

**RE-ARRANGING THE ARRANGEMENT  
LANDSCAPE: THE IMPLICATIONS OF  
*RE MAGNA INTERNATIONAL INC***

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*Although plans of arrangement have been widely used in Canada as a means of effecting a variety of commercial transactions, a comprehensive analysis of the interplay between the relevant considerations that factor into the courts' review and approval of such corporate vehicles was only recently articulated by the Supreme Court in BCE Inc v 1976 Debentureholders. However, the Supreme Court's two-pronged "fair and reasonable" analysis arguably raised as many questions as it did answer, particularly insofar as how the newly articulated legal test would play out in the practical commercial setting. The Ontario courts' recent decisions in Re Magna International Inc, which were among the first to give life to the Supreme Court's "fair and reasonable" test, directly confronted and resolved many of these practical questions. This paper discusses the Magna decision, and the guidance it provides with respect to how the BCE test will be applied by the Canadian courts. In particular, Magna reveals that the practical application of the "fair and reasonable" test requires a contextual and multifaceted evaluation of the transaction in question, resulting in a fluid interplay between the Supreme Court's various indicia of fairness.*

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*Même si les plans d'arrangement ont souvent été utilisés au Canada afin de réaliser diverses transactions commerciales, ce n'est que récemment, dans l'arrêt BCE Inc c Détenteurs de débentures de 1976, que la Cour suprême du Canada a procédé à un examen exhaustif de*

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*l'interaction des différents facteurs qui sont pris en compte lorsque les tribunaux examinent et approuvent ce genre de véhicules corporatifs. Cependant, l'analyse à deux volets de ce qui est « équitable et raisonnable » a, dans un certain sens, soulevé un nombre de questions tout aussi grand que le nombre de réponses apportées par la Cour suprême dans son jugement. Ceci est particulièrement vrai en ce qui concerne la manière dont ce critère juridique nouvellement formulé serait utilisé, en pratique, dans un contexte commercial. Les récentes décisions des tribunaux de l'Ontario dans la cause *Re Magna International Inc*, qui ont été les premières à donner vie au critère « équitable et raisonnable » de la Cour suprême, ont d'ailleurs directement abordé et résolu un grand nombre de ces questions d'ordre pratique. Cet article examine l'arrêt *Magna* et les principes directeurs qui y sont formulés quant à l'application future, par les tribunaux canadiens, du critère de l'arrêt *BCE*. En particulier, *Magna* révèle que l'application pratique du critère « équitable et raisonnable » exige une évaluation contextuelle et multidimensionnelle de la transaction qui est en jeu, ce qui entraîne une interaction fluctuante entre les différents indices sur lesquels s'appuie la Cour suprême dans sa détermination du caractère équitable d'une transaction.*

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### 1. Introduction

Plans of arrangement have been widely used in Canada as a means of effecting a variety of commercial transactions. By virtue of the fact that all such transactions require formal court approval under the applicable corporate statutes, an extensive body of case law has developed over the years with respect to the principles that should guide the courts' assessment of the "fairness and reasonableness" of a proposed plan of arrangement. As this jurisprudence evolved in the various provinces in a piecemeal fashion, however, a clear and comprehensive statement of the governing legal tests was not truly articulated until the Supreme Court of Canada's recent decision in *BCE Inc v 1976 Debentureholders*.<sup>1</sup> Unfortunately, in certain respects the Supreme Court's attempt to provide clarity produced as many questions as it did answers. In particular, a number of unresolved questions arose as to how the restated legal test articulated in *BCE* would be practically applied by the courts. Accordingly, it was not until the recent decisions of the Ontario courts in *Re Magna International Inc*<sup>2</sup> that corporate actors were provided with some clarity as to how the *BCE* principles would play out in the commercial setting.

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<sup>1</sup> 2008 SCC 69, [2008] 3 SCR 560 [*BCE*].

<sup>2</sup> 2010 ONSC 4123, 101 OR (3d) 736, aff'd 2010 ONSC 4685 (Div Ct) [*Magna* cited to OR].

In the discussion that follows, we offer an analysis of the interpretation and application in the *Magna* decisions of the Supreme Court's restated "fair and reasonable" test, as set out in *BCE*. In particular, we address the implications of the *Magna* decisions insofar as they offer insight into the manner in which the courts will approach future plans of arrangement. In so doing, we intend to demonstrate that while the *BCE* test seemingly articulated a discrete and compartmentalized inquiry with respect to court approval of proposed arrangements, the practical application of this legal test necessarily requires a contextual and multifaceted evaluation of the transaction in question.

## 2. Overview of Arrangement Transactions

"Arrangement" transactions effected pursuant to section 192 of the *Canada Business Corporations Act* or its provincial equivalents<sup>3</sup> give rise to a unique set of strategic and legal considerations by virtue of the fact that all such transactions necessarily involve the intervention of the courts. Pursuant to statutory mandate, plans of arrangement require formal judicial approval before they can be implemented. Outside of the insolvency and restructuring context, such direct judicial involvement in the structuring and implementation of commercial transactions is otherwise uncommon in the Canadian corporate landscape. The court's domain has typically been confined to intervention at the behest of an aggrieved party seeking to restrain a transaction.

Notwithstanding the additional layer of complexity introduced by the need for judicial involvement, both private and publicly-held corporations frequently avail themselves of the arrangement mechanism. In part they do so because of the flexibility of the statutory provisions, which have been invoked in a number of disparate contexts, including business combinations, continuances, spin-offs, going-private transactions and, most recently, income trust conversions.<sup>4</sup> Similarly, the court approval

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<sup>3</sup> RSC 1985, c C44; Ontario *Business Corporations Act*, RSO 1990, c B-16, s 182 [*OBCA*]; British Columbia *Business Corporations Act*, SBC 2002, c 57, ss 288-299; Alberta *Business Corporations Act*, RSA 2000, c B-9, s 193; Saskatchewan *Business Corporations Act*, RSS 1978, c B-10, s 186.1; Manitoba *Corporations Act*, CCSM c C225, s 185; New Brunswick *Business Corporations Act*, SNB 1981, c B-9.1, s 128; Newfoundland and Labrador *Corporations Act*, RSNL 1990, c C-36, s 315; Nova Scotia *Companies Act*, RSNS 1989, c 81, ss 130-131.

<sup>4</sup> On June 22, 2007, pursuant to Bill C-52, the federal government introduced legislative provisions governing the taxation of "specified investment flow-throughs" and their unitholders, which effectively imposed a tax at the trust level on distributions of certain income from publicly traded mutual fund trusts. However, trusts that were publicly traded at the time of the announcement were generally entitled to a four-year transition period, and were not subject to the new rules until January 1, 2011.

process often offers a number of strategic advantages, notably the ability to bind all affected parties – including holders of non-voting securities, option holders and other stakeholders – to the terms of the transaction without unanimous stakeholder approval. In addition, the very fact of judicial approval enables the commercial parties to invoke certain registration exemptions with respect to subsequent issuances of securities.<sup>5</sup>

Although the contextual backdrop to arrangement transactions is widely varied, the fundamental legal requirements for court approval are well established. In particular, the commercial party “being arranged” must satisfy the court (i) that it has complied with the applicable statutory and procedural requirements (including any interim order that may have been granted); (ii) that the transaction has been put forward in good faith; and (iii) that the arrangement is “fair and reasonable.”<sup>6</sup> While this tripartite test has remained largely unchanged since the introduction of the corporate arrangement provisions, its interpretation and application have been the source of some debate. In particular, the precise meaning of “fair and reasonable” in the arrangement context has been the subject of repeated judicial commentary, culminating in the recent decision of the Supreme Court of Canada in *BCE*.

### 3. *The BCE Decision*

In *BCE*, the Supreme Court concluded that the “fair and reasonable” determination could be made on the basis of a two-prong test – namely, whether the arrangement has a “valid business purpose,” and whether it “resolves the objections of those whose rights are being arranged in a fair and balanced way.”<sup>7</sup> In so doing, however, the Court acknowledged that the application of this test is inherently fact-specific, and that the particular circumstances of the proposed transaction will dictate which “considerations” will ultimately be relevant in a given case.<sup>8</sup> Moreover, the

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Accordingly, the vast majority of public income trusts converted to corporations, relying on the arrangement mechanisms in the applicable provincial or federal corporate statutes to do so; see especially *Acadian Timber Income Fund (Re)*, 2009 CanLII 72057 at paras 8, 11 (Ont Sup Ct).

<sup>5</sup> Parties often rely upon court approval to invoke exemptions provided for in US securities legislation. See *Securities Act of 1933*, 15 USC § 3(a)(10) (1933), which exempts from the registration requirements any issuance of securities where the terms and conditions of such issuance are approved following a fairness hearing by a court.

<sup>6</sup> See *Re Canadian Pacific Limited* (1996), 30 OR (3d) 110 (Gen Div), aff’d [1998] OJ No 3699 (CA); *Trizec Corp. Re*, [1994] 10 WWR 127 (Alta QB).

<sup>7</sup> *BCE*, supra note 1 at para 143.

<sup>8</sup> *BCE*, ibid 1 at para 149: “The question is whether the plan, viewed in this light, is fair and reasonable. In answering this question, courts have considered a variety of

Supreme Court's broad characterization of the two inquiries under the fair and reasonable analysis was somewhat disconnected from the ultimate application of the test to the facts before it. In particular, the Court applied narrowly-defined parameters to articulate the second prong of the traditional analysis, specifically a requirement that "the objections of those whose rights are being arranged are resolved in a fair and balanced way."

While this circumscribed language seems to call for a relatively limited inquiry, the "factors" that the Court set out as relevant under this prong of the test clearly indicate that the Court's fairness analysis encompasses a far broader spectrum of considerations than merely the fair resolution of stakeholders' objections. Indeed, in addition to the outcome of the shareholder vote and the existence of dissent rights, which have an obvious connection to the inquiry concerning "objectors' rights," the Supreme Court raised a number of other relevant considerations, including the proportionality of the compromise between various security holders, the security holders' position before and after the arrangement, the reputé of the directors and advisors who endorse the arrangement, whether the plan has been approved by a special committee of independent directors, and the presence of a fairness opinion from a reputable expert.<sup>9</sup> All of these "factors" combined imply that the proposed two-prong test prescribed by *BCE* is not as compartmentalized or structured as the Supreme Court's own commentary might suggest. To the contrary, in its application, the analytic dichotomy of the proposed "fair and reasonable" test seems to fall away entirely.

In many ways, the Supreme Court's attempt to explain the "fair and reasonable" test created more confusion than clarity, resulting in a non-exhaustive laundry list of factors that may or may not be determinative in the context of a particular transaction. Indeed, it was not until the *BCE* test was subsequently applied by the courts in the context of a contested arrangement proceeding that some degree of clarity was achieved. In this regard, *Magna* represents the first comprehensive judicial interpretation and application of the test in *BCE*, and provides insight into the manner in which the courts will approach plans of arrangement in the future. As will be explained further below, the *Magna* rulings confirm that the "fair and reasonable" determination is dependent upon a judicial finding that the proposed arrangement transaction has a "valid business purpose," and that the costs and benefits to the respective stakeholders are fairly balanced. With respect to both of these inquiries, *Magna* further illustrates the fact-

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factors, depending on the nature of the case at hand. None of these alone is conclusive, and the relevance of particular factors varies from case to case. Nevertheless, they offer guidance."

<sup>9</sup> *Ibid* at paras 149-52.

specific nature of the fair and reasonable determination, and the fluid interplay between the various indicia of fairness.

#### 4. *The Background to the Magna Decision*

In order to appreciate the implications of the *Magna* decisions insofar as the evolution of the arrangement jurisprudence is concerned, it is first necessary to understand the facts giving rise to the disputed transaction.

Since 1978, Magna International Inc (Magna) had maintained a dual class share structure. The Class A subordinate voting shares, publicly traded on the NYSE and the TSX, held one vote per share (Class A Shares). The Class B shares, which were not publicly traded, carried 300 votes per share and were wholly owned by the Stronach Trust (Class B Shares). In effect, the control block of shares held by the Stronach Trust represented approximately 66 per cent of the voting power attached to all of Magna's voting securities and less than one per cent of Magna's total equity.<sup>10</sup>

In 2010, the executive management of Magna came to the view that elimination of the dual class share structure had the potential to bring about significant benefit to the corporation. Historically, the Class A Shares had traded at a discount relative to Magna's industry peers on account of the dual share structure. Therefore, the economic theory behind the transaction that ultimately became the subject of arrangement proceedings was that elimination of the dual share structure could increase the trading multiple and trading value of the Class A Shares.

Accordingly, on May 6, 2010, Magna announced a proposal to eliminate its dual class share structure by way of a plan of arrangement pursuant to section 182(5) of the Ontario *Business Corporations Act* (*OBCA*).<sup>11</sup> Under the terms of the arrangement, Magna would purchase for cancellation all of the outstanding Class B Shares indirectly owned by the Stronach Trust for consideration comprised of a mixture of cash and Class A Shares.

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<sup>10</sup> For a more detailed discussion of Magna's dual class share structure and the background to the arrangement transaction, see Emmanuel Pressman, Jean Fraser and Jeremy Fraiberg, "Key Lessons from the Magna Decisions" (September 2010), online: Osler <<http://www.osler.com/NewsResources/Details.aspx?id=2823>>.

<sup>11</sup> *Supra* note 3.

*A) Background to the Arrangement**1) The Proposed Transaction*

Magna's Board of Directors (Board) established a special committee to review and consider the proposed transaction (Special Committee), for submission initially to the Stronach Trust, and if acceptable to the Stronach Trust, for determination by the Board as to whether the proposal should be submitted to the Magna shareholders for their consideration. The Special Committee engaged an independent financial advisor, and retained independent counsel.

When a transaction is being evaluated by a board of directors, it is customary for the financial advisor to provide an opinion on the fairness of the transaction, referred to as a "fairness opinion." In this instance, however, the Special Committee's financial advisor indicated at the outset of the engagement that a fairness opinion was not appropriate in these circumstances. This was due primarily to the fact that the value that would ultimately accrue to the Class A shareholders was entirely dependent on the extent to which the trading value of the Class A Shares increased after the transaction was announced. As future trading prices are inherently unpredictable, the financial advisor was not in a position to provide a fairness opinion. The financial advisor did, however, make a number of key findings that suggested that the proposed transaction would be beneficial to Magna, and ultimately concluded that there was the potential for an expansion to Magna's trading multiple following the completion of a dual class share reorganization.

The Special Committee determined that if the proposed transaction, as negotiated, was to be submitted to Magna shareholders for their consideration, the proposed transaction should be: (a) approved by the majority of the votes cast at a special meeting by disinterested shareholders; and (b) carried out as a plan of arrangement (the proposed Arrangement), such that it would be subject to review by a court that would consider the fairness and reasonableness of the transaction.

The Special Committee concluded that the Board should put the proposed Arrangement before the shareholders at a special meeting in order that the transaction could be voted on, and the Board should make no recommendation to the Magna shareholders as to how they should vote in respect of the proposed Arrangement. Rather, the shareholders were instructed to take into account the considerations that the Special Committee itself reviewed when evaluating the transaction. The Board ultimately adopted the Special Committee's recommendations, and referred the transaction to a shareholder vote.

## 2) *The OSC Proceedings*

On June 15, 2010, the Staff of the Ontario Securities Commission (OSC) commenced an application seeking an order to cease trade the issuance of the securities pursuant to the proposed Arrangement on the basis that the proposed Arrangement was contrary to the public interest.<sup>12</sup> Following a hearing of the issues, the Ontario Securities Commission concluded that the proposed Arrangement was *not* abusive of shareholders or the capital markets,<sup>13</sup> that the Board was not required to make a recommendation to shareholders as to how to vote in respect of the proposed Arrangement, and that the Board and the Special Committee were not required to obtain a fairness opinion or a formal valuation.<sup>14</sup> However, the OSC did conclude that Magna was required to provide certain additional disclosure to the shareholders in advance of the meeting at which the transaction would be voted on.

## 3) *The Shareholder Vote*

Under the interim order obtained by *Magna* in respect of various matters pertaining to the shareholder meeting, the approval of the arrangement resolution required the affirmative vote of a simple majority of the votes cast by disinterested “minority” holders of Class A Shares. Ultimately, 80.4 per cent of the issued and outstanding Class A Shares were represented, and the arrangement resolution was approved by 75.28 per cent of the votes cast by these Class A shareholders.

## 5. *The Application Decision*

Magna brought an application for an order seeking approval of the proposed Arrangement pursuant to section 182(5) of the *OBCA*. Notices of Appearance were delivered on behalf of both the Opposing Shareholders and the shareholders supporting the transaction.

In rendering his decision, the application judge quoted extensively from the Supreme Court of Canada’s decision in *BCE*, and reiterated the

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<sup>12</sup> A few holders of Class A Shares that objected to the proposed Arrangement – the same shareholders that ultimately appeared before the Court in the arrangement hearing (the Opposing Shareholders) – sought and obtained intervenor status at the hearing before the OSC. Other Class A shareholders that were in favour of the proposed Arrangement also sought and obtained intervenor status, taking the position that it is the shareholders that ought to be able to decide whether the proposed Arrangement should proceed.

<sup>13</sup> *Decision and Order* (24 June 2010), online: OSC <<http://www.osc.gov.on.ca/>> at paras 43-44.

<sup>14</sup> *Ibid* at paras 48, 50.



Supreme Court's articulation of the test to be applied when evaluating an arrangement in the context of a fairness hearing, namely:

- (1) the statutory procedures have been met;
- (2) the application has been put forward in good faith; and
- (3) the arrangement is fair and reasonable.<sup>15</sup>

Wilton-Siegel J made specific reference to the Supreme Court of Canada's detailed holdings in respect of the third requirement. In particular, he noted that to determine if a proposed arrangement is fair and reasonable, a court must be satisfied that:

- (a) the arrangement has a valid business purpose; and
- (b) the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way.<sup>16</sup>

In this regard, Wilton-Siegel J noted that the Supreme Court rejected the "business judgment" rule in the arrangement context, as "the business judgment test does not provide any more information than does the outcome of a vote."<sup>17</sup> The results of a shareholder vote are an important indicator of whether an arrangement is fair and reasonable. However, "the reviewing judge must delve beyond whether a reasonable business person would approve of a plan to determine whether an arrangement is fair and reasonable."<sup>18</sup>

#### *A) The Test in BCE Applied to the Magna Arrangement*

Wilton-Siegel J then proceeded to consider whether Magna's proposed Arrangement satisfied the three requirements of *BCE*. First, he determined that all of the statutory procedures had been met, and indeed, there was no objection by the Opposing Shareholders on this issue.<sup>19</sup> He also concluded that the application was put forward in good faith.<sup>20</sup> Ultimately, the question of whether the proposed Arrangement was fair and reasonable was determinative of the application, which is "customary in approval hearings."<sup>21</sup>

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<sup>15</sup> *Magna*, *supra* note 2 at para 101, quoting *BCE*, *supra* note 1 at para 137.

<sup>16</sup> *Magna*, *ibid* at para 102, quoting *BCE*, *ibid* at para 138.

<sup>17</sup> *Magna*, *ibid*, quoting *BCE*, *ibid* at para 141.

<sup>18</sup> *Magna*, *ibid*.

<sup>19</sup> *Ibid* at para 107.

<sup>20</sup> *Ibid* at para 108.

<sup>21</sup> *Ibid* at para 109.

### *B) The Position of the Parties*

Magna submitted that the valid business purpose of the proposed Arrangement was the elimination of the dual class share structure. It further argued that the proposed Arrangement would have positive consequences for both Magna and the Class A shareholders.<sup>22</sup> In addition, Magna argued that the majority vote of the Class A shareholders provided an extremely strong indication that the proposed Arrangement was fair and reasonable.<sup>23</sup>

The Opposing Shareholders put forward two principal arguments. First, they argued that the “fair and reasonable” test means that the Court must be able to conclude that the benefits that will be derived from a proposed arrangement are equal to the costs.<sup>24</sup> They argued that this was not the case with Magna’s proposed Arrangement. While the benefits to the Class B shareholder were fixed and quantifiable, the benefit to the Class A shareholders, being the potential for a sustained increase in the trading price, was uncertain, unquantifiable and could not be assured. Accordingly, they argued that the risk of the proposed Arrangement fell entirely on the Class A shareholders, thereby rendering the transaction unfair.<sup>25</sup>

In the alternative, the Opposing Shareholders argued that the expert report they put forward on the application provided objective evidence that the price to be paid by the Class A shareholders for the cancellation of the Class B shares was too high. They argued that this alone should form a basis for the Court to conclude that the proposed Arrangement was neither fair nor reasonable.<sup>26</sup>

### *C) Valid Business Purpose*

#### *1) A Valid Business Purpose in Respect of Magna*

Wilton-Siegel J specifically recognized that the proposed Arrangement was not “necessary” for the continued operation of Magna, and according to *BCE*, the level of judicial scrutiny depends on the necessity of the transaction.<sup>27</sup> Regardless, he found that “even on a standard of careful scrutiny, it is clear that the elimination of the dual-class capital structure

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<sup>22</sup> *Ibid* at para 110.

<sup>23</sup> *Ibid* at para 111.

<sup>24</sup> *Ibid* at para 114.

<sup>25</sup> *Ibid* at para 115.

<sup>26</sup> *Ibid* at para 117.

<sup>27</sup> *Ibid* at para 119.

would benefit Magna, both from a corporate governance and from a financial perspective.”<sup>28</sup>

In addition, Wilton-Siegel J rejected the argument of the Opposing Shareholders that the purported benefits of a proposed arrangement must be assured.<sup>29</sup> He clarified that the issue of certainty of benefits is more properly dealt with in the second step of the fair and reasonableness test.<sup>30</sup> To have a valid business purpose, the party seeking approval of the arrangement need only demonstrate “the prospect of clearly identified benefits to the corporation that have a reasonable prospect of being realized if the [a]rrangement is implemented, as opposed to vague and imprecise benefits that are, by their nature, unlikely to be realized.” The potential benefits to Magna of the proposed Arrangement satisfied this test.<sup>31</sup> In any event, Wilton-Siegel J found that there was evidence that at least some of the benefits of the proposed Arrangement would accrue to Magna irrespective of any increase in the trading multiple of the common shares.<sup>32</sup>

## *2) A Valid Business Purpose in Respect of the Class A Shareholders*

Wilton-Siegel J held that a valid business purpose in respect of the shareholders is not a requirement that exists at law. BCE only refers to a valid business purpose in respect of the corporation.<sup>33</sup> Moreover, issues pertaining to the effect a proposed arrangement will have on the shareholders are to be resolved in the second step of the fair and reasonableness test.<sup>34</sup>

## *3) Significance of the Opposing Shareholders’ Expert Opinion*

The Opposing Shareholders sought to tender expert evidence to the effect that the Class A shareholders were paying too high a price for control. Wilton-Siegel J found, however, that the Court was not in a position to make findings of fact in respect of the fair market value of the Class B Shares.<sup>35</sup>

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<sup>28</sup> *Ibid* at para 120.

<sup>29</sup> *Ibid* at para 121.

<sup>30</sup> *Ibid* at para 122.

<sup>31</sup> *Ibid*.

<sup>32</sup> *Ibid* at para 123.

<sup>33</sup> *Ibid* at para 125.

<sup>34</sup> *Ibid* at para 128.

<sup>35</sup> *Ibid* at paras 137-38.

Regardless, the question of benefit to the Class A shareholders was found not to be determinative. Under this step of the “fair and balanced” analysis, Wilton-Siegel J found that the Court must balance the interests of the Class A shareholders and the Class B shareholder, or in other words, must look to the “proportionality” of the respective benefits. This means that “the Court cannot approach the ‘fair and balanced’ analysis looking only at the benefit received by one party to the proposed Arrangement.”<sup>36</sup> Rather, “[t]he correct exercise in the present circumstances is the one that the Special Committee attempted to undertake – a cost-benefit analysis in respect of the Class A shareholders that addresses the benefits to *both* parties to the transaction.”<sup>37</sup>

*4) Significance of the Absence Indicia of Fairness Identified by the Supreme Court in BCE*

Many of the traditional indicia of fairness and reasonableness were absent in Magna. In particular, the financial advisors to the Special Committee did not provide a fairness opinion, neither the Special Committee nor the Board made a recommendation to the Class A shareholders, and the proposed Arrangement did not include rights of dissent and appraisal.<sup>38</sup>

With respect to the lack of fairness opinion, Wilton-Siegel J seemed to accept the rationale of the Special Committee’s financial advisor for its inability to provide a fairness opinion. He stated that “the court cannot draw an adverse inference from the absence of a fairness opinion. It is inherent in the nature of the transaction.”<sup>39</sup>

For related reasons, Wilton-Siegel J held that the Court could not draw an adverse inference from the lack of recommendation from the Special Committee. Just as the Special Committee’s financial advisor does not give opinions on future share prices, “the Special Committee could not responsibly make a recommendation based on its personal assessment of the likely direction of trading multiples pertaining to the Class A Shares.”<sup>40</sup> Moreover, Wilton-Siegel J specifically noted that the law in Ontario (whether under the *OBCA* or securities law) does not require directors or a special committee to make a recommendation to the holders of its shares regarding a proposed related party transaction.<sup>41</sup> He did point out,

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<sup>36</sup> *Ibid* at para 140.

<sup>37</sup> *Ibid* [emphasis added].

<sup>38</sup> *Ibid* at para 141.

<sup>39</sup> *Ibid* at para 143.

<sup>40</sup> *Ibid* at para 145.

<sup>41</sup> *Ibid* at para 147.

however, that the members of the Special Committee had indicated they were in favour of the proposed Arrangement as individual shareholders.<sup>42</sup>

Finally, Wilton-Siegel J found that dissent rights were not necessary in this circumstance because the Class A Shares were not being acquired on a compulsory basis. The existence of an open market where a shareholder can freely dispense of shares meant that the lack of dissent rights was of no negative significance to the proposed Arrangement.<sup>43</sup>

#### 5) Significance of the Outcome of the Class A Shareholder Vote

Wilton-Siegel J termed the significance of the shareholder vote the “principal issue” in respect of the “fair and balanced” test.<sup>44</sup>

First, he specifically noted that in *BCE*, the Supreme Court of Canada did not consider the “fair and balanced” test as applicable to a single class of shareholders. In *BCE*, the “fair and balanced” test was applied to address the fairness of the bargain between competing stakeholder groups. Significantly, “a shareholder vote can address the fairness of an arrangement either between competing groups or ... *within* a class of stakeholders having a common interest.”<sup>45</sup>

He then proceeded to discuss the significance of the shareholder vote in light of the decision in *BCE*. First, Wilton-Siegel J referred to what the Supreme Court of Canada said a shareholder vote represents, namely “the best test of whether an intelligent and honest business person, as a member of the voting class concerned and acting in his or her own interest, would reasonably approve a plan of arrangement is his or her vote.”<sup>46</sup> Second, he found that the Supreme Court of Canada’s rejection of the business judgment rule in *BCE* actually *reinforces* the need to rely on the outcome of a shareholder vote.<sup>47</sup> Therefore, when a shareholder vote is put forward as the best indicator of the fairness and reasonableness of a proposed arrangement, the Court must undertake an analysis whereby it reviews the circumstances surrounding the vote in order to determine the significance the Court can ultimately attach to the shareholder vote.<sup>48</sup>

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<sup>42</sup> *Ibid* at para 150.

<sup>43</sup> *Ibid* at para 152.

<sup>44</sup> *Ibid* at para 156.

<sup>45</sup> *Ibid* at para 159 [emphasis in original].

<sup>46</sup> *Ibid* at para 161.

<sup>47</sup> *Ibid* at para 162.

<sup>48</sup> *Ibid* at para 164.

In conducting this review, Wilton-Siegel J set out a two-pronged analysis to evaluate the significance of a shareholder vote:

- 1) Can the vote be reasonably regarded as a proxy for the fairness and reasonableness of the proposed arrangement?
- 2) If so, is there any reason arising out of the circumstances of the vote that prevents the Court from relying on that vote as an indicia of the fairness and reasonableness of the proposed arrangement?<sup>49</sup>

*6) Application of the Test to Evaluate the Significance of the Outcome of the Shareholder Vote to the Magna Arrangement*

In respect of the first question, Wilton-Siegel J determined that Magna's disclosure had set out the determinative question that a shareholder had to answer to come to a view on the efficacy of the transaction, that is, whether the potential benefits of the elimination of the dual class share structure justified the cost and the risk that the benefit would not be realized.<sup>50</sup> In answering this question in light of the outcome of the shareholder vote, he determined that the shareholders "would not have voted for the proposed Arrangement if they did not think that there was a reasonable possibility that the potential benefits justified the costs of the transaction."<sup>51</sup> Moreover, there was no suggestion that the shareholders were unable to make a decision, because of a lack of disclosure or otherwise, on the balancing of the costs and benefits of the transaction.<sup>52</sup>

In respect of the second question, Wilton-Siegel J set out four circumstances which could prevent the Court from adopting the conclusion inherent in the shareholder vote:

- (1) if a significant number of shareholders indicated that they were unable to vote because they could not reach a decision;<sup>53</sup>

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<sup>49</sup> *Ibid* at para 166.

<sup>50</sup> *Ibid* at para 168.

<sup>51</sup> *Ibid*.

<sup>52</sup> *Ibid* at para 169. As noted above, Magna had been ordered by the OSC to provide additional disclosure. The OSC reviewed and approved this disclosure. Thus, Magna shareholders had received comprehensive information about, among other things, the inception and negotiation of the transaction, and the Special Committee's decision to put the transaction to a shareholder vote. There was no suggestion by any shareholder that the level of disclosure surrounding the transaction was incomplete or insufficient to enable them to evaluate the transaction and come to a determination as to how to vote on the transaction.

<sup>53</sup> *Ibid* at para 173.

- (2) if misleading, incomplete or inadequate disclosure could be demonstrated;<sup>54</sup>
- (3) if there were conflicting interests among shareholders, such that the Court should analyze the vote in terms of separate and distinct classes;<sup>55</sup> or
- (4) if there was a coercive element to the structure of the proposed arrangement or inherent in the voting arrangement.<sup>56</sup>

Wilton-Siegel J concluded none of these scenarios applied to the facts before him and, accordingly, the Court should give considerable weight to the outcome of the shareholder vote in the analysis of whether the fair and balanced test was satisfied.

Wilton-Siegel J concluded on the basis of the market reaction, the evidence of the Special Committee's financial advisor and the Opposing Shareholders' expert, as well as the analyst reports that commented on the transaction, that there was at least a reasonable possibility that the increase in the trading price of the Class A Shares would generate an increase in the trading multiple that would be sufficient to offset the cost of the transaction.<sup>57</sup>

#### *7) Conclusion on the "Fair and Balanced" Test*

Ultimately, the Court found that the following indicia of fairness supported the conclusion that the "fair and balanced" test was satisfied on the face of the proposed Arrangement:

- (1) the outcome of the shareholder vote;
- (2) the market reaction to the announcement, which provided evidence that there was a belief among market participants that there was a reasonable possibility of achieving the benefits upon which the transaction is premised; and
- (3) the liquid trading market where Class A shareholders that opposed the transaction could sell their shares.<sup>58</sup>

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<sup>54</sup> *Ibid* at paras 174-76.

<sup>55</sup> *Ibid* at para 178.

<sup>56</sup> *Ibid* at para 179.

<sup>57</sup> *Ibid* at paras 189-94.

<sup>58</sup> *Ibid* at para 195.

In addition to the above analysis, Wilton-Siegel J specifically addressed the Opposing Shareholders' argument that the Court could not approve the proposed Arrangement because it was not and could not be in a position to conclude that the benefit to the Class A shareholders would exceed the cost of the transaction. In this regard, he held that balancing conflicting interests under the "fair and reasonable" test does not require a precise calculation. Rather, the Court must consider all qualitative and quantitative elements of the proposed arrangement and make an overall determination of its fairness.<sup>59</sup> In addition, Wilton-Siegel J clarified that this exercise does not require a fairness opinion from a financial advisor. A fairness opinion is not required in every proposed arrangement – it is ultimately the shareholders who must decide whether a proposed arrangement is fair, based on all relevant considerations.<sup>60</sup>

Finally, Wilton-Siegel J addressed the Opposing Shareholders' argument that the proposed Arrangement was unfair because the Class A shareholders bore more risk than the Stronach Trust. He concluded that there is no requirement of an equal distribution of risk in a commercial transaction, as ultimately, "the shareholders taking on the higher risk will necessarily have to make a decision as to whether the potential reward justifies the higher risk."<sup>61</sup> This is why "the outcome of a shareholder vote on the issue assumes such significance."<sup>62</sup> This conclusion was supported by three principles. First, when assessing the fairness of an arrangement, the court is not required to determine that the arrangement is perfect. A number of transactions may fall within a reasonable range of alternatives. The statutory provisions governing arrangements are not meant to regulate the characteristics of the proposed arrangement.<sup>63</sup> Second, while *BCE* requires an objective and substantive review of the proposed arrangement, this does not mean the court should disregard the shareholder vote.<sup>64</sup> Finally, an equal allocation of risk is not customarily regarded in the commercial world as necessary for a transaction to be fair.<sup>65</sup>

### 6. *The Appeal Decision*

The Opposing Shareholders appealed the decision to the Ontario Divisional Court, which found that Wilton-Siegel J correctly applied the

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<sup>59</sup> *Ibid* at para 200.

<sup>60</sup> *Ibid* at para 201.

<sup>61</sup> *Ibid* at para 206.

<sup>62</sup> *Ibid*.

<sup>63</sup> *Ibid* at para 208.

<sup>64</sup> *Ibid* at para 210.

<sup>65</sup> *Ibid* at para 211.



applicable legal test set out in *BCE*, and agreed with his findings of fact based on the record.

The Divisional Court focused its analysis on the “fair and reasonable” test, noting that it was really the only contentious issue on appeal.<sup>66</sup> In respect of the “valid business purpose” inquiry, the Divisional Court agreed with Wilton-Siegel J’s conclusion that it “requires only the demonstration of the prospect of clearly identified benefits to the corporation that have a reasonable prospect of being realized if the proposed Arrangement is implemented.”<sup>67</sup> The Divisional Court agreed that this requirement had been met, given that the Special Committee had weighed the costs and benefits of the proposed Arrangement and determined that it was in the best interests of Magna, and that the elimination of the dual class share structure would benefit Magna from both a corporate governance and a financial perspective.<sup>68</sup>

Moving to the question of whether the objections of the shareholders whose legal rights would be affected through the proposed Arrangement were being resolved in a fair and balanced way, the Divisional Court characterized the issue as “whether the costs and benefits of the proposed Arrangement to the Class A shareholders are fairly balanced in the circumstances ...”<sup>69</sup> Like Wilton-Siegel J, the Divisional Court placed considerable emphasis on the outcome of the shareholder vote. The Divisional Court also affirmed the holding that a fairness opinion is not a prerequisite in any arrangement where the analysis of the financial benefits to be received is complex, and agreed that it is ultimately up to the shareholders to decide.<sup>70</sup> The Court concluded that the shareholder vote in this particular case meant that the Class A shareholders were of the view that the value of what they were to receive was greater than what they were giving up.<sup>71</sup>

The Divisional Court disagreed with the Opposing Shareholders’ submission that Wilton-Siegel J made the outcome of the shareholder vote determinative.<sup>72</sup> The Court found that he had given consideration to (i) the Special Committee’s considerations in putting the proposed Arrangement before the shareholders; (ii) the disclosure made to Class A shareholders;

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<sup>66</sup> *Magna International Inc (Re)*, 2010 ONSC 4685, 101 OR (3d) 721 (Div Ct) at para 44.

<sup>67</sup> *Ibid* at para 50.

<sup>68</sup> *Ibid* at paras 48-49.

<sup>69</sup> *Ibid* at para 52.

<sup>70</sup> *Ibid* at para 62.

<sup>71</sup> *Ibid* at para 70.

<sup>72</sup> *Ibid* at paras 73, 78.

and (iii) the evidence that financial advisors and market analysts suggested a likelihood that there would be an increase to the trading price of the Class A Shares on a sustained basis.<sup>73</sup> The Divisional Court also noted that Wilton-Siegel J considered the other indicia of fairness set out in *BCE*, and specifically discussed why the absence of such indicia of fairness did not mean that the proposed Arrangement was unfair in this case.<sup>74</sup>

### *7. Lessons Learned: The Application of the “Fair and Reasonable” Test*

The *Magna* proceeding is instructive insofar as it addresses the application of the “fair and reasonable” test applicable to all court approvals of proposed plans of arrangement. While both the Superior Court and the Divisional Court rulings reiterated the comments of the Supreme Court in *BCE* to the effect that the analysis is necessarily fact-specific and will turn on the particular factual context of the transaction in issue, the decisions nonetheless provide some helpful insight into how the courts will carry out their statutory mandate. In so doing, the *Magna* rulings also offer direction as to how certain of the *BCE* “principles” will be applied.

The first element of the “fair and reasonable” analysis, namely the “valid business purpose” prong of the test, suffered from a lack of definitional clarity by virtue of the Supreme Court’s abstract discussion of the test in *BCE*. The reasoning adopted by Wilton-Siegel J, however, offers helpful insight into the scope and application of this aspect of the common law analysis. In particular, he observed at the outset that the “valid business purpose” is to be assessed from the perspective of the corporation as a whole, as distinct from any particular stakeholder subgroup. Clearly this must be the correct interpretation if this first prong of the test is to have any independent meaning.

Perhaps of greater significance, however, was the Court’s discussion of the principle of “necessity” and its role in the valid business purpose inquiry. In *BCE*, the Supreme Court commented that an “important factor for courts to consider when determining if the plan of arrangement serves a valid business purpose is the necessity of the arrangement to the continued operations of the corporation.”<sup>75</sup> While this principle may have intuitive appeal in the abstract, the fact remains that the vast majority of arrangement transactions are not entered into for reasons of “necessity.” Aside from instances where corporations undertake a plan of arrangement as a means to avoid an insolvency filing, which is certainly not uncommon,

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<sup>73</sup> *Ibid* at para 75.

<sup>74</sup> *Ibid* at para 76.

<sup>75</sup> *BCE*, *supra* note 1 at para 146.

the vast majority of arrangement transactions are entered into for reasons of commercial advantage. They are not strictly “necessary ... for the continued operation of the corporation.” Accordingly, a strict application of the “necessity” test would impose a significant burden on commercial parties and would unduly restrict an otherwise flexible statutory mechanism.

Fortunately, the *Magna* decision avoids this undesirable result by acknowledging the “necessity” commentary in *BCE*, while at the same time articulating a commercially reasonable threshold that must be satisfied by plans of arrangement which do not fall within the ambit of “necessary” transactions. Indeed, Wilton-Siegel J plainly acknowledged that “it cannot be said that the proposed Arrangement is necessary for the continued operation of Magna.”<sup>76</sup> Nevertheless, he proceeded to adopt a “standard of careful scrutiny” that ultimately fashions the “valid business purpose” test into a threshold inquiry that is not overly burdensome.<sup>77</sup> In so doing, he concluded that a commercial party seeking approval of a plan of arrangement must simply “demonstrate the prospect of clearly identified benefits to the corporation that have a reasonable prospect of being realized if the [a]rrangement is implemented.”<sup>78</sup> In other words, even where the transaction cannot be said to be “necessary” for the continued operation of the corporation, the applicant must merely adduce evidence of “clearly identified benefits” arising from the consummation of the proposed arrangement. This practical application of the “valid business purpose” test accords with the analysis undertaken in the pre-*BCE* jurisprudence, and is consistent with commercial realities. Simply put, a plan of arrangement should *not* be required to be deemed “necessary” so long as it has a reasonable prospect of realizing identifiable commercial benefits for the applicant corporation.

As the *Magna* decisions clearly illustrate, the more significant aspect of the “fair and reasonable” test is the second prong of the analysis, which was characterized by the Supreme Court in *BCE* as addressing the issue of whether the “objections of those whose legal rights are being arranged are being resolved in a fair and balanced way.”<sup>79</sup> Indeed, when the elements of the “fair and reasonable” test are considered as a whole, it is arguable that the “valid business purpose” test serves merely as a threshold consideration that is intended to eliminate improper or unfounded commercial transactions. Conversely, the second prong of the analysis delves more deeply into the substance of the transaction and its relative

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<sup>76</sup> *Magna*, *supra* note 2 at para 119.

<sup>77</sup> *Ibid* at para 120.

<sup>78</sup> *Ibid* at para 122.

<sup>79</sup> *BCE*, *supra* note 1 at para 138.

impact on the various stakeholders. It is in this latter context that the Court undertakes the “meat” of its inquiry into the fairness and reasonableness of the proposed plan of arrangement.

At the outset, it is interesting to note that both the Superior Court and the Divisional Court in the *Magna* proceeding refer to this second prong as simply the “fair and balanced” analysis. Although both courts began by adopting the *BCE* phraseology, their ultimate application of the test had little to do with the “resolution of objections.”<sup>80</sup> Rather, in the words of Wilton-Siegel J, the “fair and balanced” test that is to be ultimately applied by the courts addresses the question of “whether the costs and benefits of the proposed [a]rrangement ... are fairly balanced.”<sup>81</sup> What is more, the Court made it abundantly clear that this cost-benefit analysis is not simply a mechanical exercise of weighing the financial risks and rewards of the proposed transaction to the various stakeholders, although this will certainly factor into the overall analysis. Rather, the “fair and balanced” test obligates the court to look at all aspects of the transaction, including the “traditional indicia of fairness” identified by the Supreme Court in *BCE*, to determine whether the potential benefits are fairly balanced as against the inherent costs of the transaction:

The concept of “balancing” conflicting interests does not require a precise calculation. Instead, the court is required to make a determination with respect to the overall fairness and reasonableness of a plan of arrangement. It is that determination to which the Supreme Court refers in para. 136 of *BCE* when it says that what is required is that the arrangement, “viewed substantively and objectively,” must be suitable for approval. This is as much a qualitative as a quantitative determination. Such a “balancing” will often require the court to take into account more intangible, qualitative considerations as well as the quantitative elements of a plan of arrangement. Even in respect of financial benefits that can be quantified, the test requires a “balancing,” not a precise determination.<sup>82</sup>

On the facts of the *Magna* transaction, none of the “traditional indicia” of fairness (as summarized in *BCE*) were present, aside from a favourable shareholder vote. In particular, the transaction lacked a fairness opinion, a special committee or board recommendation to shareholders, and dissent rights. It was on this basis (among others) that the dissenting shareholders

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<sup>80</sup> As mentioned, the Supreme Court’s own analysis in *BCE* under this second prong of the test was also far broader than the Court’s abstract articulation of the test would suggest, incorporating a number of factors that appeared to be wholly disconnected from the issue of “resolution of objections.”

<sup>81</sup> *Magna*, *supra* note 2 at para 135.

<sup>82</sup> *Ibid* at para 200.

opposed the transaction. Accordingly, the Court was required to “substantively and objectively” assess the overall fairness of the transaction without the benefit of the traditional signposts of fairness.

In so doing, Wilton-Siegel J devoted significant attention to the relative importance of shareholder approval of the proposed transaction. This emphasis on the role played by the shareholder vote was undoubtedly influenced by the Court’s acknowledgement of the fact that while an informed shareholder vote could arguably be determinative of the relative “fairness” of any particular transaction, the governing statutory provisions nonetheless require judicial approval of an arrangement, over and above shareholder approval. In view of this, the Court described its role in assessing the importance of shareholder approval as follows:

... [T]he outcome of a shareholder vote is not, by itself, determinative of the fairness and reasonableness of an arrangement. A judge must review the circumstances surrounding the vote to assess the significance to be attached to the shareholder vote. In particular, a judge must review the nature of the shareholder vote to determine whether the vote can reasonably be regarded as a proxy for the fairness and reasonableness of the plan of arrangement and, if so, whether there is any reason arising out of the circumstances surrounding the vote that prevents the court from relying on that vote as an indicia of the fairness and reasonableness of the plan of arrangement.<sup>83</sup>

Notably, the above description of the Court’s role leaves open the possibility that, in appropriate circumstances, the vote itself will be wholly determinative of fairness. However, Wilton-Siegel J made it equally clear that in certain circumstances the shareholder vote could not be relied upon as a proxy for fairness. In particular, he considered “four circumstances which could prevent the court from adopting the conclusion inherent in the shareholder vote,” namely (i) an expression by a significant number of shareholders that they were unable to vote because they could not reach a decision; (ii) the existence of misleading shareholder disclosure; (iii) evidence of differing economic interests among members of a shareholder class; and (iv) a transactional or voting structure that is inherently coercive.<sup>84</sup>

On the facts before him, Wilton-Siegel J concluded that the favourable shareholder vote should be given “considerable weight,” although he stopped short of concluding that it was determinative of fairness. This finding in support of the shareholder approval was influenced, among

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<sup>83</sup> *Ibid* at para 164.

<sup>84</sup> *Ibid* at paras 172-74, 178-79.

other things, by the extensive shareholder and public disclosure that had preceded the vote by Magna's shareholders. Further, Wilton-Siegel J's decision suggests that a shareholder vote may carry greater weight when the transaction impacts a single class of stakeholders, or impacts multiple stakeholders in the same manner and degree. In other words, when there are objectors to a proposed arrangement *within* a class of shareholders, but this class of shareholders ultimately voted in favour of the arrangement, the shareholder vote carries great weight in respect of whether the objections of the opposing shareholders are being resolved in a fair and reasonable manner.<sup>85</sup>

Two additional features of the transaction were also deemed to be supportive of the overall "fairness and reasonableness" of the proposed Arrangement, neither of which has been traditionally recognized as an "indicium of fairness." The first – the market reaction following the announcement of the transaction by Magna – was deemed to be "evidence that there is a belief among market participants that there is a reasonable possibility of achieving the potential benefits upon which the transaction is premised."<sup>86</sup> In so finding, the Court was clear that "market reaction" was not to be taken as an indication as to whether the benefits of the transaction would ultimately be realized, or even whether the transaction was inherently "fair." Rather, a favourable reaction by the markets to the announcement of the transaction was taken to be an indication of a positive belief among market participants which, in and of itself, precluded a finding that the underlying transaction was "inherently unfair." Although the precise role of market reaction in the overall fairness assessment remains unclear, the *Magna* decision suggests that a favourable market reaction may factor into the Court's analysis under the second prong of the *BCE* "fair and reasonable" test.

In addition, the Court found that the availability of a liquid trading market was a further "indicium of fairness."<sup>87</sup> Interestingly, the very existence of such a trading market was also the basis on which dissent rights were not provided to Magna shareholders. While the Opposing Shareholders sought to use this absence of dissent rights as grounds for attacking the structure of the transaction, the Court ultimately found that the existence of a liquid trading market not only obviated the need for

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<sup>85</sup> This is in contrast to the situation in *BCE*, where the objectors were bondholders who did *not* have the same "interest" in the arrangement as the shareholders, and who were not provided with an independent vote in respect of the proposed transaction. Indeed, the bondholders were to be adversely affected by the proposed arrangement of *BCE*, whereas the shareholders were likely to benefit from it.

<sup>86</sup> *Magna*, *supra* note 2 at para 195.

<sup>87</sup> *Ibid.*

dissent rights, but was also a stand-alone indicator of fairness by virtue of the fact that shareholders could sell into the open market at any point. Accordingly, while the “typical” arrangement transaction requires stakeholders to surrender their securities in accordance with the terms of the plan, often resulting in the provision of dissent rights, the *Magna* proceedings suggest that transactions which are structured to preserve a liquid trading market will be subject to a lower level of scrutiny by the courts insofar as the “fair and reasonable” test is concerned.

While the test for court approval of a statutory plan of arrangement remains highly fact-specific, the *Magna* decision provides helpful insight into the manner in which the “fair and reasonable” test articulated by the Supreme Court in *BCE* will be applied in the context of a given transaction.