

## Related Party Transactions and Plans of Arrangement

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The recent elimination of the dual class voting structure of Magna International Inc. has provided important insights for parties undertaking related party transactions under Multilateral Instrument 61-101 - *Protection of Minority Security Holders in Special Transactions* ("61-101") and plans of arrangement under the *Business Corporations Act* (Ontario) (the "OBCA").

### Background

Magna is a diversified global automotive supplier with annual sales exceeding \$25 billion. Before the completion of the plan of arrangement under the OBCA described below, it had a dual class share structure comprised of Class A subordinate voting shares ("Class A Shares"), listed on the TSX and the NYSE, and multiple voting Class B shares ("Class B Shares").

The Class B Shares carried 300 votes per share, representing approximately 66% of the votes attached to Magna's voting securities, but represented less than 1% of Magna's total equity. The Class B Shares did not contain "coattail" protections for holders of Class A Shares in the event of a change of control, nor did they contain any "sunset" provisions by which the Class B Shares would either terminate or convert into another class of Magna shares as of any specified date. The Stronach Trust, directly and indirectly, owned all of the Class B Shares. The trustees of the Stronach Trust are Mr. Frank Stronach and family members. Mr. Stronach is the chairman of Magna's board of directors.

In late March and early April 2010, Magna's management had discussions with Mr. Stronach to see whether he would consider a transaction to eliminate Magna's dual class share structure. Mr. Stronach indicated he was willing to consider such a transaction if, among other things, it was supported by Magna's shareholders. As a result of these discussions, Magna executives developed a proposed transaction comprised of the following elements:

- Magna's purchase for cancellation all of the outstanding Class B Shares for consideration comprised of 9 million Class A Shares and US\$300 million in cash;
- amendments to consulting agreements with Mr. Stronach; and
- the reorganization of a Magna business line into a partnership controlled by Mr. Stronach.

The Magna board established a special committee to consider the proposed transaction and to move it forward. The financial advisor to the special committee did not provide a fairness opinion, adequacy opinion or formal valuation of the Class B Shares. It advised the special committee that if the Class B Shares were purchased for the consideration offered, the dilution to the holders of Class A Shares (disregarding the impact of any potential change in the trading multiple of the Class A Shares as a result of the change in the capital structure), would be significantly greater than was the case for other historical precedent transactions in which dual class share structures were collapsed.

The special committee recommended to Magna's board that it should submit the transaction as a plan of arrangement under the OBCA (the "Arrangement") to be approved by votes of the holders of Class A Shares and Class B Shares, including a vote of holders of Class A Shares which excluded Mr. Stronach and his affiliates. A consequence of the structuring of the Arrangement was that Magna's board was not required to fix the fair value of the Class B Shares in connection with their repurchase.

On May 5, 2010, Magna's board approved submitting the Arrangement to a vote of Magna's shareholders at a special meeting, though it made no recommendation as to how the shareholders should vote on the Arrangement. On June 2, 2010, Magna mailed a management information circular for this special meeting.

### **Proceedings Before the Ontario Securities Commission**

Staff of the Ontario Securities Commission commenced an application on June 15, 2010 seeking an order to cease trade the issuance of securities pursuant to the Arrangement on the basis that the Arrangement was contrary to the public interest, alleging that:

- the circular for the special meeting did not contain specific financial information obtained by the special committee from its financial advisors;
- the circular failed to provide sufficient information concerning the desirability or fairness of the Arrangement and Magna's board had not made a useful recommendation regarding the Arrangement; and
- the purchase of the Class B Shares was contrary to the public interest and should be cease traded because: (i) the holders of the Class A Shares were being asked to approve the Arrangement without a recommendation from Magna's board and without sufficient information to form a reasoned judgment concerning the Arrangement; and (ii) the approval and review process followed by Magna's board in negotiating the Arrangement and proposing it to the holders of Class A Shares was inadequate.

An OSC hearing was held on June 23 and 24, 2010. The OSC concluded that the circular provided insufficient disclosure to the holders of Class A Shares to permit them to make an informed decision on the Arrangement. In reaching this conclusion, the OSC took into consideration: (i) the fact that the proposed Arrangement constituted a material related party transaction between Magna and the Stronach Trust; (ii) the absence of any recommendation to the holders of Class A Shares from either the special committee or Magna's board as to how they should vote on the Arrangement or as to their view of the fairness of the Arrangement to those shareholders; and (iii) the absence of a fairness opinion.

The OSC concluded that, in these circumstances, the disclosure in the circular had to provide holders of Class A Shares with substantially the same information and analysis that the special committee had before it in considering and addressing the legal and business issues raised by the Arrangement. As such, the OSC ordered that the circular be amended to provide disclosure of 12 specific items and, in each case, a discussion and analysis of the implications of that information for the purposes of the Arrangement and the shareholder vote. The OSC also required that the circular contain a statement of the disinterested members of Magna's board and the special committee stating they had concluded that the amended circular provided disclosure and information sufficient to permit holders of Class A Shares to make an informed decision as to how to vote on the Arrangement.

The OSC also concluded that no formal valuation was required in connection with the Arrangement under 61-101 and that it would not require the preparation of any formal valuation.

Finally, the OSC articulated a principle of deference: "In the circumstances, whatever views we may have as to the terms of [the Arrangement] and its fairness to shareholders, we believe that it is the shareholders of Magna that should ultimately decide whether [the Arrangement] proceeds. That is a business and financial decision that shareholders are entitled to make." The OSC added that it took "comfort" from the fact that an Ontario court would, as part of the arrangement process under the OBCA, determine whether the Arrangement was fair and reasonable, expressly acknowledging that such a determination was "outside the purview of our jurisdiction as securities regulators".

As a result of the requirement to amend the circular, Magna postponed the special meeting to vote on the Arrangement from June 25, 2010 to July 28, 2010.

### ***The Arrangement***

At the special meeting, 80% of the holders of Class A Shares voted on the Arrangement. The Arrangement was approved by 75% of the those holders of Class A Shares, excluding Class A Shares held by Mr. Stronach and his affiliates. Upon shareholder approval of the Arrangement at the special meeting, Magna submitted the Arrangement to the Ontario Superior Court for approval, as required under the OBCA.

### ***Decision of the Ontario Superior Court***

In considering the Arrangement, the application judge of the Ontario Superior Court applied the general principles regarding the review of plans of arrangement set down by the Supreme Court of Canada in *BCE v. 1976 Debentureholders*.<sup>1</sup> In *BCE*, the court held that in seeking approval of an arrangement, a corporation bears the onus of satisfying the court that the arrangement is fair and reasonable. In determining whether an arrangement is fair and reasonable, the court must be satisfied that (i) the arrangement has a valid business purpose; and (ii) the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way.

With respect to the "valid business purpose" requirement for the Arrangement, the Court noted that *BCE* requires a level of judicial scrutiny of a proposed plan of arrangement dependant on the necessity of the arrangement to the continued operations of the corporation. Although the Court found that the Arrangement was not necessary for

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<sup>1</sup> Although *BCE* dealt with the plan of arrangement provisions under the *Canada Business Corporations Act*, those provisions are substantively the same as under the OBCA.

the continued operation of Magna, even on a standard of “strict scrutiny”, it was clear that the elimination of the dual class share structure would benefit Magna, both from a corporate governance and a financial perspective. The Court stated that the valid business purpose requirement need not be proved with certainty; rather, it only requires a corporation to demonstrate the prospect of clearly identified benefits to the corporation that have a reasonable prospect of being realized if the arrangement is implemented, as opposed to vague and imprecise benefits that are, by their nature, unlikely to be realized. The Court found that the Arrangement met the valid business purpose test.

In reviewing the “fairness and reasonableness” requirement for the Arrangement, the Court observed that “many of the traditional indicia of fairness and reasonableness are absent in the circumstances”, citing the lack of a fairness opinion, the lack of a recommendation to the holders of Class A Shares by either the special committee or Magna’s board and the lack of rights of dissent and appraisal for shareholders opposed to the Arrangement.

In its analysis, the Court relied heavily on the affirmative vote of the holders of Class A Shares to approve the Arrangement, saying that “one should look to the outcome of the vote to assess the extent to which it can be said that an intelligent and honest business person, as a member of the voting class concerned and acting in his or her own best interest, would consider a plan of arrangement to be sufficiently fair and reasonable”, while further adding that “both the evidence and common sense compel the conclusion that the outcome of the shareholder vote should be regarded as a determination by the Class A shareholders that the proposed Arrangement was sufficiently fair and reasonable to be acceptable to them”. The Court did, however, consider four circumstances which could prevent a court from adopting the conclusion inherent in a shareholder vote: (i) if a significant number of shareholders indicated that they were unable to vote because they could not reach a decision; (ii) misleading disclosure to the shareholders; (iii) evidence of different economic interests among the members of the class of shareholders; and (iv) a coercive element in the structure of the arrangement or inherent in the voting for the arrangement.

The court also found that the fairness of the Arrangement was demonstrated by the market reaction to the Arrangement, which it held provided evidence that there was a belief among market participants that there was a reasonable possibility of achieving the potential benefits upon which the Arrangement was premised. The court also noted the presence of a liquid trading market in which the

holders of Class A Shares opposing the Arrangement could sell their shares at prices that had not been demonstrated to have been reduced as a result of the announcement of the Arrangement.

#### *Decision of the Ontario Divisional Court*

The decision of the Court approving the Arrangement was appealed by a group of Magna institutional shareholders to the Ontario Divisional Court. The essence of their appeal was that the application judge had placed too much weight on the importance of the shareholder vote approving the Arrangement. As such, the appealing shareholders argued that the application judge had improperly changed the focus of the inquiry from an objective and substantive determination that the Arrangement was fair and reasonable to an inquiry of whether shareholders believed there was a reasonable possibility that the benefits of the Arrangement would be achieved.

In reviewing the application judge’s decision, the Divisional Court made a number of general observations, including the following:

“In our view, a court may find a plan of arrangement to be fair and reasonable in the circumstances notwithstanding the court is unable to make an exact determination of the relative financial costs and benefits of the intended arrangement. It is enough if there is credible evidence that shareholders could reasonably conclude that the perceived benefits equal or outweigh the costs of the arrangement.

A court, as seen in the Application Judge’s consideration of the situation at hand, can reach the conclusion that a plan of arrangement is fair and reasonable based upon a determination of the relative probable substantive costs and benefits of the proposed arrangement coupled with a favourable vote by informed shareholders resulting from a procedurally fair and reasonable process.”

The Divisional Court found that the application judge, as was required by *BCE*, had looked beyond the shareholder vote in considering the fairness and reasonableness of the Arrangement. The Court had determined that there was credible evidence before the shareholders that there was a reasonable possibility, on an objective basis, that the benefits of the Arrangement might exceed the costs to the holders of the Class A Shares. In particular, the Divisional Court identified that the application judge had taken into account: (i) matters that the special committee of Magna’s board had considered in deciding to submit the Arrangement to a vote of Magna’s shareholders; (ii) statements that the special committee had taken note of the market reaction to

the Arrangement as reflected in the increased trading price of the Class A Shares; and (iii) the assessment of the special committee's financial advisors regarding the likelihood that the price increase of the Class A Shares would be sustained.

### **Conclusion**

The elimination of Magna's dual class voting structure has provided insight into the OSC's views regarding the standard of disclosure required for issuers undertaking transactions governed by 61-101. The OSC has not yet published its detailed reasons for its decision. Interestingly, the OSC has said that in those reasons it will discuss concerns that it has with the process followed by Magna's board, the special committee and Magna's management in reviewing and deciding to submit the Arrangement to the holders of Class A Shares.

The transaction also demonstrates the evaluation process to be used by an Ontario court in assessing a plan of arrangement under the OBCA, and identifies criteria to be examined in determining whether an arrangement is fair and reasonable. The identification of market reaction to a transaction as evidence of its fairness and reasonableness is of particular interest.

*This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.*

*If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.*

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