EMERSON ADVISORY
333 BAY STREET, SUITE 2400
BAY ADELAIDE CENTRE, BOX 20
TORONTO, ONTARIO, CANADA M5H 2T6

H. GARFIELD EMERSON
PRINCIPAL

DIRECT 416 865 4350
FAX 416 364 7813
gemerson@emersonadvisory.com

Dated: June 28, 2011

FRANK STRONACH AND MAGNA'S ELIMINATION OF ITS DUAL CLASS EQUITY SHARES – WHAT'S THE BEEF?

Against the aggressive opposition of six major Canadian pension funds, but with the OSC's acquiescence permitting the proposal to go forward before the Magna shareholders, with the overwhelming approval of the public unaffiliated shareholders of Magna International Inc. ("Magna"), and with the subsequent unequivocal and unanimous endorsement of the Ontario courts in contested "fairness" hearings, Frank Stronach stubbornly persisted and successfully realized exceptional value for the sale and elimination of his super-leveraged, dual-class multiple voting shares through which he, as founder, had exercised absolute legal and management control of Magna as a public company since 1978.

Frank Stronach publicly referred to reasons why he agreed to sell his control block of Magna in his farewell address at Magna's annual meeting of shareholders on May 4, 2011. He mentioned a number of factors that were at play. He said, philosophically, that he had been '"soul searching" and thinking about succession at Magna after serving 40 years as the Chair of the company. He referred to the fact that he "accepted a proposal" to eliminate his control and that he had no regrets in doing so. He acknowledged, in an understated way, that he received, what he categorized as, "reasonable amount of monies" for his sale and that, while he measured success in terms of personal happiness, he expressed that it was "easier to be happier if you have

some monies". He also smilingly expressed relief that he would no longer "be constrained by a public company" as to what he wanted to do, and that he looked forward to a lot of things.

Mike Harris, the former Premier of Ontario, and the lead independent director at Magna, was the Chairman of the Special Committee[1] that considered the terms of the deal which were effectively negotiated between Stronach and Magna management and then presented to the Magna board. The Special Committee held 18 meetings in 2010 in connection with the restructuring proposal. Harris became the Chairman of the Board of Magna, and Chairman of the Nominating Committee and Chairman of the Corporate Governance and Compensation Committee of Magna after Magna's May 4, 2011 AGM. Mike Harris was quoted as saying that the "option to redeem the multiple-voting shares came about after several years of succession discussion with the board, with management, with the Stronachs." With respect to the price paid to Stronach, Mike Harris agreed that, in historical terms, the price was expensive, but added: "In terms of value to the shareholders, it's pretty cheap, actually, when you look at the share price and how it responded afterwards." (Report on Business.Com/Top1000, July/August 2011.)

The financial terms of the transaction and the related process by which the Stronach's control block was purchased for cancellation by Magna has, however, been strongly and vehemently criticized by leading investors and participants in Canada's capital markets, academics, corporate lawyers, governance advisors and others. The fundamental core of the attack stems from what is alleged to have been an unprecedented and grossly excessive purchase price paid to Stronach. It is doubtful that a number of procedural and process related complaints would have been pursued had the price paid to eliminate the Stronach control block been within, or reasonably related to, the range of previous precedent comparable transactions. Indeed, in such a case, Stronach's legacy would have been praised by his critics, notwithstanding such flaws.

Even assuming some merit in the principal attacks on the financial terms and the process that was followed to settle the deal, it is, nevertheless, appropriate to stand back and realize:

- Magna's shareholders and investors responded positively to the announcement of the proposal, adding billions of dollars to Magna's market share capitalization during the subsequent period to its closing;

- The OSC held a contested public hearing whether the deal should be stopped on the grounds that it was contrary to the public interest and harmful to the integrity of the Ontario capital markets. The OSC refused to cease trade the transaction and allowed it to proceed to a shareholder vote, requiring only that Magna's defective initial proxy circular be corrected and supplemented to the OSC's satisfaction to provide shareholders with the

[1] The Special Committee was composed of Mike Harris (Chair), Donald Resnick and Louis Lataif. Harris (age 66) became a Magna director in 2003 and Lead Director in 2007. Resnick (age 83), a chartered accountant, had a long professional and business association with Stronach and has been a director since 1982. Lataif (age 72) became a director in 2007 and was previously Dean of the Boston University School of Management (1991-2010) following a 27 year career with the Ford Motor Company. Total compensation earned by the members of the Special Committee in 2010 for all services provided that year as directors of Magna were: Harris: U.S.$749,710; Resnick: U.S.$494,420; Lataif: $U.S.$407,470.

material information they needed to make an informed decision when they voted on the proposal;

- Although the OSC expressed heavy criticism of the Special Committee's defective process that was tainted by the involvement of Magna's executive management and the Special Committee's limited mandate that the OSC considered to be "fundamentally flawed", the OSC concluded it did not have sufficient evidence to block the transaction on these grounds;

- Fully informed, public unaffiliated Class A shareholders, who paid substantially all of the high purchase price Stronach demanded, voted separately as a class in favour of the deal, after receiving the OSC mandated enhanced and supplemental disclosure, with a resounding 75% 'Yes' approval level (with 80% of the Class A shareholders represented at the meeting), and notwithstanding the continuing public dissenting views and active opposition of the pension funds recommending a 'No' vote;

- Following the significant approval by the Class A shareholders, the Ontario Superior Court of Justice, in a hearing again contested by the opposing pension funds, sanctioned the transaction after concluding, in a full and reasoned judgment, that Magna had satisfied the requirements of the "fair and reasonable" test as enunciated by the Supreme Court of Canada in *BCE Inc. v. 1976 Debentureholders* ;

- The opposing pension funds appealed the decision of the Superior Court to a three Judge panel of the Divisional Court of Ontario, which rejected the submissions of the pension funds that the application Judge arrived at his decision solely on the basis of the shareholder vote, and, in a unanimous ruling, rejected the appeal of the pension funds.

What more can be required to authorize a material related party transaction of a public company?

Magna's US $1 Billion Value Transfer to Stronach

For the sale of his multiple voting shares to Magna, which represented only 0.6% of the Company's equity but which had a controlling 66% of the votes, Stronach required a "take it or leave it" payment of U.S.$863 million (based on the closing market price of the subordinate voting Class A Shares of U.S.$62.53 on the NYSE on May 5, 2010 (before the 2:1 stock split on November 12, 2010), being the day before the announcement of the deal). This represented a payment of about U.S.$1,187 for each share sold by Stronach, or a premium of approximately 1,800% of the closing price of the Class A Shares on May 5, 2010.

Stronach also obtained the right to receive from Magna an additional estimated U.S.$120 million in fees from consulting, business development and business services agreements, which previously had one-year terms and were renewable annually. Under the transaction, the expiry date of these agreements was extended for four years from the end of 2010 to the end of 2014, at which time each agreement is to terminate automatically, with a declining fee schedule of 0.25% annually from 3% for 2010 to 2% for 2014 of Magna's Pre-Tax Profits Before Profit Sharing. (In fiscal 2010, these agreements provided that the aggregate of the annual profit sharing fees payable was 3% of Magna's Pre-Tax Profits Before Profit Sharing. Stronach's total

compensation from Magna in 2010 was U.S.$60 million (2009 – U.S.$2 million; 2008 – U.S.$10.8 million).

In addition, the deal provided that certain affiliates of the Stronach family would invest U.S.$80 million in cash for a 27% equity partnership interest and Magna would invest U.S.$220 million in assets and cash for a 73% equity partnership interest in Magna E-Car Systems ("E-Car") (Magna's vehicle electrification business). Subject to certain veto rights in favour of Magna, voting control of the E-Car partnership would be held by the Stronach group and, through a class of multiple voting shares, such voting control would continue for any corporation into which the partnership may be reorganized. Any material transaction between Magna and E-Car would be reviewed and approved by Magna's Corporate Governance and Compensation Committee (the CGCC is now constituted with the same members as the Special Committee – Mike Harris (Chair), Donald Resnick and Louis Lataif).

The main consideration that Stronach received to dissolve his control block was paid by the public unaffiliated Magna Class A public shareholders, primarily through the incurrence of an unprecedented 11.4% dilution of their equity. CIBC, the financial advisor retained by the Special Committee, advised that 15 precedent transactions had dilution from 0 to 3.04%, and averaged 0.89%, and that a post-transaction improvement in Magna's Enterprise Value/EBITDA trading multiple of at least 0.5 times would be required in order to offset the cost of the dilution to the Class A shareholders and thereby to increase the market price and value of their shares in order to compensate them for the price they paid to buy the Stronach control block.

Market Impact on Magna's Class A Shares

The benefits of the transaction to the Class A shareholders, who bore the bulk of the cost of the value transfer to Stronach, were predicated on a significant, sustained expansion in the trading multiple and thereby the trading price and value of their Class A Shares.

From the announcement on May 6, 2010 to the market close on July 7, 2010, Magna's Class A Shares price increased by 6.3% on the TSX, despite a decline of 4.0% of the S&P/TSX Index. On the NYSE, in this period, the Class A Share price increased by 4.4%, despite a decline of 9.1% in the S&P 500 Index and a decline of 13.5% in the trading price of Magna's U.S. Comparables.

The average closing trading price for the Class A Shares on the NYSE in the 10 trading days preceding the announcement of the deal on May 6, 2010 was US$64.99. The average closing trading price in the 10 trading days following the effective date of the transaction on August 31, 2010 was US$80.70 (both before the 2:1 split). This represented an increase of 24.2% in the average closing trading price of the Class A Shares before announcement, while the S&P/TSX Index dropped 0.4% during this period. This Class A Share average closing trading price rise represented a US$1.761 billion increase in the aggregate market value of the issued 112,072,348 Class A Shares (as constituted before the closing of the deal and the issue of 9 million new shares to Stronach).

The Ontario Superior Court took into account the favourable market reaction to the announcement of the proposal as indicia of fairness of the terms of the transaction. One standard of fairness that the Court applied was to determine

> "...whether there is a belief in the market that there is a reasonable possibility that the trading price of the Class A Shares will increase as a result of the implementation of the proposed arrangement, and will thereby reflect an increase in its trading multiples sufficient to offset the dilutive cost of the transaction on the Class A Shares.
>
> "Failure to satisfy this standard could, in the circumstances, be an important factor in the assessment of the fairness and reasonableness of the proposed Arrangement. A transaction which failed to meet such a standard might not be said to constitute a fair and balanced resolution of the conflicting interests of the parties depending on the extent and nature of the negative market reaction." (*Re Magna International Inc*., 2010 ONSC 4123 at paras. 186-187.)

Based on the evidence before the Court, including evidence from CIBC, the financial advisor to the Special Committee, from Morgan Stanley Canada Limited, the financial advisor to the pension fund shareholders who intervened in the OSC and the Court hearings to oppose approval of the deal, independent analysts reports and the report of RiskMetrics Group, who recommended that the Class A shareholders vote in favour, the Court determined that the positive market reaction was an indicia of fairness which provided "evidence that there is a belief among market participants that there is a reasonable possibility of achieving the potential benefits upon which the transaction is premised and therefore that the proposed Arrangement in not inherently unfair." (*Ibid*., para. 195.)

<u>Opposition to the Transaction</u>

By early June 2010, both Ontario Teachers' Pension Plan ("OTPP") and the Canada Pension Plan Investment Board ("CPP") publicly stated their strong opposition to the announced transaction and that they would vote against it. OTPP and CPP were joined in their strenuous opposition by the Alberta Investment Management Corporation, OMERS Administration Corporation, British Columbia Investment Management Corp. and Letko, Brosseau & Associates Inc. Such six opposing shareholders intervened in the hearings before the OSC and the Courts and opposed and argued against the completion of the proposed transaction. A summary of the principal points of their challenges were:

- The "outrageous premium" to be paid to Stronach was "totally unreasonable" and "an unprecedented and excessive transfer of wealth from shareholders to the Stronach Trust";

- The terms were "fundamentally unfair" to the Class A shareholders and resulted in unprecedented dilution of their interests;

- Premiums are neither warranted nor the norm and any financial benefits and value that would result from the elimination of the dual class equity share structure belonged to Magna and all its shareholders (i.e., the value of the control block is a ‘corporate asset’);
- “...controlling shareholders should not be permitted to extract outrageous premiums from a company under the guise of normalizing its governance structure...”;
- The Special Committee and the board of directors failed to make a decision and recommendation to shareholders that the terms of the proposed material related party transaction with Stronach was fair and in the long term best interests of Magna;
- The terms of the deal were “substantially negotiated between management and Mr. Stronach prior to the involvement of the Board or Special Committee.”;
- The Special Committee’s mandate was too narrow and the Committee failed to engage in any meaningful negotiation with Stronach on behalf of Magna to attempt to obtain better terms;
- The Special Committee and board of directors failed to exercise their fiduciary obligation to proceed with the transaction only if they believed it is in the long term best interests of Magna and “passed the buck to the Class A shareholders and the Court”;
- “If a board cannot say that the deal they reached is in the best interests of the corporation and is fair to shareholders, that deal should not be pursued.”;
- There was no opinion from the Special Committee’s independent financial advisor that the terms of the proposed transaction were fair to Magna or to the Class A shareholders;
- The Class A shareholders would not be able to make an informed decision on the transaction without Special Committee and board recommendations and without a fairness opinion;
- The process was “flawed” because the Court would be asked to make a judgment that the terms of transaction were fair and reasonable in circumstances where the Special Committee and its financial advisors both failed to make that determination;
- The Court approval process was not a procedural protection for shareholders because the only evidence of fairness would be the shareholder vote and it is circular reasoning to conclude that, if there is an affirmative shareholder vote, then the transaction itself must be fair and reasonable;
- The terms of the proposal would set a “dangerous precedent” for future similar transactions;
- There were concerns expressed about the “abusive nature of the proposed transaction” and “its potential impact of the future integrity of the Canadian capital markets”;

- The current consulting agreements with Stronach should not be renewed when their terms expired on December 31, 2010, and there was no need to extend the Stronach consulting agreements for another four years;

- The Special Committee did not give any thought to the value of the consulting fees to be paid under the extended consulting agreements;

- There was a lack of transparency and uncertainty whether the terms of the 'E-Car Partnership' favoured Stronach and provided him with additional or future disproportionate value opportunities;

- The proposal would establish the same dual class equity share structure for Magna's electric-car business.

The Core of the Issue

The ultimate core issue as to whether the terms of the related party transaction between Stronach and Magna were fair, reasonable and balanced involved the answer to the fundamental question whether the benefits that would flow to the Class A shareholders following the collapse of the dual class share structure were worth the cost paid by the Class A shareholders. The substantive effect of the transaction was the conversion of the subordinate voting Class A Shares, which did not have 'coattail' protection and were not subject to a "sunset" provision, into a single class of common shares and the elimination of Stronach's Class B controlling shares. While the cost was high and certain, the benefits were uncertain and in the future. As expressed by the Ontario Superior Court:

> "The unique feature in this transaction is that, while the proposed Arrangement, if implemented, would benefit Magna and the Class A shareholders in a number of ways that have been set out above, the principal rationale for the proposed Arrangement is the possibility of a sustainable increase in the trading price of the Class A Shares that is sufficient to at least offset the fixed and immediate cost to the Class A shareholders of the transaction in the form of a dilution of the Class A Shares." (*Re Magna International Inc.*, 2010 ONSC 4123 at para. 70.)

Framing the issue in other ways: did the allocation of the costs and benefits between the public Class A shareholders and the Class B shareholders (Stronach) make the transaction unfair? Was the unprecedented price paid by the Class A shareholders too high in relation to the uncertain future and potential benefits to be obtained by them as a result of a market driven "multiple expansion" in the share trading price of their Class A Shares?

This equity dilution suffered by the Class A Shares and the valuable consideration that was paid to Stronach for the cancellation of his multiple voting control block shares were considered by the Magna public shareholders to be an acceptable price to pay to eliminate Stronach's control At a special shareholders' meeting, following supplemental enhanced disclosure mandated by the OSC, the unaffiliated Magna public investors overwhelmingly approved the arrangements with Stronach by a decisive 75% vote majority, with 80.4% of the issued Class A Shares represented and voting at the meeting.

Stronach's success did not involve the sale of his Magna control block to a third party purchaser by private agreement. That was not a realistic option for Stronach to allow him to obtain the value he wanted for his control of Magna. A third party purchaser would not have paid the high price Stronach demanded for the acquisition of his minimal though controlling equity stake, even though it would have transferred control of Magna to the purchaser. Like a limited number of other dual-class voting share structures in Canadian public companies, there were no 'coattail' or 'sunset' provisions attaching to Stronach's class of controlling multiple-voting shares which were created in 1978 with Magna shareholder approval. In the absence of 'coattail' protection for the subordinate voting shares, Stronach, and other control persons in similar circumstances, could have sold control of Magna privately for the highest price the market would bear, without the purchaser being obligated to offer the identical premium price, or to make any offer, for the shares owned by the public. It would not have been financially prudent to acquire control of Magna by purchasing Stronach's control block shares in a private transaction at the very high price Stronach demanded for him to sell and relinquish control.

While the transaction eliminated Magna's control block, and the negative "Stronach Factor" effect on the market trading price of the Magna shares, the transaction did potentially unlock the way for a possible future third party premium bid for control of Magna that would be available to all its shareholders.

The OSC Hearing

The staff of the OSC filed an application to cease trade the proposal on the basis it was contrary to the public interest and harmful to the integrity of the Ontario capital markets. The OSC hearing, held June 23 and 24, 2010, addressed five principal issues that were raised as reasons to block the transaction in the public interest:

A. Did the Circular Provide Sufficient Disclosure to Class A Shareholders to Permit Them to Make an Informed Decision?

The OSC concluded that the information contained in the initial proxy circular was inadequate, and in some areas, misleading; failed to provide proper disclosure; and failed to comply with disclosure obligations under Ontario securities law. The OSC commented "That good judgment appears to have been lacking in the preparation of the Circular.". The OSC ordered that Magna would only be allowed to proceed if it amended its proxy circular, citing 12 areas of additional disclosure in particular that were required to be properly addressed, to the satisfaction of the staff of the OSC. A Supplement to Magna's proxy statement containing significantly expanded and additional disclosure was issued on July 8, 2010 for the meeting of shareholders that was adjourned from June 28 to July 23, 2010.

Absence of a Recommendation by the Special Committee or the Board

The OSC commented on the fact that the Special Committee and board did not make a recommendation to the Class A shareholders as to how they should vote. "It does not appear to us [OSC] that there is any requirement under corporate or securities law that a board make such a recommendation." The OSC said, however, that the absence of such a recommendation results in "heightened obligation to make meaningful disclosure and analysis in the Circular" and "is

generally insufficient without detailed reasons." The lack of a directors' recommendation "is not fatal to allowing shareholders to consider a transaction if there is adequate disclosure to them", and that to "hold otherwise would be to disenfranchise shareholders..."

Lack of a Fairness Opinion

In this section, the OSC also commented on the lack of providing a fairness opinion from a qualified independent financial advisor for the benefit of the Class A shareholders. The OSC noted that there is no requirement under Ontario securities law requiring a reporting issuer to obtain a fairness opinion as a condition of proceeding with a related party transaction. "Accordingly, requiring a fairness opinion might have prevented the Class A shareholders from being able to consider and vote on the Proposed Transaction, a result that, in our view, was not in the public interest." The OSC also stated that the inability to obtain a fairness opinion "did not relieve the Magna Board or Special Committee from their obligation to address and comment on the desirability or fairness of the Proposed Transaction to Class A Shareholders. To the contrary, in our view, the Magna Board and Special Committee had an obligation to do so."

B. Is the Proposed Transaction Abusive and Should the Commission Restrain It in the Public Interest?

The opposing pension funds also argued that the transaction was "coercive and abusive for Class A shareholders" in that it proposed an "exorbitant and unprecedented payment" for an "arbitrary transfer of corporate assets" (i.e., the collapse of the multiple voting share structure) and that the premium to be paid to Stronach was "unconscionable and contrary to the reasonable expectations of the Class A shareholders." The OSC ruled that the transaction was not abusive of the Class A shareholders. It noted that there was no 'coattail' protection for the Class A Shares and no sunset provision applicable to Magna's dual class structure. "As a result, the Stronach Trust was legally entitled to sell its Class B Shares to any purchaser at whatever price it negotiated." The Class A shareholders had no reasonable expectation that they would share in any control premium paid for the multiple voting Class B Shares.

The OSC did say, however, that if a majority vote of the Class A shareholders had not been a requirement for proceeding with the transaction, "we have little doubt that we would have restrained it as an abusive related party transaction."

The OSC also said that it appeared that the primary complaint of the opposing pension funds was that the price to be paid to Stronach for his control block was excessive and unprecedented. In the OSC's view, a transaction is not abusive "simply because certain investors or shareholders consider the price proposed to be paid to be outrageous." The OSC's role is not to assess the desirability of a transaction from a financial standpoint, which is for the Class A shareholders to decide.

> "...once the issue of adequate disclosure was addressed, there was no valid grounds for us to conclude that the Proposed Transaction was abusive of Class A Shareholders or should be restrained on other grounds. It is clear from Commission decisions that any view or perception that we may have as to the

> possible unfairness of a transaction is not a sufficient ground upon which we can or should intervene in the public interest."

As a final comment on this topic, the OSC stated that if, however, a transaction is abusive of shareholders or the capital markets, "then shareholder approval will not be sufficient."

C. Did the Magna Board Comply with its Fiduciary Duties in Submitting the Proposed Transaction to Shareholders?

The OSC rejected the arguments of the pension funds that the Magna directors failed to make a decision whether the transaction was in the best interests of Magna and that it was abusive and contrary to the public interest for Magna to ask shareholders to vote on the transaction where the board had not so decided. Noting that a Special Committee was formed to review the deal and report to the board whether it should be submitted to shareholders, the OSC concluded:

> "We have no reason to believe that by submitting the Proposed Transaction to shareholders for their consideration in these circumstances, the Magna Board or Special Committee improperly delegated that decision to shareholders or thereby breached their fiduciary duties."

D. Was the Process Followed by the Magna Board and the Special Committee in Reviewing the Proposed Transaction Adequate?

The OSC levied heavy criticism of what it considered a defective process followed by the Special Committee. It held that executive management of Magna, being conflicted, should not have negotiated the terms of the transaction with Stronach and should have referred the matter immediately to the Magna board once management became aware that Stronach was prepared to consider the transaction. The negotiations "should have been conducted or overseen by the Special Committee." The result was that the Special Committee was left with a transaction that had been substantially negotiated and agreed and that was presented as a 'take it or leave it' proposition.

The OSC also held that the mandate of the Special Committee was "fundamentally flawed" because it was limited to "review and consider" the proposal "as it was developed by executive management", it was not authorized to negotiate, and was to "report" to the Magna board whether the proposal should be submitted to the Class A shareholders.

The Special Committee was not mandated to consider whether the proposal was in the best interests of or was fair to the Class A shareholders. The OSC considered this the key question that should have been more fully addressed by the Special Committee and that the Special Committee could have addressed the fairness of the proposal even though there was no fairness opinion from its financial advisor. The OSC stated that:

> "...the Special Committee process appears to have been tainted by the involvement of executive management at the start and during the process, and the Special Committee's mandate and terms of reference were too narrow and fundamentally flawed."

The OSC considered intervening in the transaction "on the grounds that the Special Committee process was inadequate", but concluded that it did not have sufficient evidence or grounds to do so.

E. Should a Formal Valuation be required of the Subject Matter of the Proposed Transaction?

Magna was entitled to rely on the valuation exemption in MI 61-101 on the basis that "neither the fair market value of the subject matter of, nor the fair market value of the consideration for, the transaction ... exceeds 25% of the issuer's market capitalization....". The OSC noted that the rational for the transaction did not turn on the fair market value of Stronach's control block, but rather on the basis that the Class A shareholders would benefit from the increase in the trading multiple of the Class A Shares as a result of the elimination of the dual class share structure. The OSC concluded that a formal valuation was not necessary to the decision of the Class A shareholders given the economic rationale for the transaction.

The Superior Court of Justice Hearing

A court order approving the transaction, after considering the fairness and reasonableness of the proposal, was required because the proposal was put forward as a statutory "plan of arrangement" under the Ontario *Business Corporations Act*. The Ontario Court Superior Court (*Re Magna International Inc.* 2010 ONSC 4123) applied the principles governing the consideration of a proposed plan of arrangement as expressed by the Supreme Court of Canada in *BCE Inc. v. 1976 Debentureholders*, 2008 S.C.C. 69. The Court noted that the Supreme Court of Canada required that "the court must focus on the terms and impact of the arrangement itself, rather than on the process by which it was reached. *What is required is that the arrangement itself, viewed substantively and objectively, be suitable for approval*." [emphasis added by the Ontario Superior Court.] The corporation seeking approval 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".

In dealing with the third requirement of "fair and reasonable", the Court noted that the *BCE* decision rejected the 'business judgment' test, and that, in reviewing the directors' decision, the court must be satisfied that (a) the arrangement has a "valid business purpose" and (b) the legal rights being affected are "resolved in a fair and balanced way." The Court quoted the Supreme Court of Canada in *BCE*:

> "...votes on arrangements are an important indicator of whether a plan of arrangement is fair and reasonable. *...the reviewing judge must delve beyond whether a reasonable business person would approve of a plan to determine whether an arrangement is fair and reasonable.* Insofar as the business judgment test suggests that the judge need only consider the perspective of the majority group, it is incomplete." [emphasis added by the Ontario Superior Court.]

<u>"Fair and Reasonable" – the "Valid Business Purpose" Test</u>

The Court had no trouble in holding that the arrangement had a 'valid business purpose' as it was "clear that the elimination of the dual-class capital structure would benefit Magna, both from a corporate governance and from a financial perspective."

<u>"Fair and Reasonable" – the "Fair and Balanced" Test</u>

With respect to whether the legal rights of the Class A shareholders were affected in a 'fair and balanced way', the Court expressed the view that the correct exercise in the circumstances was to attempt to undertake a cost-benefit analysis in respect of the Class A Shares that addressed the benefits to both parties to the transaction, whether or not the price paid to Stronach was unprecedented. The 'proportionality', or the fair balancing of the interests of the Class A shareholders and Stronach, can only be satisfied "if the benefits to the Class A shareholders reasonably approximate or exceed such price [paid to Stronach]."

The Court concluded that it could not draw an adverse inference regarding the fairness of the deal from the absence of a fairness opinion because the lack of a fairness opinion "is inherent in the transaction". The Court accepted the position that fairness opinions cannot opine on the likely future trading price of an issuer's securities following the announcement or completion of a transaction. The Court also noted that there is nothing in the *BCE* decision that prevents shareholders from collectively assessing the financial merits of a plan of arrangement without a valuation or fairness opinion, and dismissed the opposing pension plans argument that a valuation or a fairness opinion was required in every instance in which the analysis of the financial benefits to be received is at all complex.

Similarly, the Court refused to draw an adverse inference regarding fairness from the absence of a recommendation of the Special Committee. It commented that, in the absence of a fairness opinion, the Special Committee could not "responsibly make a recommendation based on its personal assessment of the likely direction of trading multiples pertaining to the Class A Shares." The Court also stated that "the law of Ontario does not require that the directors, or a special committee of the directors, make a recommendation to the holders of its shares regarding a proposed related party transaction under the [Ontario Business Corporations] Act, MI 61-101 or otherwise."

The Court also said that while it was "correct that the directors' statutory duties required them to decide that the arrangement was in the best interests of Magna prior to seeking the approval of the shareholders, there is no evidence that they failed to make this determination". The Court held that the directors did not owe a duty to the Class A shareholders.

> "There is ample evidence that this proposed Arrangement would be in the best interests of Magna from a corporate governance perspective as well as from a financial perspective, as discussed above. It is an entirely different issue to say that the directors owed a duty to the holders of the Class A Shares to determine that the proposed Arrangement was in their best interests, as distinct from Magna, before seeking their approval. There is no such duty under corporate law in a related party transaction, however desirable such a requirement might be. In

allowing the transaction to be put before the Class A shareholders, the OSC Panel also determined that no such obligation existed under securities law." [*Ibid.,* para. 149.]

"Fair and Reasonable" – the "Fair and Balanced" Test - Weight to be given to the Class A Shareholder Vote

The Court said that the weight to be given to the vote of the Class A shareholders was the principal issue with respect to the 'fair and balanced' test. In seeking guidance from the *BCE* decision, the Court commented: (1) "the best test of whether an intelligent and honest person, as a member of the voting class concerned and acting in his or her own interest, would reasonably approve a plan of arrangement is his or her vote."; (2) in concluding that the "business judgment test" is not useful in the context of statutory arrangements, the Supreme Court of Canada "actually reinforced the need to rely on the outcome of a shareholder vote in appropriate circumstances."; (3) "the outcome of a shareholder vote is not, by itself, determinative of the fairness and reasonableness of an arrangement."; (4) the balancing of interest between competing groups addressed the balancing of the interests of different constituencies having different economic interests, not balancing the interests within a class of stakeholders.

The Court held that the Class A shareholder vote, considered as an indication of substantive fairness and reasonableness and not as a matter of procedural fairness, could reasonably be regarded as a proxy for the fairness and reasonableness of the arrangement.

In considering whether there was any reason that the Class A shareholder vote should not be relied on as an indicia of fairness, the Court dismissed the argument that there was a "coercive" element in the proposal because it was presented on a "take it or leave it" basis. The Court said that, given Stronach was "entitled to take this position, this cannot be treated as a coercive element is respect of the vote." The Court also noted that there was no evidence of misleading, incomplete or inadequate disclosure and that the "Class A shareholders were, therefore, in a position to make their own informed decisions regarding the likelihood that they would realize the potential benefits of the proposed Arrangement."

The Court therefore concluded that it "should give considerable weight" to the Class A shareholder vote as an indication that "the proposed Arrangement fairly balances the costs and potential benefits to such shareholders."

"Fair and Reasonable" – Conclusions regarding the "Fair and Balanced" Test

The Court proceeded to conclude that it could place reliance on the following indicia of fairness: (1) the outcome of the shareholder vote, upon which "considerable reliance can be placed"; (2) the market reaction to the proposed deal, which provides "evidence that there is a belief among market participants that there is a reasonable possibility of achieving the potential benefits upon which the transaction is premised and therefore that the proposed Arrangement is not inherently unfair"; (3) the presence of a liquid trading market in which opposing Class A shareholders can sell their shares at prices that have not been demonstrated to be reduced as a result of the announcement of the proposal.

The opposing pension funds argued that the Court could not approve the arrangement because the Court, as in the case of the Special Committee, cannot find the proposal to be fair and reasonable. The Court rejected these claims as requiring that the Court must make "an objective determination on its own regarding the financial costs and benefits of a plan of arrangement" and stated that the position of the opposing pension plans was the wrong standard. The Court then went on to say:

> "The concept of 'balancing' conflicting interests does not require a precise calculation. Instead, the Court is required to make a determination with respect to the overall fairness and reasonableness of a plan of arrangement. It is that determination to which the Supreme Court refers ... when it says that what is required is that the arrangement, 'viewed substantively and objectively', must be suitable for approval. This is as much a *qualitative as a quantitative determination. Such a 'balancing' will often require the Court to take into account more intangible, qualitative considerations as well as the quantitative elements of a plan of arrangement. Even in respect of financial benefits that can be quantified, the test requires a 'balancing' not a precise determination.*" [emphasis added.]

The Court also rejected the position of the opposing pension funds that the risks between the different stakeholder groups must be balanced or equally allocated. The pension funds argued that Stronach bore no risk in the transaction, receiving fixed benefits on closing, whereas the Class A shareholders bore all of the risks which were significant and rendered the potential benefits to them uncertain and unpredictable.

The Court ruled that Magna had satisfied the "fair and balanced" test, based on the three criteria quoted above, "including in particular, the vote of the Class A shareholders, notwithstanding that the Court is unable to make its own factual determination regarding the financial costs and benefits of the proposed transaction. ... Accordingly, Magna has also satisfied the requirements of the "fair and reasonable" test under the criteria set out in *BCE*."

The Divisional Court Hearing

The six opposing pension funds appealed the decision of the Superior Court to a three member panel of the Divisional Court (*Re Magna International Inc*., 2010 ONSC 4685). The pension funds argued that, because of the uncertain and unquantifiable potential benefits to the Class A shareholders, the Court cannot make a 'substantive and objective' determination of fairness and that there is not a 'fair and balanced' resolution of the conflicting interests of Stronach and the Class A shareholders. They also argued that the Application Judge departed from the 'substantive and objective' tests of fairness in arriving at his conclusion because he essentially treated the shareholder vote as determinative, and changed the focus of his inquiry from whether the Court would conclude that the proposal was fair and reasonable to whether others believe that there was a 'reasonable possibility' that the benefits of the proposal would be achieved.

The Divisional Court rejected the submissions of the pension funds that the Application Judge arrived at his conclusion solely on the basis of the shareholder vote. The Divisional Court agreed with the Application Judge's rulings and the reasons therefore and unanimously dismissed the appeal.

-30-

References

Magna Management Information Circular/Proxy dated May 31, 2010.

Magna Supplement to Management Information Circular/Proxy dated July 8, 2010.

Magna Management Information Circular/Proxy Statement dated March 30, 2011.

OSC Statement of Allegations of the Staff of the OSC dated June 15, 2010. http://www.osc.gov.on.ca/documents/en/Proceedings-SOA/soa_20100615_magna.pdf.

In the Matter of Magna International Inc. et al., Ontario Securities Commission Decision and Order dated June 24, 2010. http://www.osc.gov.on.ca/documents/en/Proceedings-RAD/rad_20100624_magna.pdf.

In the Matter of Magna International Inc. et al., Ontario Securities Commission Reasons for Decision and Order dated January 31, 2011; 2011 CarswellOnt 159, 34 O.S.C.B. 800, 80 B.L.R. (4th) 150; http://www.osc.gov.on.ca/en/Proceedings_rad_20110131_magna.htm.;

Magna International Inc. (Re), 2010 ONSC 4123 (Superior Court of Justice-Ontario), dated August 17, 2010. http://www.canlii.org/en/on/onsc/doc/2010/2010onsc4123/2010onsc4123.html.

Magna International Inc. (Re), 2010 ONSC 4685 (Divisional Court-Ontario), dated August 30, 2010. http://www.canlii.org/en/on/onscdc/doc/2010/2010onsc4685/2010onsc4685.html.

BCE Inc. v. 1976 Debentureholders, [2008] 3 S.C.R. 560, 2008 S.C.C. 69, (Supreme Court of Canada), http://www.canlii.org/en/ca/scc/doc/2008/2008scc69/2008scc69.html.

Ontario Teachers' Pension Plan, press releases.

CPP Investment Board, press releases.