

# Blakes Bulletin

## Corporate Governance

### Ontario Court Approves Magna's Plan of Arrangement

JOHN TUZYK AND CHRISTOPHER KOZUB

On August 17, 2010, the Ontario Superior Court of Justice (the Court) approved Magna International Inc.'s (Magna) proposed arrangement that would eliminate its multiple voting share structure (the Proposed Arrangement). The Proposed Arrangement, that would pay the Stronach Trust an estimated 1,800% premium in exchange for the elimination of all the Class B multiple voting shares (Class B Shares) held by the Stronach Trust, was met with considerable controversy when it was first announced.

Under the *Business Corporations Act* (Ontario), court approval is required for an arrangement. To provide such approval, the court must be satisfied the arrangement is "fair and reasonable". The Court held that a shareholder vote can reasonably be used as a proxy for the fairness and reasonableness of a plan of arrangement, particularly if the voting shareholders are, themselves, the party most directly affected by the proposed plan. The Court also held that, depending on the circumstances, the absence of the traditional indicia of fairness, such as a fairness opinion, a recommendation from the board of directors to the shareholders, and rights of dissent and appraisal, does not necessarily preclude a court from approving a plan of arrangement.

#### BACKGROUND

The current Magna multiple voting share structure was created in 1978 by a shareholder vote. The structure gives the Class A subordinate voting shareholders (Class A Shares) one vote per share, while the Class B shareholders receive 300 votes per share. Importantly, the Class B Shares contain no "coat-tail" or "sunset" protections for holders of Class A Shares. (A "coat-tail" provision ensures that, subject to certain exceptions, an offer on the same terms must be made for the non-multiple voting shares if an offer is made for the

multiple voting shares.) Under the multiple voting share structure, the Stronach Trust—the indirect owner of all of the outstanding Class B Shares—holds 66% of Magna's voting rights, while owning only 0.6% of Magna's total equity. Mr. Frank Stronach, the founder and Chairman of Magna, and certain members of his immediate family, are the trustees and potential beneficiaries of the Stronach Trust.

In March 2010, Frank Stronach was asked by management of Magna whether he was interested in eliminating Magna's multiple voting share structure and discussions between them ensued. In April 2010, management informed Magna's board of directors (the Board) of the discussions. The Board established a special committee of independent directors of Magna (the Special Committee) to review and consider the proposed transaction.

The Special Committee conducted further negotiations with Mr. Stronach, on behalf of the Stronach Trust, during which Mr. Stronach indicated that he was satisfied with the *status quo*, resulting in a final "take it or leave it" offer. According to the terms of Mr. Stronach's final proposal to the Special Committee, in exchange for selling the Stronach Trust's Class B shares to Magna for cancellation, the Stronach Trust would receive the following:

- nine million newly issued Class A Shares and US\$300-million in cash;
- a five-year fixed non-renewable consulting agreement with Magna entitling Mr. Stronach to 2.75% of Magna's pre-tax profits in 2011, declining by 0.25% every year thereafter; and
- a 26.67% equity interest in, and 73.33% of the voting rights of, an electric car partnership (the e-car partnership) formed between Magna and the Stronach Trust valued at US\$300-million, conditional upon the Stronach Trust contributing US\$80-million to the e-car partnership (the Proposed Transaction).

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On May 5, 2010, the Board, acting on the recommendations of the Special Committee, determined that it would:

- present the Proposed Transaction for consideration by the disinterested shareholders, the required approval of which to be a simple majority of the votes cast by disinterested shareholders at a special meeting;
- structure the Proposed Transaction as a plan of arrangement which would be subject to court approval; and
- make no recommendation to shareholders on how to vote.

The Board did not obtain a fairness opinion from its financial advisor, CIBC World Markets (CIBC), regarding the Proposed Transaction. CIBC indicated that it was unable to provide a fairness opinion because the amount of dilution associated with the Proposed Transaction was unprecedented and the potential benefit to shareholders depended on a future increase in the trading multiple of Magna's shares, which was not predictable.

### The OSC Hearing

The Ontario Securities Commission (the Commission) held a hearing on June 23 and June 24, 2010, to review the Proposed Transaction (the Hearing). At the Hearing, Staff of the Commission alleged that the Proposed Transaction was abusive and contrary to the public interest because:

- the process the Board followed in reviewing and negotiating the Proposed Transaction was flawed; and
- the disclosure included in the information circular was inadequate because the Board did not provide a recommendation to shareholders.

### The Commission's Decision

The Commission issued an expedited decision on June 24, 2010, (the Decision). Full reasons for the Decision are to be provided in due course. In its Decision, the Commission ruled that the Proposed Transaction was neither abusive of the Magna shareholders nor the capital markets. However, the Commission did find that the disclosure provided in the initial information circular was inadequate.

Accordingly, the Commission issued an order preventing the shareholders from voting on the Proposed Transaction until Magna delivered an amended information circular to the shareholders. Please see our July 2010 Blakes Bulletin: [OSC Postpones Magna's Multiple Voting Share Elimination Vote Pending Additional Disclosure](#) for a more comprehensive discussion of the Decision.

### The Amended Circular and the Shareholder Vote

On July 9, 2010, Magna mailed an amended information circular, which included the additional disclosure mandated by the Commission, to its shareholders. At a special meeting of Magna's shareholders, which was held on July 28, 2010, the Class A shareholders approved the Proposed Transaction by a 3 to 1 margin.

### ARRANGEMENT PROCEEDINGS

Magna, in accordance with the Board's recommendation, sought an order from the Court approving the Proposed Transaction (the Proposed Arrangement) pursuant to section 182(5) of the *Business Corporations Act* (Ontario).

### The BCE Test for the Approval of an Arrangement

The Court, in its consideration of the Proposed Arrangement, applied the three-part test established in the Supreme Court of Canada's (the SCC) decision in *BCE Inc. v. 1976 Debentureholders (BCE)*. Please see our December 2008 Blakes Bulletin: [Supreme Court of Canada Releases Reasons for Decision in BCE](#) for a discussion of the SCC's comments regarding the plan of arrangement process.

The Court applied the three-part test established in *BCE* for a corporation seeking approval of an arrangement (the *BCE* Test). According to the *BCE* Test, 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.

The Court's decision on the Magna arrangement primarily concentrated on the third requirement, being whether the Proposed Arrangement was fair and reasonable.

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The SCC in *BCE* created a two-pronged framework for determining whether a plan is fair and reasonable. According to the framework, the court must be satisfied that:

1. the arrangement has valid business purpose; and
2. the objections of the parties whose legal rights are being arranged are resolved in a fair and balanced way.

### **The Parties' Arguments**

#### ***The Opposing Shareholders***

Several high-profile institutional investors including the Ontario Teachers' Pension Plan Board, the Canada Pension Plan Investment Board, and OMERS opposed the Proposed Arrangement (the Opposing Shareholders). The Opposing Shareholders provided the Court with an opinion of Morgan Stanley Canada Limited (Morgan Stanley), which reached the following conclusions:

- the Proposed Arrangement was one that was capable of being subject to a fairness opinion; and
- the consideration paid by Magna to the Stronach Trust pursuant to the Proposed Arrangement was not fair to the Class A shareholders.

Relying on the Morgan Stanley opinion, among other things, the Opposing Shareholders argued that neither prong of the "fair and reasonable test" was satisfied. With regard to the first prong, the "valid business purpose" requirement, the Opposing Shareholders submitted that Magna failed to demonstrate that the benefits of the Proposed Arrangement, which were unquantifiable and uncertain, would offset the costs, which were fixed and assured. In response to the second prong, the "fair and balanced" analysis, the Opposing Shareholders argued that the Morgan Stanley opinion provided objective evidence that the cost paid by the Class A shareholders was too high and, therefore, the Proposed Arrangement was unfair.

#### ***The Supporting Parties***

Magna, the special committee of the Board, the Stronach Trust and certain Class A shareholders (the Supporting Parties) argued that the "valid business purpose" requirement was satisfied because the Proposed Arrangement would reduce Magna's cost of capital, improve the marketability of its common shares and improve its corporate governance. An independent report issued by the RiskMetrics Group, an institutional shareholder advisory firm, recommended shareholders

approve the transaction on the basis of these claims.

Finally, the Supporting Parties argued that the Court should place substantial weight on the outcome of the Class A shareholder vote as evidence that the Proposed Transaction was "fair and balanced".

### **The Court's Decision**

The Court, in its decision, ruled that each prong of the "fair and reasonable" test was satisfied and it approved the Proposed Arrangement, based on the following reasoning.

The Court's decision focused primarily on whether the costs and benefits of the Proposed Arrangement to the Class A shareholders were fairly balanced. First, the Court rejected the Opposing Shareholder's submission that the Morgan Stanley opinion conclusively demonstrated that the Proposed Arrangement was objectively unfair because of the unprecedented size of the premium paid to the Stronach Trust. The Court held that each transaction is unique and that the correct approach is a balanced approach that considers the totality of the costs and the benefits borne by the parties.

Second, the Court considered the significance, if any, to attach to the absence of a fairness opinion, a Board recommendation, and rights of dissent and appraisal for the purposes of the "fair and balanced" analysis. The Court noted that each of the factors mentioned above are recognized as traditional indicia of fairness and reasonableness. However, the Court held that, in these specific circumstances, the absence of the indicia was not fatal because:

- the Opposing Shareholders did not challenge CIBC's position that its practice regarding fairness opinions reflected general practice in Canada. Additionally, the Court noted that the Morgan Stanley fairness opinion was provided on a basis which avoided opining on future market trading multiples and it did not challenge CIBC's rationale for withholding a fairness opinion;
- the Board could not responsibly make a recommendation to the Class A shareholders in the absence of a fairness opinion and it was not legally required to provide one. Providing a recommendation in these circumstances would have required the Board to predict the likely direction of Magna's future trading multiples, which was something its expert financial advisor was

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unable to do. The Court concluded, however, that the Board had satisfied the statutory fiduciary duty it owed to the corporation to act in its best interest because the Board determined that the Proposed Arrangement was advantageous to Magna from a corporate governance and financial perspective; and

- the absence of rights of dissent and appraisal was not of any negative significance because: (i) the Class A Shares were not being acquired on a compulsory basis and (ii) the Class A shareholders had the option of selling their shares in the market at an increased price. The Court noted that the Class A Shareholders' ability to sell their shares at the increased post-announcement price provided them with an element of protection that is not always available in statutory arrangements.

Finally, the Court considered the weight to be attached to the affirmative vote of the Class A shareholders. It held that, considering the circumstances, the Class A shareholder vote should reasonably be used as a proxy for the fairness and reasonableness of the Proposed Arrangement. The Court considered whether there were any factors that could prevent a court from adopting the conclusion implicit in an affirmative shareholder vote. Four potential factors were identified, specifically: (i) if a significant number of shareholders were unable to reach a decision and did not vote; (ii) the presence of misleading disclosure; (iii) the existence of conflicting economic interests among the shareholders; and (iv) if there was an element of coercion present. The Court found that none of these factors existed.

The Court concluded that it could rely on three indicia of fairness:

1. the outcome of the Class A shareholder vote, upon which it placed considerable reliance;
2. the market reaction to the announcement, which provided evidence that the Class A shareholders had a reasonable possibility of realizing a potential gain from the Proposed Arrangement; and
3. the presence of a liquid trading market into which the Class A shareholders could sell their shares at prices equal to or greater than the pre-announcement price.

As a result, notwithstanding the fact that the Court was unable to make a factual determination regarding the financial costs and benefits of the Proposed Arrangement, the Court ruled Magna satisfied the BCE "fair and balanced" test based on the three indicia set out above and accordingly approved the arrangement.

### SUBSEQUENT DEVELOPMENTS

The Canada Pension Plan Investment Board has announced that it will appeal the Court's decision and other Opposing Parties are expected to join the appeal shortly. Magna has announced that it is seeking to have the appeal heard on an expedited basis because the Stronach Trust has the right to terminate the Proposed Transaction if the necessary approvals are not secured by August 31, 2010.

For further information, please contact:

John Tuzyk 416-863-2918

Christopher Kozub 416-863-2499

or any member of our Securities Group.

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