in establishing that an arrangement is fair and reasonable. The board should ensure that its process is free from conflict and the advice it receives from its financial advisors is adequate and free from conflict. In addressing the latter point, boards may wish to consider obtaining a fairness opinion from a financial advisor whose compensation is not dependent on the success of the transaction or, at a minimum, clearly disclosed to shareholders.

However, there are aspects of the *InterOil* decision that may mitigate its impact on financial advisors. The fairness opinion followed the "short-form" format typical in the

Canadian M&A context and did not set out the underlying basis for the opinion and the significant work done to arrive at same which was disclosed to and discussed in detail with the board. Further, no evidence was placed on the record in the approval proceedings to contradict the expert evidence put forth by the opposing shareholder. A more fulsome form of fairness opinion and putting more evidence supporting the financial advisors' conclusions in the record may suffice in addressing these issues.

Finally, the decisions highlight a disadvantage of arrangements which is that they give shareholders and others who may oppose the transaction a ready-made process for bringing their objections forward.

As a footnote, following the Yukon Court of Appeal decision, InterOil reconvened its board committee which hired independent counsel and a financial advisor compensated on a fixed fee basis, and directly negotiated a new arrangement with Exxon Mobil on substantially the same terms as the original transaction (with a slightly higher cap on the contingent resource payment). InterOil will be seeking shareholder approval of this new arrangement on February 14, 2017 based on an information circular containing the new fairness opinion and information on the detailed presentations, advice and information received by the board from its financial advisor in connection with the original arrangement, but not included in the information circular originally given to shareholders. The new fairness opinion is much more fulsome than the typical short-form fairness opinion. It will be instructive to see if these additional steps and disclosures will satisfy the court thereby allowing the arrangement to proceed.

If you have any questions or would like any assistance in connection with the application of these decisions to the approval of plans of arrangement and the use of fairness opinions in relation thereto, or have any other questions relating generally to mergers and acquisitions or securities laws, please contact Fraser McDonald at wfmcdonald@amsbizlaw.com or by phone at 416-642-2524, or any of the other partners of Allen McDonald Swartz LLP.

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