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Anita Anand

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Commentary

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## Commentary

### Was *Magna* in the Public Interest?

ANITA ANAND \*

THE RECENT COLLAPSE OF *Magna*'s dual-class share structure was one of the largest sale of control transactions in Canadian history. The transaction involved the purchase by *Magna* of all of the Class B (preference) shares—constituting 0.6 per cent of the equity but 66 per cent of the voting rights—owned by the Stronach Trust, the holding entity of Frank Stronach, in exchange for US \$300 million and nine million Class A subordinate voting shares.<sup>1</sup> The effect of the transaction was a significant dilution of the Class A shares as well as a premium paid to the Stronach Trust of approximately 1,800 per cent. The *Magna* board neither made a recommendation to shareholders nor provided them with a valuation or fairness opinion. The Ontario Securities Commission (OSC) declined to stop the transaction under its public interest power. The OSC reasoned that regardless of its own views regarding the fairness of the transaction, the Class A shareholders should decide whether to accept the transaction by a vote, which is required as part of the statutory arrangement process.<sup>2</sup>

The OSC's decision was flawed. To determine the fate of minority shareholders, the OSC relied on both the shareholder vote and the Ontario Superior Court of Justice's application of the "fair and reasonable" test pertaining to the law of arrangements.<sup>3</sup> The OSC did not consider whether the transaction would be injurious to minority shareholders specifically or to capital markets generally if permitted to proceed. It thus did not fully consider the public interest.

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\* Associate Professor, Faculty of Law, University of Toronto. Thanks to John Tuer and Andrew Green for valuable comments and to Grant Bishop, Gordon Houseman, and Adam Friedlan for excellent research assistance.

1. *Magna International Inc. (Re)* (2010), 34 OSC Bull 1290 at para 103 (OSC) [*Full Reasons*].
2. *Ibid.* See also *Magna International Inc. (Re)* (2010), 33 OSC Bull 6013 [*Initial Reasons*].
3. *BCE Inc v 1976 Debentureholders*, [2008] 3 SCR 560 at para 46 [*BCE*].

Following the Supreme Court of Canada's decision in *Committee for the Equal Treatment of Asbestos Minority Shareholders v Ontario (Securities Commission)*,<sup>4</sup> the OSC's power to uphold the public interest must be considered as a means to preserve and protect the capital markets. Thus, neither the shareholder vote nor the actions taken by a firm in the name of fairness generally is sufficient to determine whether a transaction is in the public interest. Rather, case law, including the *Asbestos* decision, dictates that the term "public interest" has a forward-looking element in which the interests of the capital markets must be taken into account more broadly.<sup>5</sup> The *Magna*<sup>6</sup> decision appears to be inconsistent with this law.

Further, the transaction presented to the minority shareholders was arguably abusive. They were asked to choose between the lesser of two evils. If they voted against the transaction, they would be signalling their desire to maintain the status quo in which the Class B shareholder controlled Magna while holding 0.6 per cent of the equity. On the other hand, if they voted for the transaction, they would be approving the collapse of the firm's dual-class share structure and the firm's repurchase of the equity held by a controlling shareholder who had historically extracted significant private benefits of control. The caveat, however, was that the total consideration to be paid for this transaction to occur was exorbitant.

This dilemma faced by minority shareholders suggests that the greater the private benefits that the controlling shareholder extracts from a corporation with dual-class shares, the higher the premium that will be paid to extricate the corporation from the controlling shareholder.<sup>7</sup> Indeed, the board of directors' decision to proceed with the transaction may heighten the incentive for a controlling shareholder to increase its private benefits in order to extort a greater premium for the collapse of a dual-class structure. This is the power of the despot—that the controlling shareholder now seems able to exert.

After the OSC's decision in *Magna*, it appears that a board's sole task in such transactions is to ensure that shareholders have sufficient information and the opportunity to vote on the transaction. Furthermore, rather than consider the protection of capital markets on a prospective basis, it seems that in considering dual-class share structures, the OSC can overlook concerns of the broader public

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4. [2001] 2 SCR 132 [*Asbestos*], aff'd [1999] OJ No 388 (Ont CA).

5. *Ibid.*

6. Referring to *Full Reasons*, *supra* note 1, and *Initial Reasons*, *supra* note 2, collectively.

7. See also Jeff 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>>.

interest and instead defer to corporate law processes. This appears to be a departure from existing legal precedent regarding the public interest power.

This commentary proceeds as follows: Part I sets the background for the discussion by outlining the arrangement at issue, the OSC's decisions, and the meaning of "public interest"; Part II analyzes the OSC's decision, arguing that the OSC inappropriately relied on the shareholder vote by deferring to the processes of the Superior Court; Part III analyzes the concept of "abuse" and suggests avenues for reform; and Part IV concludes.

It is important to bear in mind that the purpose of securities regulation differs from that of corporate law, despite overlap between the two with regard to certain legal requirements (such as proxy solicitations, shareholder meetings and votes, and board composition). Corporate law provides a board of directors with the legal authority to chart the corporation's course while balancing the interests of various stakeholders (such as minority shareholders) in the process. By contrast, securities regulation is mainly concerned with ensuring that investors are protected, that they have confidence in capital markets, and that markets are efficient. It is an understanding of this mandate, whether or not one agrees with its breadth, that drives the present argument.

## **I. BACKGROUND**

### **A. THE TRANSACTION AND THE OSC'S DECISIONS**

Magna International is a multinational public corporation that was founded by Frank Stronach in 1957. Prior to the transaction, Magna had a dual-class share structure with one vote per share attaching to approximately 112 million widely held Class A subordinate voting shares and 300 votes per share attaching to approximately 700,000 Class B shares held by Frank Stronach. This dual-class share structure enabled Stronach to maintain control of the corporation while owning a small percentage of its shares (0.6 per cent).

Under a plan of arrangement proposed in May 2010, the corporation sought to collapse its dual-class share structure. The arrangement contemplated that Magna would repurchase the shares owned by Stronach (through his holding entity, Stronach Trust) for US \$300 million and nine million Class A shares. Magna would then have one class of outstanding shares, of which Stronach would hold 7.44 per cent. The total value of the consideration to be paid by Magna to the Stronach Trust for the purchase and cancellation of the Class B Shares was approximately US \$860 million. In addition, under certain consulting contracts

with the corporation, Stronach would receive 3 per cent of Magna's pre-tax profits. Magna was required to pay the fees owing under the consulting contracts for a one-year term if they were terminated early. Finally, Magna and Stronach would enter into a partnership that would be indirectly controlled by the Stronach Trust in order to develop Magna's electric vehicle business.

In response to the proposed arrangement, OSC staff alleged that the transaction was contrary to the public interest for the following reasons: the circular did not contain specific financial information that the special committee of the Magna board (formed to consider the transaction) had obtained from its financial advisors (CIBC); the disclosure contained neither sufficient information relating to the fairness of the transaction nor useful recommendations to shareholders; the transaction was novel and unprecedented because the shareholders were asked to approve it without a recommendation and without sufficient information; and the approval and review process was inadequate. A group of shareholders, referred to by the OSC and the Superior Court as the "Opposing Shareholders," also sought a permanent cease trade order because the transaction, in their view, was abusive and coercive.<sup>8</sup>

The OSC held that the circular did not contain sufficient disclosure. Therefore, it ordered more disclosure to be filed and approved before the transaction could proceed. In particular, the OSC ordered "a clear articulation"<sup>9</sup> of how management and the board arrived at the consideration to be paid to the Stronach Trust and the potential economic benefits to shareholders. This disclosure was to include a description of the potential alternatives considered by the special committee, a discussion of the approval process adopted by the special committee, and a statement of how CIBC assessed the transaction, including reasons why it could not render a fairness opinion.<sup>10</sup> The OSC did not issue a permanent cease trade order as its staff had requested.

The OSC issued a more lengthy set of reasons after the transaction's closing. Both sets of reasons revolved around four findings. First, the OSC rejected its staff's claim that the transaction was abusive within the meaning of securities law, explaining that "[a]buse has been characterized by Commission decisions as something more than unfairness. A transaction such as this is not abusive simply because the

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8. The "Opposing Shareholders" consisted of the Ontario Teachers' Pension Plan Board; Canada Pension Plan Investment Board; Ontario Municipal Employees Retirement System (OMERS) Administration Corporation; Alberta Investment Management Corporation; Letko, Brosseau & Associates; and the British Columbia Investment Management Corporation. *Initial Reasons*, *supra* note 2.

9. *Ibid* at para 41.

10. *Ibid*.

price proposed to be paid is considered by certain investors to be outrageous.”<sup>11</sup> Apart from this statement, the OSC provided little reasoning to explain why this transaction was not abusive and, indeed, what would constitute abusive conduct on the part of an issuer in similar circumstances.<sup>12</sup>

Second, the OSC had no view on the fairness of the transaction. It concluded that “[b]ased on the evidence before us, we have been unable to come to a view as to whether or not the Proposed Transaction is unfair to Shareholders.”<sup>13</sup>

Third, the OSC viewed a shareholder vote as the necessary seal of approval for the transaction, stating, “It is not our role as securities regulators to assess the desirability of the Proposed Transaction from a financial or economic standpoint. That is ultimately for the Class A shareholders to determine.”<sup>14</sup> In other words, the OSC placed sole decision-making power with regards to whether the transaction should proceed in the hands of the shareholders themselves. The OSC believed that regardless of whether the deal was fair, shareholders should decide. It explained that “any view or perception that we may have as to the possible unfairness of a transaction is not a sufficient ground upon which we can or should intervene in the public interest.”<sup>15</sup>

Fourth, the OSC relied on what was originally (*i.e.*, at the time the initial reasons were being issued) a forthcoming decision of the Superior Court in deciding whether the arrangement was “fair and reasonable” within the meaning of the *Business Corporations Act* (Ontario). In particular, the OSC took “some comfort from the fact that an Ontario court will, as part of the arrangement process, be determining whether the arrangement giving effect to the Proposed Transaction is fair and reasonable. Making such a determination is outside the purview of our jurisdiction as securities regulators.”<sup>16</sup>

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11. *Ibid* at paras 43-44.

12. *Full Reasons*, *supra* note 1. The OSC seemed to leave the door open for a finding of abuse over and above shareholder approval processes by stating, “We would simply add for clarity that we should not be taken to be suggesting that shareholder approval can remedy a transaction or circumstances that are abusive of shareholders or the capital markets. To the contrary, if a transaction is abusive, then shareholder approval will not be sufficient” (*ibid* at para 195).

13. *Initial Reasons*, *supra* note 2 at para 43.

14. *Ibid* at para 191. This statement appears to be a dangerous abdication of the OSC’s mandate to guard against the broader capital market implications of particular transactions, as will be discussed at Part II(A), below.

15. *Ibid* at para 193.

16. *Ibid* at para 47.

In short, it appears that the OSC did not believe that the transaction was abusive. Based on the evidence reviewed, it was unable to reach a decision relating to the fairness of the transaction to the Class A shareholders. The OSC believed that the Class A shareholders should decide whether the transaction should proceed, because this was a business and financial decision that they were entitled to make. Finally, the OSC was reassured by the fact that the Superior Court was going to oversee the transaction.

## B. THE PUBLIC INTEREST POWER

The starting point for understanding the public interest power is the *Securities Act* itself, which provides the OSC with the ability to issue an order if, in its opinion, it would be in the public interest to do so.<sup>17</sup> There is a lengthy list of sanctions that can be levied if conduct is contrary to the public interest. This list includes cease trade orders, denials of exemptions, disgorgement, and a monetary administrative penalty.<sup>18</sup> Yet historically, there has been a question about how broad the public interest power should be and which principles, if any, should circumscribe it.

This question was answered in part by *Canadian Tire*,<sup>19</sup> a decision reached by the OSC and upheld on appeal to the Ontario Divisional Court. The acquisition transaction at issue involved a dual-class share structure with coattail provisions.<sup>20</sup> The OSC considered the transaction to be abusive of capital markets because it was contrary to the intention of section 123 of the Ontario *Securities Act* in place at the time (which outlined the equivalent of today's public interest power) and therefore rendered it impermissible despite there being no violation of the law.<sup>21</sup>

17. RSO 1990, c S.5, s 127 [*Securities Act*].

18. *Ibid*, s 127(1).

19. (1978), 10 OSC Bull 857 *Re Canadian Tire Corp* [*Canadian Tire*], aff'd *CTC Dealer Holdings Ltd v Ontario Securities OSC* (1987) 59 OR (2d) 79 (Ont Gen Div), leave to appeal refused [*CTC Dealer Holdings*].

20. Coattail refers to a mechanism by which minority or lesser-voting shareholders are permitted to share in gains from a takeover. If an offer for some pre-specified amount (typically 50 per cent) of the majority holding is made, the offer must be extended to the other shareholders (they ride the coattails, as it were). See D Lewis Johnson & Bohumir Pazderka, *It's No Gamble: The Economic & Social Benefits of Stock Markets* (Vancouver: Fraser Institute, 1995).

21. In *Canadian Tire*, *supra* note 19, OSC staff sought a cease trade order against a takeover bid that involved the Billes family. Counsel for the family argued that permitting the OSC to issue a cease trade order in this case would give rise to uncertainty in the capital markets. Counsel argued that the transaction should be permitted since it accorded with the terms of the share attributes laid out in the articles of incorporation. The integrity of the documents would be undermined if the takeover bid based on these share attributes were disallowed.

The OSC reasoned:

If abusive transactions such as the one in issue here, and this is as grossly abusive a transaction as the OSC has had before it in recent years, are allowed to proceed, confidence in our capital markets will inevitably suffer and individuals will be less willing to place funds in the equity markets. That can only have a deleterious effect on our capital markets....<sup>22</sup>

Thus, *Canadian Tire* set the stage for the broad application of OSC jurisdiction in deciding which matters fall within the public interest power, especially where there appears to be a deliberate effort to circumvent the intent of the *Securities Act*.

Following *Canadian Tire*, a number of cases took a broad reading of the term “public interest” and suggested that the OSC’s role is distinct from that of the courts.<sup>23</sup> For example, *Re Mithras Management* concerned a scheme that was questioned by the OSC as falling outside the terms of an exemption from the prospectus requirement.<sup>24</sup> The OSC made an order in the public interest, finding that the exemptions did not apply to the respondents. In reaching its decision, the OSC stated, “We are not here to punish past conduct; that is the role of the courts... [w]e are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient.”<sup>25</sup> The OSC thus drew a line between regulatory and judicial bodies, reiterating its role as a securities regulator.

This distinction made by the OSC laid the foundation of the Supreme Court’s decision in *Asbestos*,<sup>26</sup> a case that arose out of the decision by the Quebec government to take control of *Asbestos Corp.*, a leading producer of asbestos in the province. Pursuant to the OSC’s public interest power, minority shareholders sought redress in the form of an order removing the exemptions used to effect the takeover bid.

Counsel further argued that a cease trade order should not be issued unless there was a breach of the *Securities Act*. Relying on a previous decision of the OSC—*Re Cablecasting Ltd* (1978), OSC Bull 37—the OSC disagreed. On appeal, the Divisional Court reasoned by analogy to other statutory provisions in the applicable securities act that if the Legislature intended for discretion to be exercised only where a breach had occurred, it would have stated this in the legislation. Because the statute contained no such statement, “the inference appears compelling, that no such limitation is implied, and none should be implied.” *CTC Dealer Holdings*, *supra* note 19 at para 41.

22. *Canadian Tire*, *supra* note 19 at para 151.

23. Consider *Re HERO Industries Ltd* (1990), 13 OSC Bull 3775.

24. (1990), 13 OSC Bull 1600 [*Re Mithras*].

25. *Ibid* at 1610. See also *Re Albino* (1991), 14 OSC Bull 365.

26. *Asbestos*, *supra* note 4. See also Anita I Anand, “Carving the Public Interest in Securities Regulation: Contributions of Justice Iacobucci” (2007) 57 UTLJ 293.



Writing for the Supreme Court, Justice Iacobucci explained that the public interest power is meant to enable the OSC to remove from the capital markets “those whose past conduct is so abusive as to warrant apprehension of future conduct detrimental to the integrity of the capital markets.”<sup>27</sup> Inherent in Justice Iacobucci’s judgment is the notion that there is a societal element in the public interest power that is not present in other *Securities Act* enforcement provisions and that an application of the power requires considerations over and above fairness to investors. Importantly, he explained that “[i]n considering an order in the public interest, *it is an error to focus only on the fair treatment of investors*. The effect of an intervention in the public interest on capital market efficiencies and public confidence in the capital markets should also be considered...”<sup>28</sup>

*Asbestos* has been applied in a number of cases, including cases before the Supreme Court. In *Re Cartaway Resources*,<sup>29</sup> for example, brokers committed several breaches of the BC *Securities Act*,<sup>30</sup> including failing to disclose material information and material changes in a timely manner. One of the issues on appeal was whether the BC Securities Commission was permitted to take general deterrence into account in rendering sanctions under its public interest power. The Court held that it was well within the meaning of *Asbestos* for the Commission to consider general deterrence in making an order under the public interest section.<sup>31</sup> The Court further held that the public interest power should aim to deter future conduct that is deleterious to capital markets. The principle for which *Asbestos* and *Cartaway* stand is that the concept of public interest means more than fairness and should be applied as necessary to prevent future harm to capital markets. Prevention may include considerations of deterrence, both general and specific.

The OSC subsequently applied this broad interpretation of the public interest power. In *Re Patheon Inc.*,<sup>32</sup> for example, JLL Patheon Holdings made an offer to purchase all of the outstanding restricted voting shares of Patheon Inc. However, a special committee of Patheon Inc. objected to the offer because of a special voting

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27. *Asbestos*, *supra* note 4 at para 43, citing *Re Mithras*, *supra* note 24.

28. See *Asbestos*, *supra* note 4 at para 41 [emphasis added].

29. [2004] SCR 672 [*Cartaway*].

30. RSBC 1996, c 418.

31. *Cartaway*, *supra* note 29 at para 61. Justice LeBel, writing for the Court, stated,

A penalty that is meant to deter generally is a penalty that is designed to keep an occurrence from happening; it discourages similar wrongdoing in others. In a word, a general deterrent is preventive. It is therefore reasonable to consider general deterrence as a factor, albeit not the only one, in imposing a sanction under s. 162.

32. (2009), 32 OSC Bull 6445.

agreement reached with an individual, Joaquin Viso, who had acquired certain Patheon restricted voting shares. The voting agreement provided certain alleged collateral benefits to Viso that were not afforded to other shareholders. The OSC held that it could exercise its public interest jurisdiction even in the absence of any violation of the *Securities Act* or of any regulation or policy statement. Holding that the case directly engaged the animating principles of the takeover regime, including the fair and equal treatment of shareholders when a formal bid is made, the OSC issued a cease trade order to prevent Patheon from entering into agreements that provided unequal consideration to shareholders within the same class.

In *Re Sears Canada Inc.*,<sup>33</sup> a case that involved an insider bid by the US parent company for its Canadian subsidiary, the OSC concluded that the transaction was not so abusive to minority shareholders that a cease trade order was justified. However, it reiterated the purpose of its public interest power: In the absence of a specific violation of securities law, the OSC will exercise its public interest jurisdiction to protect the capital markets.<sup>34</sup> The OSC ordered the US parent company to comply with securities legislation regarding takeover bids, to extend the litigation release to all shareholders instead of certain shareholders, and to exclude the beneficiaries of the support agreement from participating in the minority of the majority vote.<sup>35</sup>

As in *Sears*, it may be the case that ultimately the OSC will not cease trade in cases that may, to some, appear to be abusive transactions. However, the salient point is that the case law emanating from the OSC itself, as well as from the Supreme Court, has held that the OSC must consider the prospective effects of conduct and transactions on capital markets. This fact, and the apparent lack of attention to legal precedent, renders the OSC's decision in *Magna* more perplexing, as discussed next, in Part II.

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33. *Re Sears Canada Inc.*, (2006) 84 OR (3d) 61 [*Sears*].

34. *Ibid* at para 14.

35. The litigation release in this case provided that Sears Holding Corporation released a particular shareholder, Vornado, "from any and all claims and demands of any nature arising out of or otherwise based upon the activities of Vornado ... in connection with Vornado Realty L.P.'s acquisition and disposition of Common Shares of Sears Canada Inc. and entering into and performing this Agreement" (*Re Sears Canada Inc.*, 2006 LNONOSC 1044 at para 206). In addition, the support agreements in this case were established between Sears Holding Corporation and the Bank of Nova Scotia, Scotia Capital, and the Royal Bank of Canada for a set number of shares and at a set price. The agreements were important because under Ontario Securities OSC Rule 61-501 - *Insider Bids, Issuers Bids, Business Combinations and Related Party Transactions*, (2004) OSC 27 OSC Bull 5975, the majority of the minority would have to approve the subsequent acquisition transaction, and these financial instructions held shares in Sears Canada Inc.

## II. FLAWED REASONING AT THE OSC

Building on the parameters of the OSC's public interest power, this Part analyzes the decision in *Magna* and contends that it is flawed. In particular, the OSC improperly relied on the shareholder vote, which was to occur as part of the arrangement process, in reaching its decision. Furthermore, the OSC failed to apply the principles of the public interest power that relate to the integrity of capital markets as a whole. The OSC also deferred to the Superior Court's oversight of the arrangement.

### A. RELIANCE ON THE SHAREHOLDER VOTE

The transfer of control in a corporation is often contentious. Should a controlling shareholder receive a premium for his or her shares because he or she has control? If so, what should be the size of this premium? Should minority shareholders be entitled to participate in these transactions? Debate on these issues has focused on whether a market rule should prevail whereby parties remain unregulated and unprotected via legal rules (in which case minority shareholders enjoy no rights in the sale of control), or whether an "equal opportunity rule" is preferable whereby minority shareholders are entitled to participate in the transaction on the same terms as the controlling shareholder.<sup>36</sup> In the United States, the general rule has been that minority shareholders do not enjoy participation rights in these transactions. In Canada, by contrast, minority shareholders may participate depending on the transaction chosen. For example, a change of control transaction structured as a plan of arrangement under the *Business Corporations Act* (Ontario)<sup>37</sup> will require a shareholder vote (as in *Magna* and *BCE*<sup>38</sup>). A related party transaction may also require a majority of the minority shareholder vote.<sup>39</sup>

The academic literature stresses the importance of the shareholder vote in sale of control transactions. Lucian Bebchuk proposes a takeover bid law in which shareholder tendering is accompanied by voting on whether the tender offer should proceed.<sup>40</sup> Frank Easterbrook and Daniel Fischel argue that

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36. See e.g. Lucian Bebchuk, "Efficient and Inefficient Sales of Corporate Control" (1994) 109 QJ of Econ 957.

37. RSO 1990, c B-16, s 182(5).

38. [2008] 3 SCR 560 [*BCE*].

39. *Multilateral Instrument—Protection of Minority Security Holders in Special Transactions*, OSC, MI 61-101, (2007).

40. "Toward Undistorted Choice and Equal Treatment in Corporate Takeovers" (1985) 98 Harv L Rev; "The Pressure to Tender: An Analysis and a Proposed Remedy" (1987) 12 Del J Corp L 911.

shareholder voting reduces agency costs because shareholders have a veto over transactions that reduce the firm's wealth (thereby reducing their own advantages as residual claimants).<sup>41</sup> Further, voting supplements the rights provided by contract—whether the contract terms are express or refer to provisions of a statute.<sup>42</sup> Even though shareholders might not actually exercise their vote, the vote will nevertheless induce the bidder to offer a fair price. Referring to “the beauty of shareholder voting,” Richard Booth explains that “putting the issue to a vote relieves any pressure to sell for fear of being relegated to the minority... .”<sup>43</sup> He contends that a certain value attaches to the vote, explaining that “[s]ince a vote is clearly valuable to the bidder or management who can use it to control the company... the shareholder will insist on getting top dollar for it... .”<sup>44</sup> He further argues that “there is reason to believe each vote will be actively courted ... and that much, if not all, of the coercion (or temptation) to tender will be obviated... .”<sup>45</sup>

The general view in the literature is that procedural fairness outweighs concerns of substantive unfairness—the vote is determinative of whether or not the transaction should proceed. Yet these arguments are expressed in the context of a change of control transaction between two unrelated parties. In *Magna*, by contrast, the change of control transaction involved a collapse of a dual-class share structure by way of a share buy-back (or issuer bid) between related parties—the Stronach Trust, on behalf of Magna's controlling shareholder (Stronach), and Magna, the firm that Stronach founded. Although it is important to examine the specific context of each particular capital structure at issue, the general rationale underpinning dual-class share structures is to allow firms to build their businesses by accessing capital without the founder having to fear that he or she will lose the business by falling prey to a hostile takeover.<sup>46</sup>

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41. “Voting in Corporate Law” (1983) 26 *JL & Econ* 395 at 401-06.

42. *Ibid* at 402.

43. “The Promise of State Takeover Statutes” (1988) 86 *Mich L Rev* 1635 at 1682.

44. *Ibid* at 1684.

45. *Ibid* at 1685.

46. See Tara Gray, “Dual Class Share Structures and Best Practices in Corporate Governance” (Ottawa: Library of Parliament, 2005), online: Parliamentary Information and Research Service <<http://www2.parl.gc.ca/Content/LOP/ResearchPublications/prb0526-e.htm>> at 5. Gray states:

Historically, Canadian companies issued shares with multiple voting rights to preserve family control while gaining access to capital in public equity markets. To retain voting control over the firm, the family kept the high-voting stock for themselves and sold the restricted-voting shares to the public. Even today, these structures are common among family businesses that wish to go public, and often represent a transitional phase between private and full public ownership.

See also Stephanie Ben-Ishai & Poonam Puri, “Dual Class Shares in Canada: A Historical Analysis”

Furthermore, the issuance of non-voting shares allows corporations to instill a sense of ownership among employees without altering control.<sup>47</sup>

The literature tells us little about why, in this particular circumstance, the vote should be determinative of whether or not the transaction should proceed. Multiple-voting share structures place economic power in the hands of superior class shareholders, even if they do not carry the bulk of the financial risk. In addition, such structures give rise to an agency problem, whereby the controlling shareholder can extort additional proceeds from the firm to the detriment of minority shareholders. Thus, in *Magna*, as stated in the introduction, while the minority shareholders were presented with a choice, it was a choice between the lesser of two evils.<sup>48</sup>

Some may say that the minority shareholders exposed themselves to this possibility by purchasing shares in *Magna* with knowledge of its dual-class share structure and controlling shareholder. This is a fair point, and absent the existence of a securities regulator whose mandate is to protect investors under a broad-based public interest power, it would be persuasive. However, the role of the OSC is to ensure that capital markets, and especially investors in those markets, are protected. Exercising this power may mean, and has previously meant, that abusive transactions are not permitted to proceed. The argument in the following part rests on the claim that the OSC did not properly exercise its public interest jurisdiction in this case in allowing the transaction to proceed.

(2006) 29 Dal LJ 117. Past restrictions on foreign investment also served to encourage the use of dual-class share structures.

47. For these reasons, multiple voting structures are permitted under corporate statutes in Canada, although typically at least one class of shares must carry the right to vote. See *Canada Business Corporations Act*, RSC 1985, c C-44, s 24(3)-(4). See also Robert WV Dickerson, John L Howard & Leon Getz, *Proposals for a New Business Corporation Law for Canada* (Ottawa: Information Canada, 1971) at 9 and Ben-Ishai & Puri, *supra* note 46.

48. Examples of these private benefits included Mr. Stronach holding 0.6 per cent of *Magna*'s equity; establishing a separate corporation (*Magna Entertainment*) that invested in horse racing, which related more to Mr. Stronach's personal tastes than to the manufacturing of auto parts; and entering into lucrative consulting contracts. Professor Iacobucci calls this [t]he elephant in the room. Under the status quo, Stronach controlled *Magna* while holding only 0.6% of the stock. This creates a conflict of interest: Stronach can use his influence on the corporation to benefit himself whether or not these benefits are shares 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.

Edward Iacobucci, "Making Sense of *Magna*," in this volume 237 at 251 [Iacobucci, "Making Sense"].

## B. THE FAILURE TO CONSIDER THE PUBLIC INTEREST

In *Magna*, the OSC focused on disclosure and voting as the means to ensure that the minority shareholders would be able to make a fully informed decision. In doing so, the OSC stopped short of a full analysis of public interest that takes into account the defining principle of the public interest power set forth in *Asbestos*. That is, the OSC failed to consider whether the *Magna* transaction—and similar transactions modelled on it—should be prevented because they would undermine the integrity of capital markets on a prospective basis. Therefore, the OSC shied away from the very purpose of its public interest role.

To reiterate, after *Canadian Tire*, no violation of the law is required for the public interest power to be exercised. Rather, as the OSC held in that case, abusive transactions should not proceed because of the deleterious impact they can have on capital market confidence. Individuals will, the OSC reasoned, have less confidence in capital markets if abusive transactions are permitted.<sup>49</sup> *Canadian Tire* thus set the stage for a broad application of jurisdiction relating to the public interest by securities regulators. In *Asbestos*, the Court narrowed the breadth of *Canadian Tire*, stating that “the public interest jurisdiction of the OSC is not unlimited.”<sup>50</sup> Writing for the Court, Justice Iacobucci upheld the decision of the Court of Appeal for Ontario. He considered section 127 as one element in an entire scheme of enforcement provisions in the *Securities Act*. He noted that under sections 122 and 128, the courts are able to remedy or punish past conduct. In contrast, he reasoned that under section 127, the goal is to protect the public interest on a prospective basis.<sup>51</sup>

Understanding *Canadian Tire* and *Asbestos* allows us to better analyze the OSC’s decision in *Magna*. Given the similarities between the transactions in *Magna* and *Canadian Tire*, it is perhaps surprising that the OSC did not cease trade in the *Magna* transaction. Both were change of control transactions involving dual-class share structures, both involved a sizable premium to be paid to the controlling shareholder, both were alleged to be abusive of the public interest, and in both cases, cease trade orders were *sought* by OSC staff. However, while the OSC granted a cease trade order in *Canadian Tire*, it did not do so in *Magna*.

The OSC distinguished the issues that arose in *Magna* from those in *Canadian Tire* on the basis that the Class A shareholders in the latter case had a reasonable

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49. *Canadian Tire*, *supra* note 19 at para 151.

50. *Asbestos*, *supra* note 4 at para 41.

51. *Ibid* at para 45.

expectation, because of the coattail, that they would share in any control premium paid for their shares. By contrast, in *Magna*, the minority shareholders had no coattail and thus knew that they were not going to be allowed to share in the premium, nor allowed to vote on the transaction.<sup>52</sup> Viewed in this light, *Magna* seems quite different from *Canadian Tire*. The absence of a coattail in *Magna* meant that “the Stronach Trust was legally entitled to sell its Class B shares to any purchaser as whatever price it negotiated.”<sup>53</sup> This was true as a matter of pure contractual interpretation.

However, securities regulation places a layer of regulatory considerations over and above the contract that shareholders have entered into with the corporation. These considerations include the concept of public interest, which has traditionally meant more than the reasonable expectations of shareholders. While there were undoubtedly factual differences between *Magna* and *Canadian Tire*, it was the OSC’s holding in the latter case that broadened the public interest power, ensuring that this power is flexible enough to respond to abusive transactions that are or may be injurious to capital markets. As the OSC stated in *Canadian Tire*:

[T]he Legislature has vested in the OSC the power to intervene where it has been demonstrated that such intervention is necessary to fulfill the OSC’s mandate to regulate the capital markets in the public interest .... A regulatory agency charged with oversight of the capital markets must have the capacity to move quickly to stop transactions which it considers to be injurious to the capital markets.<sup>54</sup>

After *Canadian Tire*, and certainly after *Asbestos*, it is evident that there is a societal aspect to the public interest power that was neither considered nor applied in *Magna*. In applying section 127 of the *Securities Act*, the OSC must have in mind the prospective integrity of capital markets.

Given the strong precedents in *Canadian Tire* and *Asbestos*, it is questionable why the OSC did not intervene to prevent the *Magna* transaction in the public interest. The minority shareholders in *Magna* had a reasonable expectation (voiced effectively by the opposing shareholders) that they would not be presented with a lose-lose proposition and that in the case of a buyout of the controlling shareholder’s interest, the board and special committee would ensure a fair price was being offered to them. At the very least, following *Canadian Tire*, the question arises as to why the OSC did not order a coattail in *Magna* and thereby allow the Class A shareholders the opportunity to convert their shares to Class B shares and tender on the same terms as Stronach.

52. *Full Reasons*, *supra* note 1 at para 188.

53. *Ibid* at para 189.

54. *Canadian Tire*, *supra* note 19 at para 127.

### C. DEFERENCE TO THE SUPERIOR COURT'S PROCESS

Ultimately, in the *Magna* case, the OSC deferred to the Superior Court's determination of whether the transaction was fair to the minority shareholders. There is little precedent for the OSC's deference to the court in this respect, especially given that the concept of public interest historically has not included an analysis of, and reliance on, courts' considerations of fairness.

The Superior Court's own analysis of fairness raises questions. It considered fairness from the standpoint of the "fair and reasonable" calculation pertaining to the law of arrangements. When a court is approving an arrangement, *BCE* requires, first, that the applicant must have complied strictly with the statutory provisions relating to plans of arrangement; second, that the plan of arrangement must be put forward in good faith; and third, that the plan must be fair and reasonable.<sup>55</sup> It is this third principle—the "fair and reasonable" requirement—that primarily concerned the Supreme Court in *BCE* and the Superior Court in *Magna*.

In *Magna*, Justice Wilton-Siegel articulated the two prongs of the "fair and reasonable" calculation: first, whether the arrangement has a valid business purpose; and second, whether the objections of those who oppose the transaction are being resolved in a fair and balanced manner.<sup>56</sup> In terms of whether the transaction had a valid business purpose, he affirmed that the *Magna* transaction did—namely, the elimination of the dual-class share structure. He then held that the "fair and balanced" aspect of the test was met despite the absence of traditional indicia of fairness, including a fairness opinion and a recommendation from the board. Finally, he held that the shareholder vote is a proxy for the transaction's fairness and reasonableness.<sup>57</sup>

In contrast to Justice Wilton-Siegel's decision, the Court in *BCE* laid out numerous factors relevant to the decision of whether the arrangement fairly balanced the ongoing interests of the corporation,<sup>58</sup> including: whether a majority of security holders voted to approve the arrangement; whether an intelligent and honest busi-

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55. *BCE*, *supra* note 3 at para 46.

56. *Magna International Inc (Re)*, 2010 ONSC 4123 at para 102 [*Application*], citing *BCE*, *ibid* at para 132.

57. *Application*, *supra* note 56 at paras 166-67. But see also remarks by Justice Wilton-Siegel following the transaction, in Tim Kiladze, "Magna board 'spectacularly' vacated field: judge," *The Globe and Mail*, 22 February 2011, online: <<http://www.theglobeandmail.com/globe-investor/investment-ideas/streetwise/magna-board-spectacularly-vacated-field-judge/article1916419/>>.

58. *BCE*, *supra* note 3 at para 148. See also Anita I Anand, "Flexibility vs. Certainty: The Law Relating to Arrangements after *BCE*" (2009) 48 Can Bus LJ 174.



ness person, as a member of the class concerned acting in his or her own interest, might reasonably approve the plan;<sup>59</sup> whether the compromise between various securities was proportionate; whether security holders' positions before and after the arrangement had changed and in what respects; whether security holders' rights had been impacted; whether the reputations of directors and advisors who endorsed the arrangement were questionable; whether a special committee existed; whether a fairness opinion had been delivered from a reputable expert; and whether shareholders had access to dissent and appraisal remedies.<sup>60</sup>

In the end, rather than applying the multitude of factors laid out in *BCE*, Justice Wilton-Siegel relied on three indicia of fairness: (1) the outcome of the shareholder vote, (2) the market reaction to the announcement that provided evidence to shareholders that they had a reasonable possibility of realizing a potential gain from the transaction, and (3) the presence of a liquid trading market into which the shareholders could sell their shares at prices equal to or greater than the pre-announcement price. These indicia can be summed up as hold that it is fair if it is better than the status quo. There was little balancing of the factors set forth in *BCE*. The compromise between various securities seemed disproportionate; the special committee existed, but did a poor job of identifying transactional benefits,<sup>61</sup> and there was no fairness opinion.

Regardless of the flaws in Justice Wilton-Siegel's analysis of the fair and reasonable test (which are arguably besides the point for the purposes of this analysis), the OSC should not have relied on the Superior Court's process to determine fairness. The court's test of fairness need not (and did not) consider the broader implications of capital markets—it only considered the fairness to Magna and its shareholders. Neither the court nor the OSC opined on the substantive fairness of the transaction. The OSC held, from a procedural standpoint, that the transaction was fair because the shareholders would vote on it and the court would examine the transaction. The court held that the transaction was fair because the shareholders approved it. Neither body, however, analyzed whether

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59. *Ibid* at para 151.

60. *Ibid* at para 152. The Court stated that

in determining whether a plan of arrangement is fair and reasonable, the judge must be satisfied that the plan serves a valid business purpose and that it adequately responds to the objections and conflicts between different affected parties. Whether these requirements are met is determined by taking into account a variety of relevant factors, including the necessity of the arrangement to the corporation's continued existence, the approval, if any, of a majority of shareholders and other security holders entitled to vote, and the proportionality of the impact on affected groups.

*Ibid* at para 154.

61. Iacobucci, "Making Sense," *supra* note 48.

the transaction was fair to the minority shareholders in substance, nor did they evaluate whether it was abusive to prospective capital markets.

### III. POLICY ANALYSIS

The gist of the discussion thus far has focused on the fact that the OSC did not exercise its public interest jurisdiction according to pre-defined principles that hold that the public interest power is preventative, prospective, and concerned with the well-being of capital markets as a whole. Rather, it deferred to the Superior Court and to the processes inherent in statutes and case law relating to arrangements to determine the issue. In short, the OSC relied on fairness of process in court-driven corporate law procedures rather than the substantive elements of the public interest embedded in securities regulation. Still, we have not yet answered whether the Magna transaction violated the public interest, and, if so, what should occur from a regulatory standpoint as a result.

#### A. WHY MAGNA SHOULD HAVE BEEN CEASE TRADED

Why did this transaction violate the public interest and therefore warrant regulatory intervention? In securities law, decisions about whether a transaction is abusive are separate from *ex post* improvements in firm value. Thus, while the value of Magna's common shares increased significantly following the arrangement, this is not an indication that the public interest was not violated.

The concept of abuse relates to two principal factors: the treatment of shareholders in the transaction at issue and the transaction's prospective impact on capital markets. The first factor prompts several questions: Did the board make a recommendation to the shareholders? Were a fairness opinion and/or valuation provided? Is there a coattail? Do shareholders have the right to vote, and, if so, do they have adequate information? The second factor refers to the prospective impact of allowing the transaction to proceed in terms of the individual shareholders in the corporation, the investing public at large, and capital markets generally.

On both fronts, it appears that the Magna transaction was abusive and that the OSC should have intervened. It must be recognized that the 1,800 per cent premium was exorbitant in comparison to both market value and the typical price range that would be paid to eliminate a controlling shareholder.<sup>62</sup> In the face of

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62. See Ben Amaoko-Adu, Brian Smith & Vishaal Baulkaran, "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

an astoundingly high premium, the processes that the Magna board and special committee followed warranted close scrutiny and ultimately were inadequate.<sup>63</sup> The special committee did not obtain a fairness opinion, and the board did not make a recommendation to shareholders. Furthermore, no valuation was provided. Over and above the absence of these traditional safeguards, as Professor Iacobucci argues, the special committee concluded that the transaction had benefits for Magna without assuring itself that it was positive for Class A shareholders.<sup>64</sup> However, the question must be asked: If the board refuses to make a recommendation, and no valuation or fairness opinion is provided, how is it that the minority shareholders are to arrive at an informed opinion that underpins their position and ultimately their vote? Therefore, process becomes strikingly important at the end of the day.

There may be a natural tendency to view the board's decision-making process solely as one relating to directors' fiduciary duties that, as Justice Wilton-Siegel held, are to be discharged by the board in the best interests of the corporation rather than in the best interests of any one particular stakeholder group (e.g., Class A shareholders). This conclusion follows from *Peoples Department Stores Inc (Trustee of) v Wise*<sup>65</sup> and *BCE*.<sup>66</sup> However, from a securities regulation standpoint, whether the board breached its fiduciary duties is not the central question and arguably is irrelevant in a determination of whether the public interest has been violated. The OSC is required to consider the interests of Class A shareholders as part of its investor protection and public interest mandate. Even if the duties of the board are relevant, they are not determinative in a public interest analysis.

Quite apart from the fate of Class A shareholders in this particular circumstance, the OSC's decision establishes a poor legal precedent. *Canadian Tire* allowed for

Toronto 15 February 2011, [unpublished], online: <[http://www.rotman.utoronto.ca/userfiles/cmi/file/Magna%20Unif2\\_Feb%207%20\(Revised\).pdf](http://www.rotman.utoronto.ca/userfiles/cmi/file/Magna%20Unif2_Feb%207%20(Revised).pdf)>. The paper compares

Stronach's percentage return to the return paid to what other companies paid their controlling shareholders who held superior voting shareholders of the 31 previous cases of unification on the TSX, only one had a special payout to the controlling shareholder similar to that of Magna ... [o]n a comparative basis with other unification deals, the Stronach case is exceptionally large.

*Ibid* at 14.

63. See Kiladze, *supra* note 57. Kiladze's opinion on Justice Wilton-Siegel's remarks following the conclusion of the transaction that the board "spectacularly vacated the field" is notable.
64. Iacobucci, "Making Sense," *supra* note 48.
65. [2004] 3 SCR 461 [*Peoples*].
66. According to the *Peoples* and *BCE* decisions, the fiduciary duty to act in the best interests of the corporation is not owed to any particular class of stakeholders of the corporation, and is not owed uniquely to its shareholders. See Edward Iacobucci, "Indeterminacy and the Canadian Supreme Court's Approach to Corporate Fiduciary Duties" (2009) 48 Can Bus LJ 232.

securities regulators to prevent abusive transactions in which shareholders are inadequately protected either because of the procedures adopted by the corporation or because of the substantive terms of the deal itself. This broad power is at the very heart of the OSC's public interest jurisdiction. However, after *Magna*, as long as a court vets the transaction and shareholders have a vote under corporate law processes, it appears that firms can dismantle their dual-class share structures by paying unprecedented prices to the controlling shareholder with minimal safeguards in place at the board level *ex ante* and with minimal OSC intervention *ex post*. This is the despotic power of the controlling shareholder.

After *Magna*, there will likely be some impact on dual-class firms in terms of their costs of capital. Restricted share issuances will presumably be more costly for any dual-class corporation, given that equity owners are going to price in a premium for conversion. *Magna* renders it important for firms to dismantle their dual-class structures in order to avoid a prospective increase in the cost of capital but at the same time makes it more expensive to do so.

## B. THE REGULATORY LANDSCAPE FOLLOWING MAGNA

Current regulation relating to dual-class structures found in the OSC Rule 56-501 requires disclosure about restricted shares in offering documents but does not contain requirements for coattails.<sup>67</sup> In addition, the *Toronto Stock Exchange Company Manual* mandates coattail provisions as a condition to listing any new restricted shares.<sup>68</sup> However, firms that already have dual-class structures in place are not required to insert a coattail in the share conditions of the subordinated class. Prior to the transaction, Magna was one such firm.

The OSC has examined the issue of mandating coattails in the past. In 1983, the OSC indicated that it would intervene where the shareholders had been abused but it expressed faith in firms themselves to ensure that the appropriate protections were implemented (thereby undermining the need for regulation).<sup>69</sup>

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67. *Restricted Shares*, OSC, Rule 56-501 (2008).

68. *Toronto Stock Exchange Company Manual*, s 624, online: TMX Group <[http://tmx.complinet.com/en/tsx\\_manual.html](http://tmx.complinet.com/en/tsx_manual.html)>. Prior to OSC Rule 56-501, the OSC implemented Policy 1.3, which was rescinded in 1999. This policy had been preceded by intensive debate in the press and hearings held by the OSC itself. This history is outlined in Ben-Ishai & Puri, *supra* note 46. At the time of implementation, the TSX indicated that it would take action against firms that structured a bid to avoid the spirit of the policy. See *TSX Company Manual*, s 624, online: Thomson Reuters Accelus <[http://tmx.complinet.com/en/display/display.html?rbid=2072&element\\_id=299](http://tmx.complinet.com/en/display/display.html?rbid=2072&element_id=299)>.

69. Ben-Ishai & Puri, *supra* note 46 at 148.

The OSC was averse to abolishing dual-class share structures but argued that the “appropriate approach” to regulating dual-class shares would entail “giv[ing] investors a stronger voice in the corporate action required to create these shares, and to prescribe certain minimum standards for the terms of these shares to protect holders in the event of a takeover bid for the issuer.”<sup>70</sup> The OSC was of the view that issuing restricted shares without protective or coattail provisions was contrary to legislative policy.<sup>71</sup> Yet, the OSC stopped short of mandating coattails, perhaps because the TSX policy that emerged in the meantime was aimed at providing a more equitable opportunity for restricted shareholders to participate in an offering through a right of conversion.<sup>72</sup>

*Magna* demonstrates, at the very least, the potential for abuse in dual-class firms where no coattails attach to the subordinate shares. It calls for a re-examination of the OSC’s approach to dual-class structures, coattail provisions, and indeed *ex ante* regulation that governs issuers’ behaviour on the collapse of these structures. Implementing mandatory coattail provisions (for new and existing dual-class firms) would be consistent with the OSC’s equal treatment principle embodied in Part XX of the *Securities Act*, which, at present, requires identical consideration to be paid to shareholders within a class but not across share classes.<sup>73</sup>

It has been argued that mandatory coattails may be inefficient because controlling shareholders are not paid a sufficient premium to relinquish control.<sup>74</sup> If this is true, then perhaps dual-class share structures should be banned as potentially abusive if not outright abusive. This legal change could be efficient despite the increased benefits that would then exist for firms seeking to dismantle their dual-class structures because of the *Magna* transaction. Indeed, Ben Amaoko-Adu, Brian Smith, and Vishaal Baulkaran recently found that elimination of dual-class share structures increases stock prices and improves stock liquidity.<sup>75</sup> At the very least, one can argue that the regulation of transactions in which dual-class share structures are collapsed is, or should be, reconsidered after the OSC’s decision in *Magna*.

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70. *Ibid* at 148, citing “Position Paper Draft and Interim Policy on Restricted Shares and Request for Comments,” OSC Position Paper, (1984) 7 OSC Bull.

71. Ben-Ishai & Puri, *supra* note 46 at 149.

72. *TSX Company Manual*, *supra* note 68, s 624.

73. See *Securities Act*, *supra* note 17, s 97(1). See also Edward Iacobucci, “Why does Ontario Require Equal Treatment in Sales of Corporate Control?” (2008) 58 UTLJ 123.

74. See Iacobucci, *ibid*.

75. *Supra* note 62.

## IV. CONCLUSION

At the announcement of the plan of arrangement on 6 May 2010, the market price of Magna's common shares (which were the Class A shares prior to the arrangement) soared from CAD \$32.14 to CAD \$36.63 (a 14 per cent increase) and has since climbed to CAD \$45.50, dipping slightly from even higher values.<sup>76</sup> The question arises as to why common shares have increased in value if the transaction was abusive. Magna's management might say that the market has priced in the collapse of the dual-class structure. But this is not necessarily the case. The reason may well be related to the market's view of the firm's growth prospects. Without question, it is difficult to separate these two occurrences.

A more pertinent question perhaps is whether Magna's Class A shareholders would have paid the price they did to purchase their shares if they knew that there would be a large conversion premium that would be exercised. Viewing the transaction in hindsight, it is not clear that they would have done so. Class A shareholders likely had a reasonable expectation that they would not be asked to choose between an exorbitant premium and the retention of a controlling shareholder that extracted significant private benefits of control. They would have reasonably expected the securities regulator to protect their interests (as well as those of other capital market participants) and to preserve capital market integrity. This is the role of the securities regulator.

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76. As of 1 June 2011. Ticker: TSE: MG. Data from TSE and Google Finance, online: Google <<http://www.google.ca/finance?q=TSE%3AMG>>. See also MacIntosh, *supra* note 6 (who analyzes Magna's stock price movements over the course of the transaction and beyond).

