

# Making Sense of Magna

Edward Iacobucci

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# Making Sense of Magna

## **Abstract**

In 2010, Magna International Inc. (Magna) obtained court approval of an arrangement to buy back its super-voting shares, which placed control in the hands of a shareholder with 0.6 per cent of the equity, at a 1,800 per cent premium to non-voting shares. I agree with the decision to approve but disagree with some of the court's reasons. Magna's board failed to provide a clear description of the possible benefits of the transaction. For example, theory and empirical analysis challenge the board's suggestion that liquidity benefits would help justify the arrangement. The board and the court also failed to describe clearly the beneficiaries of the transaction. A special committee of the board concluded that Magna would benefit from the arrangement but offered no conclusion on whether shareholders would benefit. This is internally inconsistent: Since Magna issued shares as consideration in the arrangement, the only way to determine whether Magna would benefit on net was to determine the arrangement's impact on share value. I analyze these and other errors, identify the possible benefits and beneficiaries of the arrangement, and conclude that while the court could have been more critical of Magna's approach, it was correct to look to shareholder support-both from market signals and from voting-as a justification for approving the arrangement.

## **Keywords**

Magna International Inc.; Stock repurchasing; Corporations--Finance--Law and legislation; Securities; Ontario

## Making Sense of *Magna*

EDWARD IACOBUCCI \*

In 2010, Magna International Inc. (Magna) obtained court approval of an arrangement to buy back its super-voting shares, which placed control in the hands of a shareholder with 0.6 per cent of the equity, at a 1,800 per cent premium to non-voting shares. I agree with the decision to approve but disagree with some of the court's reasons. Magna's board failed to provide a clear description of the possible benefits of the transaction. For example, theory and empirical analysis challenge the board's suggestion that liquidity benefits would help justify the arrangement. The board and the court also failed to describe clearly the beneficiaries of the transaction. A special committee of the board concluded that Magna would benefit from the arrangement but offered no conclusion on whether shareholders would benefit. This is internally inconsistent: Since Magna issued shares as consideration in the arrangement, the only way to determine whether Magna would benefit on net was to determine the arrangement's impact on share value. I analyze these and other errors, identify the possible benefits and beneficiaries of the arrangement, and conclude that while the court could have been more critical of Magna's approach, it was correct to look to shareholder support—both from market signals and from voting—as a justification for approving the arrangement.

Magna International Inc. (Magna) a obtenu en 2010 l'assentiment du tribunal relativement à un mécanisme visant à racheter ses actions à droit de vote multiple, ce qui a eu pour résultat de placer le contrôle entre les mains d'un actionnaire détenant 0,6 pour cent des avoirs, en prime de 1 800 pour cent par rapport aux actions sans droit de vote. Je conviens avec cet assentiment, mais je suis en désaccord avec certaines des raisons invoquées par le tribunal. Le conseil de Magna n'a pas fourni une description claire des avantages éventuels de la transaction. Ainsi, la théorie et l'analyse empirique sont en désaccord avec la suggestion du conseil voulant que des avantages de liquidité permettent de justifier ce rachat. Le conseil et le tribunal ont également omis de décrire clairement les bénéficiaires de la transaction. Un comité spécial du conseil a conclu que Magna bénéficierait du mécanisme, mais n'a offert aucune conclusion quant à savoir si les actionnaires en bénéficieraient. Cela est foncièrement

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\* Osler Chair in Business Law, Faculty of Law, University of Toronto. For helpful conversations and comments, the author wishes to thank Ben Alarie, Anita Anand, Jeremy Fraiberg. He would also like to thank participants in the Magna Roundtable at the Faculty of Law, University of Toronto, in a Faculty Workshop at the Faculty of Law, Queen's University, and in a Law and Economics Workshop at the Faculty of Law, University of British Columbia. Thanks also to Andrew Clark for valuable research assistance and to the James Tory Fund for Studies in Business Law and the Osler Chair in Business Law for financial support.

illogique : étant donné que Magna a émis les actions en contrepartie du mécanisme, la seule façon d'établir si Magna allait tirer un bénéfice net consistait à déterminer l'incidence du mécanisme sur la valeur de l'action. J'analyse ces erreurs et d'autres errements et j'identifie les avantages et les bénéficiaires possibles de ce mécanisme, et je conclus que le tribunal aurait pu se montrer plus critique de l'approche de Magna, mais qu'il a eu raison de considérer le soutien des actionnaires, tant du point de vue des signaux du marché que de celui du vote, afin de justifier son approbation du mécanisme.

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**FRANK STRONACH IS THE FOUNDER** of Magna International Inc. (Magna), a company incorporated under the Ontario *Business Corporations Act*.<sup>1</sup> Magna is an automotive manufacturer based in Ontario with worldwide operations. Since 1978, it has had a dual-class share structure. As of May 2010, it had about 112 million Class A subordinate shares, with one vote per share, and about 727,000 Class B shares, with the same financial rights as Class A shares but with 300 votes per share. While the Class A shares were dispersed across many shareholders and traded on the Toronto and New York Stock Exchanges, Stronach and his family owned all the Class B shares through various trust and corporate vehicles. Thus, Stronach controlled the company while owning 0.6 per cent of the shares.

In an arrangement announced on 6 May 2010 and approved by the Ontario Superior Court of Justice,<sup>2</sup> Stronach agreed to cede control of Magna. There were three elements to the arrangement.<sup>3</sup> First, Magna would buy back and cancel the

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1. RSO 1990, c B-16 [*OBCA*].  
 2. *Re Magna International* (2010), 101 OR (3d) 736 (Sup Ct) [*Magna*, Sup Ct], aff'd (2010), 101 OR (3d) 721 (Div Ct) [*Magna*, Div Ct].  
 3. Many of the facts that follow are drawn from the special committee's "Supplement to Management Information Circular/Proxy Statement" (8 July 2010), online: EDGAR <[http://edgar.brand.edgar-online.com/EFX\\_dll/EDGARpro.dll?FetchFilingHtmlSection1?SectionID=7354489-5268-653906&SessionID=jey3HWRH7jSeiA7](http://edgar.brand.edgar-online.com/EFX_dll/EDGARpro.dll?FetchFilingHtmlSection1?SectionID=7354489-5268-653906&SessionID=jey3HWRH7jSeiA7)> [Supplement].

Class B shares for consideration of \$300 million in cash and 9 million Class A shares issued from the treasury. The total market value of the consideration as of the date of the announcement was \$863 million. Second, Stronach and Magna would renew what was a year-to-year consulting contract for a four-year term expiring 31 December 2014, with consideration falling regularly from 3 to 2 per cent of pre-tax profits by the end of the period. Finally, Magna and Stronach agreed to establish a partnership for Magna's electric vehicle business that Stronach would control despite owning only a 27 per cent minority interest in the venture. Using then-current market values, the premium payable to Stronach for his Class B shares relative to Class A shares was 1,799 per cent.<sup>4</sup>

The proposed arrangement resulted from negotiations between management and Stronach and from the deliberations of a special committee of Magna. The committee proposed a shareholder vote on approving the deal. This is not strictly required by the *OBCA* for an arrangement but has become standard practice. The special committee failed to obtain a fairness opinion on the deal from its financial advisor, CIBC World Markets, nor did the special committee or the board of directors make a recommendation to Class A shareholders to vote in favour of or against the proposed arrangement. Rather, the special committee suggested that shareholders reach their own conclusions on how to vote, in part by observing market reactions to the public announcement of the proposal.

While Class A shares appreciated in value following the announcement, the proposed arrangement nevertheless provoked strong negative reactions from important institutional investors such as the Ontario Teachers' Pension Plan (OTPP) Board and the Canadian Pension Plan Investment Board (CPPIB). There were complaints about disclosures and the process associated with the meeting. The staff of the Ontario Securities Commission (OSC) argued that the arrangement

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4. This premium, calculated by the special committee, was predictably conservative given that the value of Class A shares (if the deal made sense) would increase following the arrangement. If the special committee was correct that the observed roughly 10 per cent appreciation in value of the Class A shares following the announcement was attributable to the arrangement, then the consideration was worth around \$920 million, implying that the premium was over 1,900 per cent. In addition, the arrangement contemplated an investment by Magna and Stronach in an electric car venture, which gave Stronach control despite a minority investment. This, too, could have provided extra value to Stronach. See Jeffrey MacIntosh, "Some Reflections on Magna and Dual Class Share Structures" (2011) [unpublished], online: <<http://www.rotman.utoronto.ca/userfiles/cmi/file/jeff%20macintosh%20paper.docx>>. Given the large scale of the premium no matter how one looks at it, however, I will continue to refer to the more conservative 1,799 per cent premium calculated by the special committee. Another way of understanding the cost of this deal is that there was a dilution for the Class A shareholders of 11.4 per cent.

was contrary to the public interest. The OSC Panel hearing the matter agreed only in part and ordered greater disclosure prior to the shareholder vote.<sup>5</sup> The special committee of Magna complied with these orders and postponed the shareholder meeting by a month in order to do so.

Despite the concerns expressed by investors like the OTPP and CPPIB, shareholders voted overwhelmingly in favour of the arrangement at a 28 July 2010 meeting. Stronach voted all the Class B shares in favour of the deal. Of the 80.4 per cent of the minority Class A shares that were voted at the special meeting, 75.3 per cent voted to approve the transaction.

The OSC litigation and vote did not end the legal controversies. A court must approve an arrangement as being “fair and reasonable.”<sup>6</sup> A number of institutional investors intervened before the Superior Court to argue that the plan was not fair and reasonable and thus not worthy of court approval.

There were different aspects to the opposing investors’ argument. Opposing investors objected to the process, noting in particular that there was no fairness opinion and that the special committee did not recommend that the Class A shareholders approve the transaction. The latter objection was based on the proposition that the directors’ fiduciary duties did not allow them to abdicate responsibility for evaluating the transaction. The opposing shareholders also argued that the transaction was not fair or reasonable in substance. The argument here was that the consideration to Stronach was excessive, based in part on a report from Morgan Stanley opining that the transaction was not financially reasonable.<sup>7</sup> Despite these objections, the Superior Court concluded that the transaction was fair and reasonable and approved the arrangement.

Many aspects of this transaction are fascinating. In this paper, I set aside entirely debates about the consistency of the transaction with the “public interest” under securities law<sup>8</sup> and focus instead on a subset of the issues that were before the Superior Court when it decided the matter under the *OBCA*. I initially focus on a question that is of fundamental importance in the analysis, yet inadequately answered by either Magna or the court: What were the benefits of the transaction? For example, Justice Wilton-Siegel of the Superior Court relied significantly on

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5. See Ontario Securities Commission, “In the Matter of *The Securities Act*, RSO 1990, c S-5, as Amended and In the Matter of Magna International Inc and In the Matter of the Stronach Trust and 446 Holdings Inc” Decision and Order (24 June 2010), online: OSC <[http://www.osc.gov.on.ca/documents/en/Proceedings-RAD/rad\\_20100624\\_magna.pdf](http://www.osc.gov.on.ca/documents/en/Proceedings-RAD/rad_20100624_magna.pdf)>.

6. *BCE Inc v 1976 Debentureholders*, [2008] 3 SCR 560 at para 46 [*BCE*].

7. See *Magna*, Sup Ct, *supra* note 2 at para 89.

8. For discussion of securities law and the public interest, see Anita Anand, “Was *Magna* in the Public Interest?” in this volume at 311.

a list of possible benefits highlighted by the special committee, but examination reveals that none of the benefits in the list is persuasive. The most plausible reason why the arrangement had the potential to bring net benefits is that it would reduce agency costs: There is a significant danger that a controlling shareholder with 0.6 per cent of the shares would succumb to strong incentives to realize value for itself at the possible expense of shareholders as a group.<sup>9</sup> In Part I, I discuss the possible reasons why the transaction might have added value.

On a related point developed in Part II, there is confusion in this case on another fundamental question: Who benefits from the transaction? The court's opinion pays some attention to this matter, but the discussion is at times puzzling. In particular, the decision draws a distinction between the interests of the Class A shareholders on the one hand and Magna on the other. The attempt to draw this distinction may be invited by recent Supreme Court jurisprudence—*Peoples Department Stores Inc (Trustee of) v Wise*<sup>10</sup> and *BCE Inc v 1976 Debentureholders*<sup>11</sup> in particular—but the court's invocation of this distinction may have led it to overlook key elements of value in the present context.<sup>12</sup>

Parts I and II establish my agreement with the opposing shareholders that the behaviour of the board in this case was not exemplary. In Part III, I note another shortcoming of the board's conduct that was not raised in the court's opinion. The decision of the board to refer to market reactions to guide the Class A shareholders and the court's acceptance of this deference are ultimately acceptable but troubling, for reasons that I discuss in Part III.

In Part III I conclude that, despite concerns over process and the lack of a convincing discussion about the benefits or the beneficiaries of this transaction, the decision of the Superior Court to approve the transaction under the *OBCA* was the right one. The Superior Court placed significant emphasis on the shareholder vote approving the proposed arrangement. In my view, this was entirely appropriate. While the case continues in the worrisome direction of Canadian corporate law since *Peoples* and *BCE*, in the end, *Magna* was able to achieve the correct result despite resting on some shaky foundations.

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9. As I discuss in Part I, the Supplement, *supra* note 3, refers to potential gains from greater alignment of shareholder interests at points, but it does not include this benefit in its highlighted list of potential benefits of the transaction that the court considered.

10. [2004] 3 SCR 461 [*Peoples*].

11. *BCE*, *supra* note 6.

12. For a critique of the recent Supreme Court cases, see *e.g.* Edward M Iacobucci, "Indeterminacy and the Canadian Supreme Court's Approach to Corporate Fiduciary Duties" (2009) 48 Can Bus LJ 232 [Iacobucci, "Indeterminacy"].

## I. WHAT WERE THE BENEFITS OF THE PROPOSED ARRANGEMENT?

The effect of the arrangement was that Stronach would sell his super-voting shares to Magna in exchange for a much larger number of common shares and cash. This would collapse the dual-class share structure into a single class of shares. While I discuss in the next section who in particular might benefit from the alteration of a dual-class into a single-class structure, here I ask a more fundamental question: Why would it be beneficial to collapse the share classes in this manner? Stronach received handsome consideration for selling his control stake, acquiring a 1,800 per cent premium for his super-voting shares relative to the market price of subordinated voting shares. If this transaction was to be anything other than a naked transfer of wealth to Stronach, it must have been that eliminating the super-voting shares would create value. How would spreading voting power more evenly among shareholders result in an increase in value?

The special committee that proposed the arrangement offered a number of possible benefits that might arise from the restructuring. Justice Wilton-Siegel focused on the following considerations, reproducing a highlighted list of potential benefits that the special committee provided to shareholders in the Supplement:

- the trading price of the Class A Shares may increase relative to the pre-announcement trading price to the extent that the trading price reflected a discount attributable to the dual class share structure;
- the opportunity to receive and consider a change of control transaction and any change of control premium associated therewith on a pro rata basis in connection with a take-over bid;
- all shareholders will have a vote in proportion to their relative equity stake in Magna, consistent with the capital structure of many of its competitors;
- certain investors who choose not to invest, or whose investment policies prevent them from investing, in shares of corporations with dual class share structures may now consider purchasing Class A Shares, thereby potentially enhancing liquidity; and
- the Class A Shares may be more attractive for purpose of raising capital or as acquisition currency in the future.<sup>13</sup>

Justice Wilton-Siegel placed some reliance on these purported benefits in concluding that the arrangement had a “valid business purpose” under the *OBCA*

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13. *Magna*, Sup Ct, *supra* note 2 at para 43.



section 132 approval process, noting that “[t]he Opposing Shareholders . . . do not challenge the proposition that the elimination of the dual-class capital structure would benefit Magna in the manner described by the Special Committee.”<sup>14</sup> Despite the role that the proffered reasons played in the case, however, there is little substance to them.

#### A. CIRCULAR REASONING

Some of the purported benefits of the collapse of the dual-class share structure offered by the special committee and accepted by Justice Wilton-Siegel boil down to circular claims that the restructuring will be beneficial because the restructuring will be beneficial. For example, one potential benefit offered by the special committee is that the trading price of Class A shares may increase because of a discount attributable to the dual-class share structure. But why is there a discount attributable to the dual-class structure? An increase in the price of Class A shares only arises if there is a gain in expected value resulting from the purchase and cancellation of the Class B shares; that is, it is a symptom of the value-creation implied by the dual-class recapitalization, but it does not offer any insight into why such value-creation might be expected. Even if it is empirically true, as CIBC had advised the committee, that the elimination of dual-class shares has historically resulted in an appreciation of subordinated voting shares in other companies, without understanding why such appreciation takes place, it is difficult to predict or quantify sensibly the impact on the Class A shares in the present case.

Another potential benefit that the special committee offered and the court accepted is that the Class A shares will be more attractive as acquisition currency or for raising capital in the future. There are two problems with this claim. First, it is repetitive. For example, to say that Class A shares will be more attractive for raising capital is to restate that the shares will appreciate in value, as in the claim noted earlier. Second, as also noted above, stating that the Class A shares will appreciate in value does not describe a benefit that explains why the Class A shares will appreciate in value.

Another conclusory benefit advanced by the special committee is that shareholders post-arrangement will have votes in proportion to their equity stake, which is consistent with the capital structure of many of Magna’s competitors. But why is there a benefit to having a capital structure that is consistent with Magna’s competitors? If a dual-class share structure is optimal for Magna, why does it matter what its competitors do?<sup>15</sup> The response presumably is that the dual-class

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14. *Ibid* at para 120.

15. There is no single optimal capital structure. See *e.g.* Edward Iacobucci & George Triantis, “Economic and Legal Boundaries of Firms” (2007) 93 Va L Rev 515.

structure reduces value, and a consequential higher cost of capital disadvantages Magna. But this answer does not explain why a dual-class structure destroys value in the present context and thus fails to say anything interesting or informative about the benefits to Magna itself or to its position vis-à-vis its competitors.

## B. LIQUIDITY

While the three aforementioned benefits all reduce to an assertion that the recapitalization will increase value without offering reasons for that increase, the special committee outlined two other potential benefits that avoid this shortcoming. They are nevertheless unpersuasive on their own terms.

First, the special committee suggested that a potential benefit of the arrangement was that certain investors who choose not to invest in companies with dual-class shares may subsequently consider purchasing Class A shares, thereby potentially enhancing liquidity. This suggestion fails to explain why certain shareholders have a categorical aversion to dual-class shares. If there is a rational basis for this aversion, then the benefits of eliminating the dual-class structure presumably flow from this basis and not from enhanced liquidity. Moreover, it is not plausible to predict that liquidity will be meaningfully affected by the addition of investors in Magna that have a policy against dual-class shares.

To elaborate on this last point, CIBC reported to the special committee that, in some past cases, analysts expected improved liquidity from the elimination of dual-class structures. CIBC's empirical analysis was not particularly rigorous. It examined the trading volume of fourteen stocks before and after the announcement of the elimination of a dual-class share structure and noted that, on average, the daily volume increased after the announcement. From these data, CIBC apparently inferred that Magna may benefit from improved liquidity post-arrangement.

There are a number of flaws in the analysis. First, measuring liquidity by counting the number of shares traded is extremely crude. For one, counting trades does not measure the dollar value of trades. Compare two companies, Company A and Company B, of equivalent market capitalization of \$1 million. The companies are identical in every way but one: Company A has 1 million shares worth \$1 each, while Company B has 500,000 shares worth \$2 each. There is no reason at all to conclude that if 100,000 shares a day trade hands in the \$1 stock, Company A is more liquid than Company B if its stock trades 50,000 times a day. The stocks are identical in terms of value traded.

But even if one accepts that there might be some relationship between volume and liquidity, this is at best a highly indirect and imprecise measure. The concept

of liquidity captures the cost of buying and selling a good. When markets are thick (that is, where there are many buyers and many sellers), the costs of buying and selling the good will be small. Publicly traded stocks are generally very liquid assets, but there is variance in liquidity across stocks: Some stocks have more potential buyers and sellers than others. Rather than examining volume—which might have some correlation with the costs of buying and selling—stock markets provide a direct indicator of liquidity: the bid-ask spread.<sup>16</sup> The bid-ask spread is the difference between the price at which someone in the market is willing to buy the stock immediately and the price at which someone is willing to sell the stock immediately. It indicates the cost of buying and selling in the market: If one were to buy and sell a stock that otherwise had not changed value, one would have incurred a loss on the bid-ask spread.

Various studies of dual class collapses into a single class have found an improvement in liquidity following such restructurings.<sup>17</sup> These studies typically examine bid-ask spreads and other economic indicators of the costs of buying and selling, not daily volume traded. In a recent working paper, Ben Amoako-Adu, Brian Smith, and Vishaal Baulkaran examined the effect of thirty-two dual class restructurings on a stock's relative bid-ask spread (*i.e.*, the spread over the stock's value) and the ratio of absolute daily return to daily dollar volume (the Amihud illiquidity measure<sup>18</sup>).<sup>19</sup> They found that there is a statistically significant improvement in liquidity as given by these measures following such restructurings. They did not ask whether daily volume alone was affected.

In contrast to Amoako-Adu, Smith, and Baulkaran, in its study of past recapitalizations, CIBC examined a very crude measure—volume of shares

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16. See *e.g.* Yakov Amihud & Haim Mendelson, "Asset Pricing and the Bid-Ask Spread" (1986) 17 J Fin Econ 223.

17. For a helpful survey of this literature, see Anete Pajuste, "Determinants and Consequences of the Unification of Dual-Class Shares" (2005) European Central Bank Working Papers No 465, online: European Central Bank <<http://www.ecb.int/pub/pdf/scpwps/ecbwp465.pdf>>. The closest published examination of the issue in the Canadian literature is Ben Amoako-Adu & Brian Smith, "Dual Class Firms: Capitalization, Ownership Structure and Recapitalization Back into Single Class" (2001) 25 J Banking & Fin 1083. Amoako-Adu and Smith find that corporations frequently invoke improved liquidity as a motivation for seeking to collapse a dual-class structure.

18. See Yakov Amihud, "Illiquidity and Stock Returns: Cross-section and time-series effects" (2002) 5 J of Fin Markets 31.

19. "Unification Of Dual Class Shares In Canada With Clinical Case On Magna International" (Paper delivered at the Capital Markets Institute Conference on Dual Class Shares, Rotman School of Management, University of Toronto, 15 February 2011), [unpublished].

traded—while ignoring a very useful measure of liquidity—the bid-ask spread. It noted that the daily volume in the sample of all fourteen restructurings increased by an average of 52 per cent in the one-year period after the deal compared to the year before the deal, while the exclusion of one outlier still resulted in an average increase in volume of 26 per cent.

Using bid-ask spreads from the Canadian Financial Markets Research Centre (CFMRC) database, I examined the change in the bid-ask spread for 150 trading days before and after the announcements of the fourteen restructurings identified in the CIBC study.<sup>20</sup> There was a change in the relative bid-ask spread, as measured by the bid-ask spread over the mid-quote, but this change was much more modest than the change in volume. The entire sample experienced a drop in the relative bid-ask spread of 10.9 per cent, from 1.58 to 1.41 per cent, while the sample excluding an outlier experienced a drop of 7.6 per cent, from 1.46 to 1.34 per cent. These are statistically significant at the 1 per cent level of confidence but are much less economically significant than indicated by the simple measures of changing volume.<sup>21</sup>

Even accepting that in past share conversions there was some improvement in liquidity related to the conversions, there is another significant weakness in CIBC's liquidity analysis. When volume was used as a measure of liquidity, Magna's volume pre-conversion was well above the pre-conversion volume of every firm but one in the sample. Magna's average daily volume in the year leading up to the conversion was 1,076,000 shares, while the average in the sample was 281,000 shares and the median was 144,000 shares. Only one company in the sample, Laidlaw, which had a daily volume of 1,269,000 shares pre-conversion, had a daily volume greater than 500,000 shares. It is not reasonable to expect companies with such small volumes to experience changes that are helpful in predicting the impact of the conversion on Magna.

This is also true when examining the more meaningful measure of liquidity—bid-ask spread. Pre-conversion bid-ask spreads in the sample were much higher than Magna's. While the average bid-ask spread for the sample was 1.58 per cent of share value in the 150 days before the announcement, and the median was 1.33

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20. More specifically, I examined closing bid and ask quotes for the 150 trading days preceding the announcement and the announcement day plus the 150 trading days after the announcement. The CFMRC TSX database was missing data for one stock, Sceptre, on one of the 150 days preceding the announcement date.
21. To reach this conclusion, I regressed the relative bid-ask spread of all firms in the sample over the 150 day windows pre- and post-announcements on a dummy variable equal to zero, if the date was before the announcement date, or one, if the date was the announcement date or later. The coefficient on the dummy, which indicates the difference in means before and after the announcement, was statistically significant (P-value of 0.000137).

per cent, Magna's bid-ask spread was only 0.22 per cent of share value over the analogous period. Not a single firm in the sample had a relative pre-conversion bid-ask spread that was below Magna's. Again, there is little reason to conclude that changes in the bid-ask spread associated with these very different companies will be instructive in predicting Magna's change in liquidity following the conversion.

While patterns are difficult to discern statistically with a sample size of fourteen, some empirical results appear to support this reasoning. For example, I regressed the absolute percentage change in the relative bid-ask spread following the conversion on the relative bid-ask spread pre-conversion. There was a positive relationship between the proportionate impact of the conversion on the relative bid-ask spread and the absolute size of the relative pre-conversion bid-ask spread, and this relationship is significant at the 10 per cent level. This suggests that the more illiquid the stock is initially, the more likely the transaction will affect liquidity. Given Magna's initial liquidity, this was another reason to doubt CIBC's liquidity analysis.

In summary, CIBC's analysis of liquidity is unconvincing. It is true that CIBC and the special committee identified liquidity only as a possible benefit of the deal, not as a certain one, but the analysis that accompanies this conclusion paints an excessively optimistic picture.

These criticisms of CIBC's analysis appear to be supported by subsequent experience. The bid-ask spread for Magna was, as noted above, 0.22 per cent of share value in the 150 days before the announcement, but there was an increase to 0.29 per cent in the 150 days after the announcement, which was statistically significant at the 5 per cent level.<sup>22</sup> This experience supports the conclusion that, at the time it was given, CIBC's advice that liquidity might improve lacked a strong foundation.

### C. FUTURE CONTROL TRANSACTIONS

The final purported benefit from the highlighted list provided by the special committee and accepted by the court as a justification for the transaction was that Class A shareholders would now assure themselves of full participation in any

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22. This difference exists on many alternative windows before and after both the announcement and the closing dates, such as a 120 day window, as well 2010 preceding either date compared to 2010 experience after either day. Curiously, using a combination of the CFMRC TSX database for 2009 data and Thomson Datastream for 2010 data, Amoako-Adu & Smith, *supra* note 17, find a reduction in liquidity for Magna in the 120 days before and after the announcement date. I thank the authors for their helpful discussion of this issue.

future control transaction. The Ontario *Securities Act*<sup>23</sup> has a rule of equal treatment in takeovers for shares within the same class: If a takeover bid is made, the bid must be extended on equal terms to all shareholders within the class, and shares must be taken up on a pro rata basis.<sup>24</sup> But the *OSA* does not require equal treatment across share classes in a takeover bid.<sup>25</sup> The Toronto Stock Exchange requires corporations listed after 1987 to have “coattail” provisions that extend the equal treatment rule across classes.<sup>26</sup> Magna was listed before 1987. It was not required to have equal treatment of the Class A shares in the event of a sale of control involving the Class B shares and had not adopted a coattail. The cancellation of Class B shares and their conversion into Class A shares implies that any acquirer of control must bid for Class A shares, and all shareholders will be treated identically as a consequence.

To understand whether future equal treatment in takeovers should be considered a potential benefit of the transaction, it is necessary initially to define precisely what should be considered a “benefit.” In my view, the only meaningful understanding of what constitutes a benefit in this context is reason to predict that the transaction will create value. The special committee and the court were engaged in an analysis of whether the transaction was a good one to pursue. Unless the transaction creates value, there is no reason to pursue it. A right to participate in a change of control transaction, conditional on the transaction taking place,<sup>27</sup> is valuable; the shareholder has an option to cash out that he or she would not otherwise have. But this is not to say that value is created as a consequence of the conferral of the right. If committing to equal treatment simply transfers resources from the erstwhile controlling shareholder to minority shareholders, the controlling shareholder would require compensation for this transfer. There is no affirmative reason to pursue equal treatment in such a case.<sup>28</sup>

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23. RSO 1990, c S-5 [*OSA*].

24. See *ibid*, s 7. For a discussion of the equal treatment rule in Ontario, see Edward M Iacobucci, “Why Does Ontario Require Equal Treatment in Sales of Corporate Control?” (2008) 58 UTLJ 123 [Iacobucci, “Why Does Ontario”].

25. Section 97 of the *OSA*, *supra* note 23 refers only to equal treatment of shareholders within a class.

26. See Toronto Stock Exchange Venture Exchange, “Policy 3.5: Restricted Shares” (as at 14 June 2010), online: TMX <<http://www.tmx.com/en/pdf/Policy3-5.pdf>>.

27. The equal treatment rule affects the probability of the transaction taking place. See Iacobucci, “Why Does Ontario,” *supra* note 24; Lucian Arye Bebchuk, “Efficient and Inefficient Sales of Corporate Control” (1994) 109 Qrtly J of Econ 957 [Bebchuk, “Efficient and Inefficient Sales”].

28. This assumes that Stronach and minority shareholders have a similar view of the likely probability and value of a future change in control transaction.

In the present case, suppose that the conversion does not affect the bargaining power of Magna vis-à-vis a potential acquirer. If this is so, the acquirer will pay the same price for a control block before and after the equal treatment rule applied, but in the latter case the consideration will be spread across all shareholders, not just Stronach. This is not a net benefit to the minority since Stronach would want compensation for losing the right to enjoy personally any takeover premium that would in expected terms equal the benefits that the minority would receive in a future control transaction. The equal treatment rule does not create value if bargaining is unaffected.

The only way that the conversion creates value is if the equal treatment rule allows Magna shareholders as a group to extract greater consideration out of a future buyer than without the rule in place.<sup>29</sup> This may or may not be the case. To explain, there are two sources of value to a controlling shareholder from his or her control block.<sup>30</sup> First, the controlling shareholder realizes his or her pro rata share of the cash flows generated by the business; call this a share of the “public value” of the corporation. Second, the controlling shareholder realizes “private benefits of control” that accrue only to the controlling shareholder. These private benefits may arise at the explicit expense of minority shareholders. For example, the controlling shareholder may also be an executive and use control of the board to pay himself or herself excessively; this is a private benefit of control. Or the controlling shareholder may use his or her control to cause the corporation to invest in enterprises that bring value to the shareholder but not to the corporation as a whole, perhaps because of the personal enjoyment of being involved in a certain business. Alternatively, private benefits could arise independently of the minority shareholders. A controlling shareholder may simply derive utility from continuing to control a family business, for example.

Consider the case where a controlling shareholder derives  $Bi$  in private benefits and  $sVi$  in public value, where  $s$  is her percentage shareholding and  $Vi$  is the public value of the corporation. In the absence of a rule of equal treatment, she would be willing to sell her control block to a buyer of control that could generate value greater than  $Bi+sVi$ , say  $Bii+sVii$ . Buyer and seller of control would bargain, and some price between the new and old value would be mutually agreeable.

Now suppose that there is no controlling shareholder, but the total value of the corporation is the same:  $Bi+Vi$ . The only difference is that those in charge (and thus realizing private benefits) no longer have a veto on a control transaction.

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29. See Iacobucci, “Why Does Ontario,” *supra* note 24.

30. See e.g. Bebchuk, “Efficient and Inefficient Sales,” *supra* note 27; Milton Harris & Artur Raviv, “Corporate Governance: Voting Rights and Majority Rules” (1988) 20 *J of Fin Econ* 203.

It is straightforward to point to cases where existing shareholders as a group are better off vis-à-vis the acquirer post-conversion—that is, where the creation of equal treatment benefits existing shareholders—and to cases where this is clearly not true.

To see how shareholders may be better off as a group, that is, how creating the equal treatment rule changes bargaining such that more value is extracted from the acquirer, consider an acquirer that will generate value greater than that under the incumbent management, but all the value will be from public value. That is,  $V_{ii} > B_i + V_i$ , while  $B_{ii} = 0$ . Suppose further that  $sV_{ii} > B_i + sV_i$  such that the control block is worth more to the acquirer than the incumbent.<sup>31</sup> Pre-conversion, the buyer could bargain with the controlling shareholder, and some price for the control block between  $sV_{ii}$  and  $B_i + sV_i$  could be struck. Post-conversion, on the other hand, no single shareholder determines whether the control transaction is successful. As a consequence, unless the acquirer offers the full value of the company under new management, shareholders have an incentive not to tender into the bid. Shareholders may attempt to free ride on other shareholders' willingness to accept less than the post-transaction share value in order to ensure that the sale of control takes place.<sup>32</sup> Thus, to get the deal done, the buyer may need to offer its maximum price,  $SV_{ii}$ , for some fraction  $S$  that gives it control. In these circumstances, the equal treatment rule could add value to existing shareholders collectively by extracting more from acquirers.<sup>33</sup>

On the other hand, it is also possible that the conversion will lead to lower value from a future acquisition. Suppose now that some buyer will realize value exclusively in the form of private benefits of control; public value will drop to zero post-transaction. That is,  $B_{ii} > 0$  and  $V_{ii} = 0$ . Pre-conversion, there is a potential deal between the controlling shareholder and such an acquirer if  $B_{ii} > B_i + sV_i$ . Post-conversion, it is conceivable that shareholders would tender into a bid at even a nominal price. There is a collective action problem for shareholders.<sup>34</sup> If shareholders tender and the bid for a fraction of  $S$  shares is unsuccessful, shareholders get their shares back. If, however, the bid is successful, only shares that are tendered will be taken up. The rest will become minority shares with a value,

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31. Where private benefits of control initially are high, as in the present case, this may not be plausible as an empirical matter.
  32. See Sanford J Grossman and Oliver D Hart, "Takeover Bids, the Free-Rider Problem and the Theory of the Corporation" (1980) 11 *Bell J of Econ* 42.
  33. Of course, such a rule could also deter offers for control, which would cut against value for existing shareholders.
  34. See *e.g.* Lucian Arye Bebchuk, "Toward Undistorted Choice and Equal Treatment in Corporate Takeovers" (1988) 98 *Harv L Rev* 1693; Lucian Arye Bebchuk, "The Sole Owner Standard for Takeover Policy" (1998) 17 *J Legal Stud* 197.



on current assumptions, of zero. Therefore, it is better (a “weakly dominant strategy” in game theory terms) to tender into any offer greater than zero. In these circumstances, the value on offer from an acquirer could be dramatically lower than where there is a controlling shareholder; the controlling shareholder does not suffer from this collective action problem since its decision to sell control is pivotal. The arrangement to collapse the dual-class structure reduces value for existing shareholders collectively.

Exactly which one of these opposing effects dominates is an empirical question. It is possible, however, that gaining the right to participate in future control transactions comes at a net cost to Class A shareholders. It is clear that simply becoming eligible to receive some share of the consideration in a change of control transaction is not an unambiguous benefit. First, if the arrangement does not affect future bargaining, the minority would simply pay for the right to receive the premium in the future in a zero-sum way. Second, if, as is more likely, the arrangement does affect bargaining, it is not clear whether the corporation will extract more or less value from an acquirer. Should it be less value, the transaction reduces value for the firm, all things being equal.

#### **D. IMPROVED CORPORATE GOVERNANCE**

We have seen that the purported benefits of the proposed transaction highlighted by the committee and relied upon by the court are of dubious significance. It is safe to say that none of the offered reasons could explain how Class A shareholders could benefit from a transaction that pays Stronach such a remarkable premium for his shares. But there is another benefit that could justify the deal. In its summary of the benefits of the transaction that the court relied upon, the special committee of Magna did not clearly identify the elephant in the room. Under the status quo, Stronach controlled Magna while holding only 0.6 per cent of the stock. While perhaps creating benefits by, for example, insulating management from ill-conceived shareholder pressure, such a structure also creates a conflict of interest. Stronach could use his influence on the corporation to benefit himself, whether or not these benefits are shared generally by investors. For every dollar that Magna spent on actions that benefited Stronach personally, Stronach was out-of-pocket 0.6 cents. This creates very strong incentives to take self-interested actions at the expense of minority shareholders.

It is not difficult to identify conduct on the part of Magna over the years that could be explained by Stronach’s self-interest rather than the interests of Magna as a whole. Magna is an automotive manufacturing business. It is not an obvious move for an automotive manufacturing business to invest in horse race tracks.

Yet this is precisely what Magna did, investing in what has now become Magna Entertainment Corp. The business was not prosperous and was eventually spun off from Magna International, later becoming bankrupt. Why did an automotive parts manufacturer invest in racetracks? Stronach, in part reflecting the wealth he derived from his success at Magna, had become interested in thoroughbred horse racing. It is plausible that he would derive personal enjoyment from an investment in horse racing that would be independent of the financial returns from such a business. While one, of course, cannot be certain that the investment was simply a manifestation of the private benefits of control for Stronach (perhaps there are non-obvious synergies between horse racing and automotive manufacturing), at the very least it is consistent with Stronach's self-interest and a willingness to exploit his control position for the investment to have taken place.

Another possible manifestation of the private benefits that Stronach realized at the expense of the minority involved consulting contracts that he entered into with Magna. These contracts were worth potentially tens of millions of dollars, with 3 per cent of pre-tax profit payable to Stronach in exchange for his agreement to provide consulting services to Magna. Again, it is not clear that this arrangement reflected a diversion of assets from Magna minority shareholders to Stronach—Stronach's advice could have been worth it—but such a transfer would be consistent with the incentives that the ownership structure created. Stronach himself in effect paid only 0.6 cents for every dollar Magna paid under these contracts. Thus, even if Stronach provided zero value in his consulting services, or even if he provided significantly negative value, Stronach himself was better off with these contracts in place. The combination of these incentives with Stronach's control of the board of directors that approved these consulting deals creates at least the possibility that these contracts simply reflected Stronach's self-interest.

The proposed conversion of Stronach's shares from Class B to Class A shares would dramatically affect Stronach's ability and incentives to realize private benefits.<sup>35</sup> Stronach would no longer be the only person responsible for appointing the board, which presumably undermines his influence over them. Indeed, under the proposed arrangement, Stronach agreed to step down from the nominating committee of the board. That this was a term of the arrangement suggests its significance.<sup>36</sup> Moreover, Stronach's incentives to realize value at the expense of shareholders as a class would be at least attenuated given that he would end up with a greater percentage of equity post-arrangement.

As in the discussion of participation in a change of control transaction, to

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35. See *e.g.* Harris & Raviv, *supra* note 30.

36. Moreover, Stronach subsequently announced his resignation as chair of the board.

determine the benefits of the arrangement, it is necessary to appreciate whether the diminution of Stronach's influence and skewed incentives had the potential to create value, not just re-allocate it. If, for example, before the conversion Stronach would expect to divert \$100 million to himself from Magna without destroying value, then nothing is gained from the transaction: Stronach would require \$100 million in compensation for giving up the power to divert. It is plausible, however, that any manifestation of a conflict of interest would have destroyed value. His consulting influence, for example, could have reduced, not created, value.<sup>37</sup> His influence over decisions about which business opportunities to pursue, for example horse racetracks, might also have led Magna to make decisions that were bad for the bottom line but good for Stronach personally. While an observer cannot be certain, it would be unsurprising if a controlling shareholder holding 0.6 per cent of the shares would make decisions that reduce overall value. If this is so, then the transaction to buy out Stronach predictably creates value; changing the governance structure could be a true benefit of the proposed conversion. Every party to the transaction can be made better off.

In my view, the change in the governance structure is the most plausible reason why the proposed arrangement would create value. However, the special committee downplayed this possibility in its circular. As noted, the highlighted list of benefits in the Supplement did not clearly identify the change in corporate governance as a benefit. Elsewhere in the Supplement, the special committee alluded to the benefits of aligning the interests of all investors by collapsing the dual-class structure. The committee chose its words carefully, stating that the transaction could address "the concern expressed by some holders of Class A Subordinate Voting Shares as to the alignment of interests of all shareholders."<sup>38</sup> That is, even when it engaged with the possibility that aligning the interests of shareholders could be a benefit, it did not itself embrace the justification for the transaction, but rather ascribed the concern for this issue to "some holders" of Class A shares.<sup>39</sup>

Why was the committee so reluctant to espouse a theoretically plausible benefit of the deal?<sup>40</sup> It is, of course, possible that the special committee simply did not

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37. There is evidence that when founders of public companies who remain in control unexpectedly die, share prices go up. See Bruce Johnson et al, "An Analysis of the Stock Price Reaction to Sudden Executive Deaths: Implications for the Managerial Labor Market" (1985) *J of Accounting and Econ* 151.

38. Supplement, *supra* note 3 at 2, 7.

39. *Ibid.*

40. It has been suggested to me by a referee and others that since the market was well aware of the potential for value-destruction associated with the dual-class structure in this case,

believe that changing the ownership structure would create value because of the elimination of a conflict of interest. But even if they did hold such a belief, it would have been difficult for the directors to emphasize such a reason for the arrangement. Any reference to the benefits of improving corporate governance by reducing the means and incentives for Stronach to pursue private benefits at the expense of overall value would potentially have implicated the directors themselves, who were ultimately responsible for Magna's strategic choices.

Moreover, even if the committee believed that removing Stronach as a controlling shareholder would eliminate a value-destroying conflict of interest, it is conceivable that when considering eventual judicial approval of the arrangement, the special committee was concerned that it would not appear proper for Stronach to be paid off handsomely possibly in compensation for losing private benefits of control. This concern about the appearance of impropriety may have been valid as a matter of litigation strategy, but should not be influential in any objective assessment of the transaction's fairness. The law cannot entirely prevent controlling shareholders from making decisions that benefit themselves, even at the possible expense of the minority. For example, judges are not business people and would not be in a good position to judge investments like the one Magna made in the horse business.<sup>41</sup> Such potentially self-interested investments defy regulation.

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spelling this out in the circular was unnecessary. I have little doubt that the market generally was aware of the potential governance benefits of changing the structure. But this is not the criterion for evaluating whether the disclosures themselves are satisfactory under Ontario securities or corporate law, which is the purpose of the present analysis. Mandatory disclosure laws seek to ensure that the corporation provides certain information to shareholders whether or not this information is novel. Given that the purpose of this aspect of the circular was to provide shareholders with reasons why the special committee saw potential gains from the transaction, it is in my view appropriate to judge it according to its success on this dimension, not on whether investors were fooled by any inadequacies. The harm, or lack thereof, of the inadequacies in disclosure on shareholders is relevant to the assessment of whether the arrangement was fair and reasonable in light of the supportive shareholder vote; I consider this in Part III.

41. This conclusion is illustrated by another case connected to Stronach. See *Greenlight Capital Inc v Stronach* (2006), 22 BLR (4th) 11 (Ont Sup Ct J). In this case, a hedge fund, Greenlight Capital, launched oppression remedy proceedings involving MI Developments, Inc., which was controlled by Stronach. MI Developments had increased its investments in real estate properties, including a number of race track investments, that were connected with Magna Entertainment Corp., a company in which MI Developments owned a block of shares. In essence, Greenlight alleged that Stronach was using MI Developments to further Stronach's personal agenda for the properties contrary to the reasonable expectations of investors. Given that Stronach followed proper procedures, including appointing a special committee to review the transactions, the court concluded that there was no oppression. The court, rightly in my view, displayed appropriate judicial restraint in evaluating business decisions,

The law can be tougher on straightforward self-dealing transactions, but it will never be perfect, even in these cases. The law in this context relies heavily on disinterested directors to evaluate the merits of a self-dealing transaction for the corporation and to vote on it accordingly. There is a significant danger that weak directors will capitulate to a controller even where a deal is clearly bad for the corporation. Again, since judges are not business people, they must be cautious in reviewing disinterested directors' decisions. The reality is that there will be scope for controlling shareholders to realize disproportionate value for themselves, and the law cannot prevent this. Since such private benefits are inevitable, there ought to be no difficulty for the law to accept that the need to change governance so as to minimize conflicts of interest is a legitimate reason for an arrangement.<sup>42</sup>

Even if the special committee anticipated that the court would accept this general approach, there might still have been residual concern that the scale of the private benefits that Stronach must have realized for the transaction to make sense for Class A shareholders would be difficult for a court to accept. Setting aside the consulting contract and the electric car deal, Stronach was given consideration of \$863 million for Class B shares with cash flow rights that were equivalent to Class A shares that were worth around \$50 million. The special committee concluded that Stronach would not have accepted lower consideration than he was offered in the arrangement. If this were true, this would imply that Stronach, before the transaction, realized private benefits with a present value of around \$800 million. Even accepting that some of these private benefits may not come at the expense of the minority or overall value, this is a staggering figure. The special committee may have been wary of drawing attention to it.

The apparent scale of the private benefits in the present case is not an objective reason to reject the proposed arrangement. If the governance structure not only creates private benefits for Stronach but also destroys value, then everybody

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but the case illustrates the difficulties confronting the law in constraining self-interested actions by a controlling shareholder. If independent directors tend to comply with the controlling shareholder's wishes, rightly or wrongly, and proper procedures are otherwise followed, there is little that a court can (or should) do.

42. MacIntosh suggests that allowing the minority to pay a significant premium to the controlling shareholder in exchange for relinquishing control will encourage controllers to engage in self-interested behaviour, anticipating that they will be able to cash out by selling control in the future. See MacIntosh, *supra* note 4. But if a controller can realize private benefits, it is far from clear that an inability to sell control at a premium will deter the controller from realizing these benefits. The sale at a premium simply reflects the anticipated stream of private benefits that the controller is giving up by selling control; that is, if the sale does not take place, the controller will realize a stream of benefits equal to the minimum premium it would accept in a sale of control.

can be made better off by changing the governance structure. The fact that the required payoff is very high should not deter approval; indeed, the scale of the private benefits, if anything, suggests that changing the control structure would have the potential to create significant value.

To summarize, in my view, the most plausible benefit of the proposed conversion was to eliminate the private benefits and possible value destruction associated with a controlling shareholder with only 0.6 per cent of the equity. This was not among the possible benefits that were highlighted by the special committee and that the court emphasized in approving the arrangement.

## II. WHO BENEFITS FROM THE PROPOSED TRANSACTION?

The special committee's analysis of the benefits of the transaction was inadequate, and the court's ready acceptance of these benefits was therefore problematic. Moreover, there is another fundamental question on which the special committee's and the court's analyses were weak: Who would benefit from the transaction?

The court described the special committee as having concluded that the transaction was in the best interests of Magna itself. While the special committee concluded in the Supplement that putting the matter to a shareholder vote was in the best interests of Magna, the court understood the special committee to have concluded that the arrangement itself was in the best interests of Magna. It noted that this is an implication of the following passage from the Supplement:

As the Proposal relates to Magna, the Special Committee was able to reasonably understand the benefits to Magna of implementing the [conversion] against the costs to Magna. In that regard, the benefits to Magna include the impact of a single class structure on its cost of capital and liquidity, the transitional period in which Mr. Stronach will continue to provide his consulting services to Magna at a cost that will reduce over time and [the electric car business benefits]. In addition, the Special Committee was able to reasonably understand the costs to be borne by Magna to achieve these benefits.<sup>43</sup>

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43. *Magna*, Sup Ct, *supra* note 2 at para 49, citing Supplement, *supra* note 3 at 34 [edited by author]. I agree with the court that the passage implies that the committee concluded the deal was in the best interests of Magna: If it could assess the costs and benefits of the arrangement, it should have, as a matter of fiduciary law, only put it to a shareholder vote if it were in the best interests of Magna. I also agree with the court that the fact that the special committee ultimately concluded that the deal was in the best interests of Magna in authorizing the transaction following the vote was indicative of its conclusion. Finally, I agree with the court that the directors had a duty to determine whether the arrangement was in the best interests of Magna, so this was a necessary prerequisite to proposing the deal. See *Magna*, Sup Ct,

In stark contrast to this stated confidence in understanding the net benefits to Magna, the special committee refused to make a recommendation to Class A shareholders to approve the arrangement because it was not able to resolve the “challenging task” of determining whether the transaction was in their best interests.<sup>44</sup> It stated that “the extent of this increase [in the price-earnings ratio of the Class A shares], and its sustained impact, could not be predicted or estimated with any certainty and would only be known over an extended period of time following the announcement and the consummation of the proposed Arrangement.”<sup>45</sup> At the same time, there was an 11.4 per cent dilution in the Class A shares from the conversion, and the costs of this were also difficult to anticipate with any confidence.

Justice Wilton-Siegel accepted this distinction between benefits to Magna and benefits to Class A shareholders. Objecting shareholders argued that the directors of Magna were under a fiduciary duty to make a recommendation to shareholders on how they should vote on the proposal. The court rejected the argument, holding that while there was a duty to determine whether the deal was in the interests of Magna, which the directors had discharged, there was no duty to determine whether it was in the interests of a class of shareholders:

While it is correct that the directors’ statutory duties required them to decide that the proposed 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. For this purpose, it is necessary to separate the duty to act in the best interests of a corporation from whatever duty exists to act in the best interests of the shareholders of the corporation.

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 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.<sup>46</sup>

In my view, the conclusions of the special committee and the court on the benefits to Magna and Class A shareholders are flawed. The distinction between the benefits to Magna and the benefits to Class A shareholders does not make

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*supra* note 2 at paras 50, 148.

44. *Ibid* at para 51.

45. *Ibid*.

46. *Ibid* at paras 148-49.

sense in the present context. The confusion begins, unfortunately, with the foundational Supreme Court of Canada cases of *Peoples* and *BCE*. These cases held that the fiduciary duty to act in the best interests of the corporation does not give rise to a fiduciary duty to act in the best interests of any particular stakeholder, including shareholders. Indeed, in contemplating a conflict between the interests of stakeholders as a group and the interests of the corporation, the Supreme Court held that directors may sometimes be under an obligation to act in a manner that is contrary to the interests of stakeholders collectively.<sup>47</sup>

There is much to be concerned about in the Supreme Court's formulation of fiduciary duties, especially the duty to act in the interests of a legal fiction in opposition to flesh and blood stakeholders. It is difficult to know what this even means.<sup>48</sup> The distinction between the interests of stakeholders and the interests of the corporation is front and centre in *Magna*. The court was correct, strictly speaking, in light of *Peoples* and *BCE* to conclude that determining the best interests of the corporation does not require a conclusion on the best interests of a particular stakeholder. But the narrow attention to the best interests of the corporation that these cases invite, and the corresponding disregard for the interests of shareholders, perhaps led the court down the erroneous path also taken by the special committee in this case. In particular, as I will explain, even if one accepts that the interests of the corporation may deviate from the interests of shareholders or other stakeholders, it is difficult to see how one could be confident that the transaction in the present case is in the interest of the corporation without determining its impact on Class A shareholders. The confusing distinction between a corporation's interests and stakeholders' interests did not necessarily cause the court's too-easy acceptance of the special committee's flawed approach, but the result is not surprising in light of the state of Canadian fiduciary law.

The special committee's self-described capacity to evaluate the arrangement from *Magna's* perspective is inconsistent with the committee's self-described incapacity to do the same from the Class A shareholders' perspective. The court's acceptance of this internally inconsistent description of the special committee's abilities is therefore troubling. Consider *Magna's* perspective. The arrangement made sense for *Magna* if the benefits exceeded the costs. The special committee described the benefits (inadequately, as outlined above) and also stated that it

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47. See *BCE*, *supra* note 6 at para 81. See also Iacobucci, "Indeterminacy," *supra* note 12.

48. I have analogized the duties in *BCE* and *Peoples* to the relationship between a driver and bus passengers. Some passengers want to drive one route, some a different route. The driver attempts to decide how to act by reference to a *BCE*-like duty. The answer under *BCE* would be to take the route that is in the best interests of the bus. *Ibid.*



had a reasonable understanding of the costs to Magna. But the special committee misapprehended the costs of the deal for Magna.

A central element of the costs of the arrangement was payment to Stronach of 9 million Class A shares. Both the special committee and the court appear to treat this payment of shares as a cost borne by Class A shareholders in the form of a dilution of their interests. The special committee, for example, stated that “[s]ubstantially all of the cost is to be borne by the holders of Class A Subordinate Voting Shares in the form of the dilution resulting from the issuance of nine million Class A Subordinate Voting Shares and the payment of \$300 million in cash to the Stronach Trust in exchange for its Class B Shares.”<sup>49</sup> Justice Wilton-Siegel observed that “the primary cost of the proposed Arrangement falls on the Class A shareholders.”<sup>50</sup> On appeal, the Divisional Court, in upholding Justice Wilton-Siegel’s order, stated, “We also agree with his conclusion that the primary cost of the Arrangement falls on the Class A shareholders and not on Magna.”<sup>51</sup>

An issuance of such a vast quantity of shares and cash is of course costly to Class A shareholders, but it would be incorrect to think of this issuance as somehow irrelevant to Magna itself. This is so whether one believes—sensibly, in my view—that Magna’s interests should only be thought of in terms of some aggregation of stakeholder interests,<sup>52</sup> or even, presumably, whether one believes in some independent conception of the interests of a legal fiction.<sup>53</sup> There is a clear opportunity cost to Magna from issuing these Class A shares to Stronach; had Stronach not been issued them, they could have been sold to the market in a secondary offering, realizing hundreds of millions of dollars for Magna. It is true that the economic benefit of these millions would have been realized by Class A shareholders as the residual claimants in a solvent corporation, but if one believes this means that Magna itself does not bear any cost, then one simply rejects the idea that Magna could itself have interests independent of its shareholders. On the other hand, if, following *Peoples* and *BCE*, one accepts that Magna can itself have interests independent of its shareholders, as did the special committee and the court, it would be bizarre to think that forgoing hundreds of millions of dollars in a sale of Class A shares to the market was not costly to Magna. The

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49. Supplement, *supra* note 3 at 41.

50. *Magna*, Sup Ct, *supra* note 2 at para 123.

51. *Magna*, Div Ct, *supra* note 2 at para 50.

52. See Edward M Iacobucci, “Directors’ Duties in Insolvency: Clarifying What’s at Stake” (2003) 39 Can Bus LJ 398.

53. I say “presumably” because I have a difficult time understanding what the interests of a legal fiction are, but unless there were an entirely idiosyncratic understanding of Magna’s interests, the payment of these shares to Stronach would be relevant.

court accepts the distinction between Magna and Class A shareholders invited by *Peoples* and *BCE*, but such a focus distracts the court from recognizing that any plausible conception of Magna's interests would consider the cost of the sale of Class A shares.

The next question is how one should assess the costs of the issuance. The answer is to determine the amount that the shares could have realized on the open market. Rather than buying Stronach's shares back with a mixture of cash and shares, suppose that the special committee proposed that Magna pay cash only. It would raise this cash by issuing Class A shares on the market. How much cash would 9 million Class A shares have raised given the use of the proceeds to buy out Stronach? This is the best way to determine what the Class A shares were worth and, thus, the cost of the proposed deal to Magna.

It is apparent, therefore, that to confirm that the transaction would bring net benefits to Magna itself, it was necessary to determine the opportunity costs of the issuance of the Class A shares, which in turn required a valuation of the Class A shares post-restructuring. It was inconsistent for the special committee to claim that it could determine the benefits and costs of the arrangement for Magna, but because valuation of the Class A shares was intractable, determining the same for Class A shareholders was not possible. To determine the costs of the deal to Magna on virtually any understanding of what Magna's interests were, it was necessary to value the Class A shares that were issued to Stronach.

It is true that *BCE* and *Peoples* confer considerable discretion on the directors of Magna to make their own determination of the best interests of Magna. A response to the above analysis is that, even though the court and the special committee speak of Magna as having its own interests, it would be more apt to speak of the best interests of Magna as deriving from some aggregation of stakeholder interests. There then may be room for arguing indifference about the actual consideration that Magna paid for Stronach's shares. The argument would be as follows. Suppose that the elimination of Stronach as a controlling shareholder with 0.6 per cent of the equity will create value in total; Magna is worth more in some aggregate sense without Stronach in control than with him in control. Suppose further that the directors' conception of the best interests of the corporation treats a zero-sum transfer of wealth from Class A shareholders to Stronach as a matter of indifference; both Stronach and Class A shareholders are stakeholders in the corporation, and the board adopts an entirely neutral stance as between the two. Then the argument might follow that whatever the consideration that Magna, and in effect the Class A shareholders, pay Stronach for his super-voting shares is irrelevant to the conclusion that buying Stronach out is in the best interests of

Magna: Any underpayment results in a zero-sum gain to Class A shareholders and an offsetting loss to Stronach, while any overpayment results in a gain to Stronach perfectly offset by a loss to Class A shareholders. If this argument were acceptable, it might then follow that, even if the special committee of Magna could not value the consideration Magna paid to Stronach, this was defensible because the size of the consideration was not relevant to the overall aggregate gains that were predictable from cancelling the super-voting shares.<sup>54</sup>

There are significant shortcomings in this line of argument as a justification for the approach of the special committee in the present case. For one, if the special committee's approach to the best interests of Magna allowed the committee to treat a transfer of wealth from Class A shareholders to Stronach as a matter of indifference, the committee should have been explicit in saying so. In *BCE*, the board of directors was explicit that they viewed the best interests of the corporation as requiring them in the circumstances to maximize shareholder value while respecting the contractual rights of creditors. The Supreme Court ultimately accepted such a view, appreciating in particular the deliberations about creditors' interests that the board had undertaken. In the present case, the failure to determine the value of the consideration paid by Magna could only be justified by indifference about the division of gains between Class A shareholders and Stronach, and the special committee should have been more explicit about this. Otherwise, how would Class A shareholders—or anyone else, including the court—understand what the board meant when it stated that the transaction was in the best interests of Magna?

Indeed, not only was the special committee not explicit about indifference to the Class A shareholders, it gave indications of concern about the value of Class A shares not just in discussing the interests of Class A shareholders but also in setting out the potential benefits of the transaction to Magna. For example, as a potential benefit of the transaction “to Magna and holders of Magna's Class A Subordinated Voting Shares,”<sup>55</sup> the special committee stated (in a conclusory fashion) that the Class A shares may trade without a dual-class discount. If a

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54. An analogy might help illustrate the point. Suppose that Magna is the highest-valued user of a piece of land that Stronach owns. The land is worth \$100 to Stronach, but would be worth \$110 to Magna. Any price that Magna pays does not affect the gain of \$10 that is created by conveying the land from Stronach to Magna; the price simply divides the gain across other stakeholders in Magna and Stronach. If Magna pays \$130 for the land, Stronach gains \$30 and other stakeholders lose \$20, but the gain is \$10. If Magna pays \$80 for the land, Stronach loses \$20 and other stakeholders gain \$30, for a net gain of \$10. If the best interests of Magna do not depend on transfers between stakeholders, then the consideration is irrelevant to a determination that the sale of land to Magna is in the best interests of Magna.
55. Supplement, *supra* note 3 at 28.

potential benefit of the transaction to Magna was the appreciation in the value of Class A shares, then it appears that the special committee was taking seriously the effects on Class A shareholders in assessing the benefits of the deal for Magna.<sup>56</sup> But if this is true, then the committee was not indifferent about transfers of wealth to Stronach, which in turn means that its failure to determine the value of the Class A shares paid to Stronach was improper.

Setting aside what the special committee may or may not in fact have taken as its role vis-à-vis the Class A shareholders, it would in my view be inappropriate for a board to be indifferent about the consideration paid in a transaction with a controlling shareholder, or any other individual for that matter. There are two reasons not to accept this approach to the best interests of the corporation. First, allowing fiduciary duties of directors to accommodate an attitude of indifference to the returns that minority shareholders receive creates flaws from a systemic perspective. In the instant case, shareholders paid their capital to Magna in the past. But think of how minority shareholders would react at the time of the investment if they could anticipate that the board of directors would adopt an attitude of indifference about transfers between the controlling shareholder and the minority in a transaction between the two. As long as a transaction creates value, the board is indifferent about where the value ends up. Such a posture creates a systematic bias in favour of the controlling shareholder. The controlling shareholder who is engaged in a transaction with the corporation, of course, will be able to look out for his or her own interests, will bargain for the best transaction he or she can obtain, and will reject any transaction in which he or she is not made better off. If, on the other side of the negotiation, there is a board that is indifferent about dividing gains between the controller and minority shareholders, minority shareholders will anticipate that the bargaining process will tend to result in deals that favour the controller. Anticipating this bias, minority shareholders will be more reluctant to invest in the first instance. This creates potential efficiency losses in that the corporation's cost of outside capital will be higher. From an ex ante perspective, a bias in favour of controllers will not lead only to zero-sum transfers from the minority but will also lead to value-destruction.

From a systemic perspective, it would be preferable to offset the self-interest of the controlling shareholder with a board that is concerned about protecting the minority from both wealth-destroying and wealth-transferring related-party transactions. While the latter may not destroy value in the short run in that existing

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56. As Justice Wilton-Siegel stated, in following the list of potential benefits outlined above, "All of these potential benefits related to the market price of Class A shares after implementation of the proposed Arrangement." *Magna*, Sup Ct, *supra* note 2 at para 44.

investment has already taken place, these transactions will destroy value in the long run by raising the cost of capital and deterring investment. An attitude of indifference to minority shareholders should be understood as inconsistent with fiduciary duties as a normative matter.

But even if one sets aside systemic concerns and instead focuses simply on this transaction, it was undesirable for the special committee to take a view of the best interests of the corporation that would allow it not to value the impact of the transaction on Class A shares. To this point, I have assumed that the board was considering a transaction that was going to add value, but I have concluded that their actions were only consistent with a view that where the value was allocated was irrelevant. As a preliminary matter, however, in order to determine whether the transaction will add value, it is necessary to understand what the impact on all relevant parties will be. To elaborate, Stronach had a good idea of what remaining in control was worth to him, while the special committee could not know precisely what control was worth to him. Stronach could obviously protect his interests in the arrangement simply by refusing to sell on terms that did not at least compensate him for the value that he would lose by ceding control. Stronach, however, might have accepted selling control even if the deal did not increase value overall as long as the price was high enough. To ensure that the transaction would add value, the special committee would have been well-advised to ensure that the other essential party to the arrangement, the Class A shareholders, would also benefit from the transaction.

There is another way of looking at this point. Market transactions between arm's-length parties can be understood to add value because it is (usually) reasonable to assume that each party would not enter into the deal unless it made him or her better off. In a related-party transaction between a corporation and a controlling shareholder, the controlling shareholder clearly is in a position to protect its interests. To ensure that the deal replicates a market outcome, and achieves the value-creation that this implies, it would be appropriate for the special committee to negotiate on behalf of the minority shareholders and to ensure that the deal is good for them. Only then can they be confident that the transaction adds value overall.<sup>57</sup>

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57. On appeal, the Divisional Court stated:

In our view, the Class B shareholders and the "minority" Class A shareholders are in a position analogous to two arm's-length contracting parties with respect to the proposed Arrangement.

Opposite parties to a contract or bargain subjectively place different values on what is

In the present case, the special committee was willing to conclude that the transaction had positive net benefits for Magna without assuring themselves that it was good for the Class A shareholders. This should not be acceptable: Such a posture must depend on a focus on value-creation and indifference about value-allocation, but how can the special committee be sure that the transaction adds value without understanding the impact on the Class A shareholders? That Stronach gains is self-evident; otherwise he would refuse the deal. But to be sure that his gains result from value-creation rather than mere diversion from the minority, some conclusion about the impact on Class A shares was necessary.

To summarize the analysis of the confusion over who would benefit from the transaction, the consideration that Magna paid to Stronach for his Class B shares consisted in large part of Class A shares. Even accepting for the sake of argument that Magna has interests independent of its shareholders' interests, it is necessary to value the Class A shares in order to understand the costs of the deal for Magna. The fact that the special committee did not value the Class A shares, yet stated that they could ascertain the benefits and costs of the deal for Magna, was therefore problematic. There is only one conception of Magna's interests that might be consistent with the special committee's approach: The special committee could have been focused on the total value that the deal would create, while remaining indifferent about whether the Class A shareholders or Stronach realized

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being exchanged. That is why an arm's-length bargain is necessarily a win-win exchange and is a foundation of commercial activity in a free market to the benefit of collective society.

*Magna*, Div Ct, *supra* note 2 at paras 67-68. The court appreciated the objective of gains to both parties, but its analysis is questionable. Its description of this deal as representing a bargain between Stronach and Class A shareholders is entirely reasonable, but where do the interests of Magna enter into the picture? The court upheld Justice Wilton-Siegel's finding that Magna's interests were protected by the special committee and the board but simultaneously conceived of the arrangement as a deal between shareholders independent of Magna. The only conception of the best interests of Magna consistent with this view is one that is indifferent about the realization of value by any given shareholder as long as the sum of these values is maximized. The court, at a minimum, should have made this view of Magna's best interests explicit. But then such a conception of Magna's interests and the special committee's approach sits uncomfortably with the emphasis of the court on the benefits of market exchange. If Magna's best interests require the maximization of the sum of Stronach's and Class A shareholders' values, then before concluding that the arrangement is good for Magna, it would be appropriate to be sure that both Stronach and Class A shareholders are better off from a transaction. This is what is invited by the court's emphasis on the benefits of arm's-length contracting, but the court accepted Justice Wilton-Siegel's indifference about the valuation of Class A shares post-transaction.

the benefits of the deal. This conception of the best interests of the corporation is problematic for three reasons: The special committee should have clearly stated its understanding of the best interests of Magna; the conception creates costs from a systemic perspective by deterring investment; and such an approach fails to ensure that the board only pursues transactions that add value.

### III. FIDUCIARY DUTIES AND THE DECISION TO APPROVE THE ARRANGEMENT

The special committee did not offer a compelling analysis of the potential benefits of the proposed arrangement, and it also failed to identify exactly who the potential beneficiaries of the transaction would be. It is unfortunate, in my view, that the court accepted some of the special committee's statements on the potential benefits and beneficiaries of the deal. The confusion about the beneficiaries is perhaps unsurprising given the state of Canadian fiduciary law post-*Peoples* and *BCE*. Given the Supreme Court's willingness to draw distinctions between the interests of the corporation and the interests of shareholders, as well as any other stakeholder, it is not hard to see how a court would accept the internally inconsistent distinction that the special committee drew between the interests of Magna and the interests of Class A shareholders in the present case.

But what are the implications of these flaws in the approach of the special committee and the court? Should the special committee's shortcomings have invited the court not to approve the transaction? In this section, I conclude that the answer to the latter question is "no." I will first argue that, while the special committee failed to specify precisely its perspective on the best interests of the corporation, the state of fiduciary law in Canada at present is so indeterminate that whatever underlying conception it had, the committee could defend its actions in substance even if its disclosures were lacking. I will then turn to the major justification for the court's approval of the arrangement: its deference to the shareholder vote. The court was charged with evaluating whether the plan was fair and reasonable. In my view, the shortcomings of the special committee's analysis discussed thus far—as well as other problematic aspects of its behaviour that I identify below—failed to undermine the very clear message sent by the vote of the Class A shareholders in this case, and the court was right to approve the transaction regardless of the suspect conduct of the special committee. This is so even though some of the shortcomings of the committee concerned disclosures prior to the vote. While these disclosures were inadequate, the inadequacies related largely to the committee's own views of the transaction. Given that the

facts were comprehensively before the shareholders, and that the committee's views were likely to be of marginal utility in informing shareholders on how to vote, the court was right to rely on the shareholder vote as it did.

#### A. ALMOST ANYTHING IS POSSIBLE UNDER *BCE* AND *PEOPLES*

As I have outlined, there are questions about the internal consistency of the special committee's views of the benefits and beneficiaries of the arrangement. It appears at times to take seriously benefits to the Class A shareholders as well as benefits to Magna, but its ultimate refusal to conclude that the Class A shareholders would benefit from the transaction logically implies an indifference to their fate when deciding how to act in the best interests of Magna. Could the special committee act in a manner that is inconsistent with Class A share value, and even inconsistent with overall value to investors, yet still comply with fiduciary duties? In my view, the answer following *Peoples* and *BCE* is yes.

*BCE* states precisely that the directors owe a duty to the corporation, full-stop.<sup>58</sup> Directors do not owe duties to any particular stakeholder. Where the Supreme Court discusses the possibility of conflict between stakeholders as a group and the corporation, it makes clear that only the latter's interests are important.<sup>59</sup> *Peoples* explicitly contemplated and rejected the idea that directors should owe a duty to maximize the total value of the corporation to all stakeholders. The Court said that while such an approach may be consistent with economic conceptions of the corporation's interests, these interests would not necessarily govern.<sup>60</sup>

Under current precedent, a board of directors has a great deal of discretion in adopting a particular view of the best interests of the corporation. There are caveats. For example, at one point, *BCE* suggests that while directors may consider particular stakeholder interests, they must consider the corporation's interests.<sup>61</sup> However, at other points *BCE* seems to require consideration of a particular stakeholder's interests in order for the corporation to be a "good corporate citizen."<sup>62</sup> When this apparent obligation to consider certain stakeholder interests arises is an open question. Suffice it to say for present purposes that the board could not be accused of failing to consider relevant stakeholders in the present case. The board clearly considered Class A shareholders but, in the end, professed not to

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58. *BCE*, *supra* note 6 at para 66.

59. *Ibid.*

60. *Peoples*, *supra* note 10 at para 42.

61. *BCE*, *supra* note 6 at para 39.

62. See *e.g. ibid* at para 66.



know what was best for them.<sup>63</sup>

Under *BCE* and *Peoples*, the board has wide discretion to decide how to act in the best interests of the corporation. In my view, it would be consistent with such latitude for a special, independent committee of a board to choose to maximize overall value even if, in so doing, it favours a controlling shareholder at the expense of the minority. I think such an outcome is wrong from a policy perspective, as I have outlined, but the flexibility offered by *BCE* accommodates such a possibility. Any error by the special committee in the present case did not go to the fundamental question of their duty to act in the interests of the corporation because they had the discretion to determine how to evaluate those interests. This is unfortunately the state of the law following *Peoples* and *BCE*.

## B. FAIRNESS OPINIONS

Even accepting that the board did not necessarily commit a wrong under current doctrine in ultimately taking a position that logically implies indifference to Class A shareholders, there are nevertheless problematic aspects of the board's behaviour. As noted above, the board failed to outline plausible benefits of the deal and to state explicitly what it had in mind when it concluded that the arrangement would be in the best interests of Magna. If the board failed to define its conception of the best interests of Magna, it failed to inform meaningfully any stakeholder of its views of the proposal, which is obviously dubious from a fiduciary perspective.

In my view, there is another clear impropriety in the manner in which the special committee presented the proposed arrangement. The special committee did not obtain a fairness opinion on the proposal, but rather described the costs and benefits of the deal to Class A shareholders in general terms and put it to the shareholders to vote according to their own views of the transaction. In putting it to the shareholders to decide, the special committee suggested that the shareholders monitor stock price movements to glean information on the predicted impact of the transaction on value. The way the committee put the matter to shareholders was, in my view, problematic, but not for the reasons that the objecting shareholders advanced and that Justice Wilton-Siegel rejected.

Objecting shareholders argued that the special committee's unwillingness to

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63. Another restriction on directorial freedom is that, presumably, traditional rules against conflicts of interest would continue to apply. A director could not claim that the best interests of the corporation are her own interests and proceed accordingly. Again, this caveat does not apply to the independent members of the special committee in the present case. Finally, *BCE, ibid*, requires directors as a fiduciary matter to ensure that the corporation is complying with statutory and legislative obligations. This too does not affect the outcome in the present case.

provide a fairness opinion or a recommendation tainted the proposed arrangement. They commissioned and provided to the court an opinion from Morgan Stanley that the transaction was in fact unfair to Class A shareholders. In my view, the failure to make a recommendation or to obtain a fairness opinion was not in itself necessarily problematic. At root, I am extremely skeptical that a fairness opinion from CIBC or any other bank would have the sufficient authority to be treated as a necessary prerequisite to approve an arrangement such as this. The opinions obtained from both CIBC and Morgan Stanley in the present case have shortcomings that suggest that such opinions ought not to be considered indispensable. For example, in explaining their reluctance to provide a fairness opinion, the special committee reported that “CIBC took into account that the primary rationale for the transaction was an increase in Magna’s trading multiple and that the proposed elimination of the Class B Shares would not significantly affect the fundamental valuation of Magna while resulting in significantly greater dilution” than precedent transactions.<sup>64</sup> If the transaction would not “significantly affect the fundamental valuation of Magna,” then how could the transaction possibly make both Class A shareholders and Stronach better off? Why consummate the transaction at all if not to create value?

Morgan Stanley’s opinion was that the proposed arrangement was not fair to Class A shareholders. It reached this conclusion, in part, on the basis of its examination of other conversions of dual-class share structures, noting (as CIBC did) that the premium payable in the present case is much higher than in other transactions.<sup>65</sup> Such a comparison, however, lacks nuance and is potentially misleading. Not all dual-class structures are alike, nor is corporate governance at every corporation necessarily similar even if the share ownership structure is alike. For example, if other dual-class share structures had controllers with a greater percentage of shares, then the impact from eliminating the structure would be predictably smaller. Again, fairness opinions are hardly authoritative statements on the economic effects of a transaction, and it should not be a breach per se for a board not to obtain them in this sort of transaction. As the court aptly put it, a requirement of a fairness opinion “gives undue credibility to fairness opinions and to valuations.”<sup>66</sup>

### C. THE ANNOUNCEMENT OF THE PROPOSED ARRANGEMENT

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64. Supplement, *supra* note 3 at 44.

65. Morgan Stanley also valued Class B shares on a discounted cash flow basis. Such a basis is inappropriate if the controlling shareholder realizes significant private benefits of control.

66. *Magna*, Sup Ct, *supra* note 2 at para 201.

There is clear impropriety in one other action of the board that I have not mentioned to this point. The special committee urged shareholders to monitor the market for its reactions to the announcement of the proposal and to draw inferences about the transaction accordingly. Financial economists have relied for decades on market reactions to unexpected announcements to determine whether certain events add value or not.<sup>67</sup> These “event studies” can be difficult to undertake, however, if there are multiple possible causes of stock price movements. For example, Roberta Romano has studied migrations of corporations from other states to Delaware and has found positive stock price reactions to these reincorporations in Delaware.<sup>68</sup> While this evidence may suggest that Delaware corporate law adds value, there is the confounding effect that firms may reincorporate just prior to fundamental changes like acquisitions, which may have their own impact on value. The Delaware effect and the fundamental change effect may be confounded in examining stock price reactions to reincorporations.<sup>69</sup>

In the present case, there is a confounding effect on the stock price reaction at the time of the announcement of the arrangement proposal. Magna made the announcement at the same time that it released a positive earnings report. Obviously the latter would tend to have put upward pressure on stock price that could interfere with inferences about the value of the transaction itself. It could be that price increased because of the positive earnings news, not because of the proposal. Magna and CIBC, in a follow-up report, acknowledged the noise introduced by the earnings announcement, but suggested to shareholders that post-announcement gains relative to the stock market<sup>70</sup> were likely attributable to the proposed arrangement, given that the market would have anticipated Magna’s positive earnings announcement in light of previously disclosed results in the industry.

It may be, and likely is, a reasonable inference that the post-announcement movements of the stock price resulted from the proposed arrangement. For example, the stock price increased by a seemingly large 11.9 per cent on the day after the announcement, and the price dropped by 5 per cent when OSC staff decided

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67. See *e.g.* Sanjay Bhagat & Roberta Romano, “Event Studies and the Law: Part I: Technique and Corporate Litigation” (2002) 4 *Am L. & Econ Rev* 141.

68. Roberta Romano, “Law as a Product: Some Pieces of the Incorporation Puzzle” (1985) 1 *JL Econ & Org* 225.

69. *Ibid.*

70. See Supplement, *supra* note 3. CIBC made some effort to control for general stock market and industry trends, but its approach (comparing returns of Magna to returns of the market and industry generally) would not meet the standards of an academic event study, which would usually rely on an asset pricing model to generate predictions about returns around the event in question as a point of comparison against actual returns.

to challenge the transaction.<sup>71</sup> But the approach that the board took was, in my view, clearly improper. While researchers cannot control the flow of information when conducting event studies *ex post*, the board of Magna clearly could control the information flow to avoid confounding influences on share price. There was no good reason why the board disclosed positive earnings simultaneously with the arrangement announcement knowing that it would then counsel shareholders to watch the stock price to infer the deal's value added.

In explaining why the arrangement and positive earnings were announced simultaneously, the Supplement states:

Magna routinely announces its earnings results immediately prior to or during its annual general meeting. The decision to do so this year was consistent with past practice and, in Magna's view, general public company reporting standards. The Special Committee and the Magna Board decided to announce the Proposal at the same time in light of the opportunity to use the annual meeting as a platform to discuss the Proposal with analysts and shareholders who would be expected to attend the meeting and/or the investor and analyst conference call which was open to the public and scheduled to occur prior to the annual meeting and which had been publicly announced on May 3, 2010. Moreover, given the time that had elapsed and the evolution of the Proposal since the initial April 8, 2010 meeting to consider the Stronach Trust's apparent willingness to consider a possible transaction, the annual meeting was viewed as an appropriate time to announce the Proposal, provided that the Transaction Agreement was entered into by that time, thereby ensuring the Stronach Trust was committed to proceeding with the Proposal when it was announced.<sup>72</sup>

This paragraph is, in my view, unhelpful in explaining why earnings and the arrangement were announced at the same time. For example, while we learn from the paragraph that Magna has a view that it is standard practice for public companies to report earnings at annual meetings, we do not learn why Magna did not deviate from this practice in order to isolate the stock market effects of the announcement of the proposed arrangement knowing that it would counsel shareholders to draw inferences from these effects. Moreover, given the process that was to follow, including a special shareholder meeting, the idea that announcing the transaction at the meeting itself was very important for discussion purposes seems implausible. If the board intended, as it did, to refer shareholders to stock market reactions to determine how to vote, the board had a duty, in my view, to provide the stock market with a chance to react to the announcement

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71. For a more thorough discussion of the stock price movements in this case, including controlling for market movements, see MacIntosh, *supra* note 4.

72. Supplement, *supra* note 3 at 36-37.

and only the announcement. Relying *ex post* on financial advisors to aver that the reaction to the earnings was already reflected in the stock price at the time of the announcement, rather than ensuring that the reaction was independent of earnings by not disclosing them at the same time as the transaction, is inconsistent with the relative confidence in market reactions over advice that the special committee otherwise professed.

#### D. COURT APPROVAL WAS APPROPRIATE

I conclude that there were important flaws in the approach of the special committee. The committee failed to identify the source of value in the transaction, it failed to identify precisely the beneficiaries of the transaction, and it failed to disclose the transaction in a manner that was consistent with the importance that it placed on stock market reactions. However, I also conclude that the flexibility in conceptualizing fiduciary duties offered by recent Supreme Court jurisprudence provides a defence against at least some of the possible bases for alleging a breach of a fiduciary duty. Ultimately, support for the decision of the court to approve the arrangement does not hinge on resolving the question of whether the shortcomings of the special committee amounted to breaches of fiduciary duties. It might have been preferable for the court to have scrutinized the conduct of the special committee more carefully, particularly with respect to its inadequate disclosure, but ultimately the court was correct that any inadequacies did not affect the appropriate conclusion here. Approval was justified.

*BCE* confirms prior jurisprudence in holding that an arrangement should be approved by a court if three basic requirements are met: the arrangement complies with the statute; it is proposed in good faith; and it is fair and reasonable.<sup>73</sup> There was no dispute about compliance and good faith, but the third requirement was the subject of strong disagreement. To be fair and reasonable, an arrangement must have a valid business purpose and must resolve in a fair and balanced way the objections of those whose rights are affected. The opposing shareholders argued that the arrangement did not have a valid business purpose vis-à-vis the Class A shareholders and that the shareholders were not treated fairly.

Any deficiencies in the understanding of fiduciary duties on the part of the Magna directors does not go directly to the question at issue, namely, whether the plan was fair and reasonable. Of course, the consequence of a breach of a fiduciary duty may be a plan that is not fair and reasonable, but this is not necessarily so. A director could completely misapprehend, and thus act inconsistently with, his or

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73. *BCE*, *supra* note 6 at para 137.

her fiduciary duties, but nevertheless propose a plan that ultimately is fair and reasonable. If so, the plan should be approved notwithstanding any impropriety. It is therefore unnecessary to resolve the question of whether the directors breached their fiduciary duties in the present case; the relevant question before the court was whether the plan was fair and reasonable.

There is a possible linkage between the specific fiduciary improprieties and the fairness of the plan. The court placed significant weight on the shareholder vote in concluding that the plan was fair and reasonable. The shareholder vote took place following disclosure that was, in some important respects, deficient. The opposing shareholders objected that the special committee should have made a recommendation to shareholders on how to vote. I conclude that the special committee failed to identify both the purpose and the beneficiaries of the arrangement. Moreover, the committee timed its disclosures in an improper way. It might be argued that these deficiencies in the board's conduct tainted the shareholder vote.

The court placed significant reliance on the shareholder vote in concluding that the plan was fair and reasonable. It was correct to do so. A 75 per cent majority of Class A shareholders voted in favour of the plan. Unless the deficiencies in disclosure were significant, this vote ought to be treated as a near-dispositive indicator of the fairness and the reasonableness of the plan from the perspective of Class A shareholders. Moreover, in the present case, Class A shareholders were the only stakeholder class that would be significantly affected by the arrangement, other than Stronach (who could obviously protect himself). This focus on shareholders may not be appropriate in other settings, at least following *Peoples* and *BCE*, because of an arrangement's impact on other stakeholders such as creditors, but these considerations are not relevant here. The shareholder vote was crucial in this case, and the deficiencies in disclosure did not undermine its importance.

Ultimately, the core of the shortcomings of the special committee with respect to disclosure rests on its failure to inform the shareholders of its opinion about the transaction. The committee failed to provide clearly a plausible view of the benefits of the transaction, and it failed to say who would benefit from the arrangement. But this is not to say that there were neither significant potential benefits (the elimination of a potentially value-destroying controlling shareholder governance structure) nor beneficiaries (both Stronach and the Class A shareholders) that the shareholders would appreciate. The extensive disclosures in question provided shareholders with necessary facts from which inferences about costs and benefits were available.

The important question in considering the weight to be given to the shareholder

vote is this: If the special committee had expressed its opinions about the benefits and beneficiaries, would these have had a plausible chance of significantly influencing a vote of Class A shareholders? Not only were a number of sophisticated institutional investors voting,<sup>74</sup> but one sophisticated advisory firm, RiskMetrics Group, offered its opinion that shareholders should vote for the plan, while another firm, Glass, Lewis & Co., recommended a vote against but acknowledged the potential benefits of the transaction.<sup>75</sup> Every analyst that considered the proposal was positive. The shareholders were informed of the structure of the deal and all the advice that the special committee received. In my view, the opinion of the special committee would not have added significantly to the mix of information upon which shareholders would have relied in voting.<sup>76</sup>

The court was correct to place significant weight on the shareholder vote. As the court stated, “[T]he position of the Opposing Shareholders disregards entirely the significance of the shareholder vote from the perspective of an implicit contract among shareholders of a public corporation.”<sup>77</sup> The court set out circumstances where the vote may not be dispositive of fairness and reasonableness, such as where there was misleading (not simply potentially incomplete) disclosure, or where there was a lack of commonality of the interests of those voting.<sup>78</sup> The court also noted that the vote in the present case was not coercive. I agree, and I

74. Of course, sophisticated institutional investors objected to the arrangement. But as the court pointed out, the opposing shareholders in the proceeding held less than 3 per cent of the shares. *Magna*, Sup Ct, *supra* note 2 at para 181. One suspects that something other than maximizing the value of their Magna shares was driving the opposing shareholders. At the limit, the OTPPB owned only a single share of Magna—it clearly was not motivated by increasing returns in Magna when it appeared before the court.

75. Magna International, Press Release, “Press Release – Glass Lewis issues recommendation on Magna Transaction” (15 June 2010), online: Magna International <<http://www.magna.com/media/press-releases-news/2011/10/04/press-release---glass-lewis-issues-recommendation-on-magna-transaction>>.

76. For a recent statement by the Supreme Court on the importance of the existing mix of information in evaluating the implications of possible omissions in disclosure, see *Sharbern Holding Inc v Vancouver Airport Centre Ltd*, [2011] 2 SCR 175. (The author acted as co-counsel for the respondents in this case.)

77. *Magna*, Sup Ct, *supra* note 2 at para 203.

78. If, for example, there were evidence of so-called empty voting, in which certain voters did not hold an economic interest in the shares that they voted, perhaps because of derivative contracts, there would be reason to doubt the reliability of the vote. See *e.g.* Bernard Black & Henry Hu, “The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership” (2006) 79 S Cal L Rev 811. This concern was not mentioned by the court, but it falls within the court’s example of varying economic interests within a class. There was no evidence of such voting noted by the court in the present case.

will elaborate briefly on this point.

It was apparent that shareholders perceived that this arrangement would increase shareholder value, and subsequent market reactions supported this prediction.<sup>79</sup> An argument against the transaction might be that while buying Stronach out as a controller as per the arrangement would bring gains both to Stronach and to shareholders, the division of the gains was unfairly skewed toward Stronach. Even if one accepts the controversial premise that a plan might be called unfair and unreasonable though it makes all parties better off, this would not be an argument for the court to reject the plan, as there was no coercion. If Class A shareholders believed that there could have been a better deal, and that Stronach was simply posturing when he stated that the arrangement was a take-it-or-leave-it matter, these shareholders could have voted against the arrangement in hopes of a better deal in the future. Courts should not interfere if shareholders collectively decide not to hold out for more in an arrangement.

There were improprieties on the part of the board that the court did not satisfactorily address. The court placed some significance both on the market information that was available to shareholders at the time of the vote in satisfying itself that the vote was informed and on the actual positive movement of the share price itself in satisfying itself that the arrangement was fair and reasonable.<sup>80</sup> I have noted that the board did not disclose the earnings and arrangement appropriately. The court did not make the same observation, simply noting that “the [c]ourt cannot resolve [the] dispute” about the inference to be drawn from the positive price movement, given the simultaneous announcement of positive earnings.<sup>81</sup> As a matter of policy, it would have been welcome for the court at least to have admonished the special committee for both deferring to the market and, at the same time, muddying the inferences to be drawn from it.

On other disclosure matters, it also would have been welcome for the court to have identified the internal inconsistencies of the special committee in claiming knowledge about the costs and benefits of the deal for Magna, yet claim ignorance about the same for Class A shareholders. The costs and benefits to Magna should have required consideration of the costs and benefits to Class A shareholders. Finally, the court would have been correct to chide the committee for highlighting dubious

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79. See MacIntosh, *supra* note 4.

80. In discussing the absence of appraisal rights, for example, the court noted that any objecting shareholders could sell at a gain following the announcement, thus diminishing the negative impact of the lack of appraisal.

81. *Magna*, Sup Ct, *supra* note 2 at para 189.



potential benefits of the transaction.

In the end, however, the disclosure failures of the special committee did not plausibly affect the outcome of the vote. Moreover, the wisdom of the vote was supported by market evidence, despite the committee's less than ideal approach to disclosure. The court appropriately relied on good evidence of this; when the OSC announced a hearing into the arrangement, the share price dropped by 5.2 per cent.<sup>82</sup> This announcement increased the probability that the arrangement would not eventually happen and was not confused with other material information that was being released at the same time. This is clear evidence that the market viewed the transaction favourably and that the court was right to rely on it. The board acted improperly, but this did not and should not affect the ultimate decision about the fairness and reasonableness of the arrangement.<sup>83</sup>

#### IV. CONCLUSION

There is much to criticize in the conduct of the special committee in the present case. The committee did not identify plausibly the benefits and beneficiaries of the transaction, and it asked shareholders to look to the market for guidance at the same time that it obfuscated market signals. It is unfortunate, particularly having regard to *Magna's* precedential value, that the court did not do more in its opinion to admonish the committee rather than accept the disclosures as adequate. But the court was ultimately responsible for deciding whether the arrangement was fair and reasonable. Given that the inadequate disclosures largely concerned the opinions of the directors (and not facts), given the extensive factual record that was available to shareholders, given the resounding approval of shareholders and other market participants (*e.g.*, analysts), given the market evidence, and given the absence of significant effects on any other stakeholder, the court was correct to approve the arrangement.

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82. *Ibid* at para 191.

83. There is one other tangential point to make regarding the reliance of the board and the court on stock price reactions. If a positive stock price movement is a prerequisite to approval either because of its influence on shareholder voting or on the court, there is a potential circularity with consequential multiple equilibria. Assume that the arrangement does add value to shareholders. One equilibrium is that the stock price increases and the arrangement is approved. Another is that the stock price does not increase and approval is withheld. The latter may arise if shareholders rationally expect disapproval because share prices have not increased. How problematic this possibility would be in practice is an empirical question.

