

## **Down the rabbit hole: The Magna investors' tale**

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The Ontario Securities Commission's recent decision in *In the Matter of Magna International Inc.* is a cautionary tale for aggrieved investors looking to the commission for protection from potentially abusive corporate transactions.

The commission convened a hearing in June 2010 to consider whether to halt a proposed plan of arrangement by Magna International Inc., whereby Magna would indirectly purchase for cancellation all of its Class B multiple voting shares and thereby collapse its dual class share structure. The transaction would result in the holder of Magna's Class B multiple voting shares receiving a premium of 1800 per cent over the trading price of the Class A shares, and the Class A shareholder suffering an unprecedented level of dilution.

Commission staff alleged that the disclosure contained in the Management Information Circular/Proxy Statement was insufficient, and that the transaction was contrary to the public interest because: (1) Magna's board of directors had not made a recommendation to shareholders; (2) shareholders had insufficient information to form a reasoned judgment about the transaction; and (3) the process followed by the board in negotiating the arrangement and proposing it to shareholders was inadequate.

Prior to the hearing, the commission refused to give a group of objecting Class A shareholders, consisting of several major Canadian pension plan investment corporations and boards, full intervenor status (*In the Matter of Magna International Inc.*, (2011), 33 OSCB 800). Instead, the commission granted limited status to them to make submissions, but not to call evidence or cross-examine. The commission cited concerns about the short timeline for the hearing, which was only days prior to the scheduled shareholder vote, and also expressed confidence in the ability of commission staff "to establish an appropriate evidentiary record."

As a result, the objecting shareholders were precluded from adducing evidence on the process followed by Magna's board of directors and special committee, including on their failure to obtain a fairness opinion and make a determination that the proposal was fair to the Class A shareholders. The shareholders were also prevented from cross-examining any of Magna's witnesses about, among other things, the rigour of the negotiations leading to the proposal.

At the conclusion of the hearing, which lasted less than two days, the commission decided not to halt the proposed transaction, provided enhanced disclosure was given to the shareholders in advance of the shareholder vote. The commission declined to conclude that the proposed transaction was unfair to the Class A shareholders, electing instead to leave that issue to the court scheduled to hear an application to approve the plan of arrangement under the Canada Business Corporations Act.

Significantly, although the commission indicated in its brief decision and order (*In the Matter of Magna International Inc.* (2010), 72 B.L.R. (4th) 235) that it had some concerns with the process followed by the board, special committee and management, it did not articulate the concerns nor explain their significance.

Despite continuing opposition by the same objecting shareholders, the Ontario Superior Court of Justice subsequently approved the transaction as fair (*Magna International Inc., (Re)*, [2010] O.J. No. 3454).

In reaching that conclusion, the court applied the test for approval of plans of arrangement articulated by the Supreme Court of Canada in *BCE Inc. v. 1976 Debentureholders*, [2008] S.C.J. 37, which requires courts to focus on "the terms and impact of the arrangement itself, rather than on the process by which it was reached." As a result, the objecting shareholders' concerns about potential deficiencies in Magna's corporate governance processes were largely ignored.

Notwithstanding the failure of the special committee to obtain an opinion from an independent financial advisor that the transaction was fair, and evidence from a financial advisor retained by the objecting shareholders that the proposal was unfair to the Class A shareholders from a financial perspective, the court deferred to the vote of the majority of the shareholders, who had voted in favour of the transaction, and made an order approving the plan of arrangement. That decision was upheld on appeal (*Magna International Inc., (Re)*, [2010] O.J. No. 3791 (Div. Ct.)).

Six months later, the commission released a second and considerably longer set of reasons for the decision it had rendered in June, prior to the shareholder vote and court approval (*In the Matter of Magna International Inc., Reasons For Decision and Order*, released Jan. 31). In these reasons, the commission identified, for the first time, numerous and significant flaws in Magna's corporate governance processes relating to the proposal.

According to its reasons, executive management of Magna was "fundamentally conflicted" in purporting to negotiate the key financial terms of the proposal directly with Frank Stronach, a beneficiary of the trust that owned the Class B shares, without any independent financial advice or oversight by the special committee. The special committee's own process "was defective from the start" and "tainted by the involvement of executive management." Its mandate and terms of reference were "too narrow and fundamentally flawed." The special committee also failed to fully address "the key question," namely, the fairness of the proposed transaction.

No explanation for the commission's failure to articulate these important corporate governance concerns in its original decision, prior to the shareholder vote and argument of the application for court approval, was offered. The commission stated that it had elected not to halt the proposed transaction on these grounds because the opposing shareholders, who were effectively muzzled by the commission's decision not to allow them to call evidence or cross-examine witnesses at the hearing, and commission staff, who were not so constrained, had not adduced "sufficient evidence[...]of the actual process" followed by the special committee.

In future, aggrieved shareholders should think twice about seeking relief from the commission in similar circumstances, absent the ability to adduce evidence and the opportunity for meaningful participation at the hearing.

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