Corporate Securities Law

June 30, 2010

Magna - The OSC Decision

The proposed reorganization of the share capital of Magna International Inc. – which would result in the collapse of Magna's dual class capital structure – has attracted significant attention due to, among other things, the profile of the parties, the premium proposed to be paid to Frank Stronach and related entities to collapse a share structure that many institutional shareholders have found objectionable, and the possible implications of the transaction as a precedent for other Canadian issuers with similar structures.

On June 24, 2010, the Ontario Securities Commission (the "OSC") released its decision (with reasons to follow) in connection with an application by Staff of the OSC to, among other things, cease trade the transaction on the basis that it was in the "public interest" to do so as a result of what Staff believed was insufficient disclosure and flaws in the process followed by the Magna board of directors.

Magna's Dual Class Share Structure

Since it was founded by Frank Stronach, Magna has had a "dual class capital structure" through which Mr. Stronach and related entities control approximately 66% of the voting rights through a special class of Multiple Voting Shares that represent less than 1% of the outstanding equity. Mr. Stronach, directly and through associated entities, also provides services to Magna under consulting agreements pursuant to which aggregate annual fees are payable of up to $2.3 million plus 3% of Magna's pre-tax profit. In 2007, 2008 and 2009, those fees amounted to $40 million, $10 million and $0, respectively.

This share structure and these consulting agreements have been the subject of ongoing criticism from various shareholders over the years and, according to some, have resulted in a depressed trading price for Magna's shares.

The Proposed Transaction

Discussions between senior management of Magna and Mr. Stronach earlier this year resulted in a proposal by management to the Magna board to collapse the dual class share structure and "cap" the payments under the consulting agreements and under which:

- the 776,961 Multiple Voting Shares controlled by Mr. Stronach would be repurchased by Magna for consideration consisting of nine million Subordinate Voting Shares and $300 million cash – total consideration that Magna valued at $863 million and that, by some calculations, was about 18 times the market value of the Multiple Voting Shares,
- the consulting agreements would be extended for five years with fixed annual fees, and
- Magna's E-car business would be reorganized and held through an entity that would be controlled by a Stronach entity through a dual class share structure.

Magna's board created a special committee of independent directors to consider the proposal for submission initially to Mr. Stronach and, if acceptable to him, to report to the board as to whether the proposed transaction should be submitted to Magna shareholders for their consideration. The special committee engaged its own advisors, including CIBC World Markets Inc. as its independent financial advisor and PricewaterhouseCoopers LLP as an independent financial advisor to prepare a valuation of Magna's E-car business. CIBC was not engaged to, and did not, provide a fairness opinion, adequacy opinion or formal valuation of the Multiple Voting Shares. However, CIBC did advise the special committee that the repurchase by Magna of the Multiple Voting Shares on the

proposed terms would result in dilution to the other shareholders of Magna that would be significantly greater than was the case for other historical transactions in which dual class share structures were collapsed.

The special committee and, on its recommendation, the Magna board concluded that the proposed transaction – which would be implemented pursuant to a court-approved plan of arrangement, in which the court would address the fairness and reasonableness of the approval – should be submitted to Magna's shareholders for their consideration and approval (including approval by a majority of the independent holders of the Subordinate Voting Shares).

A special meeting of Magna shareholders was scheduled for June 28, 2010. The materials for that meeting did not contain a recommendation by the special committee or the board or a fairness opinion or copies of the reports prepared by CIBC and PricewaterhouseCoopers.

The Challenge

While the trading price of the Subordinate Voting Shares moved up after the announcement of the proposed transaction, it received mixed reaction from institutional shareholders, with a number of large, Canadian institutional investors reacting strongly and vocally against the premium that would be received by Mr. Stronach and related entities.

On June 15, 2010, Staff of the OSC issued a notice of hearing seeking orders in the "public interest" preventing completion of the proposed transaction and requiring enhanced disclosure to shareholders on the basis that the transaction would be contrary to the public interest in that:

- the shareholders were being asked to consider the transaction without a recommendation from the Magna board and the disclosure provided to Magna's shareholders was insufficient for them to make an informed decision about the proposed transaction, and
- the approval and review process followed by the Magna board in negotiating the transaction and proposing it to shareholders was inadequate.

Magna subsequently released additional information regarding certain aspects of the proposed transaction, including two reports that had been prepared by CIBC and PricewaterhouseCoopers' valuation of Magna's E-car business.

The OSC Decision

After a two-day hearing, a three-member panel of the OSC determined that the proposed transaction was not "abusive" and that it was the shareholders of Magna that ultimately should decide whether it proceeds.

At the same time, the panel determined that the disclosure provided to Magna shareholders was insufficient to permit them to make an informed decision as to how to vote. The panel noted that the proposed transaction is complex and constitutes a material related party transaction with no recommendation to shareholders from either the board or the special committee as to their view of the fairness of the proposed transaction. As result, the panel expressed concern that shareholders would be left to their own devices in making the decision as to how they will vote. In this context the panel required that, to the extent reasonably possible, shareholders be provided:

> *substantially the same information and analysis that the Special Committee received in considering and addressing the legal and business issues raised by the Proposed Transaction. [emphasis added]*

The panel also indicated that, in these circumstances, the meeting materials must contain a statement that the disinterested members of the board or the special committee have concluded that the materials provide disclosure and information sufficient to permit shareholders to make an informed decision as to how to vote on the proposed transaction. The panel ordered that the transaction not proceed until the disclosure was augmented and approved by Staff.

The panel did not accept Staff's submissions that the circumstances of the proposed transaction gave rise to the level of "abuse" that would warrant intervention

by the regulator. The panel also noted that, while neither the special committee nor the board was required to make a recommendation to shareholders:

> *We have some concerns with the process followed by the Board, the Special Committee and management in reviewing and deciding to submit the Proposed Transaction to Shareholders for approval. We will discuss those issues in our reasons.*

Implications of the Decision

Notwithstanding that the panel's decision recognized that the proposed transaction is "extraordinary" and "unique", based on past experience it is inevitable that the decision will be relied upon as precedent in other circumstances. While its implications will depend significantly on the reasons that are yet to be written:

- The decision suggests a greater willingness than has been evidenced in the past for the OSC to review disclosure provided in the context of shareholder meetings.
- The decision suggests that where a board does not provide a recommendation to shareholders as to how to vote (or, perhaps, whether to accept a take-over bid), the OSC may require that shareholders have access to the same information that the board had access to in assessing the transaction.
- The disclosure required by the panel, which although qualified by a standard of reasonableness, may have the potential to compromise privilege that otherwise might attach to advice provided to a board and committees of a board.
- As it did in connection with its *HudBay* decision, it appears that the OSC will continue to comment on corporate governance processes even in situations where those processes were found not to warrant intervention by the OSC.

Please contact any member of Goodmans' Corporate Securities Group to discuss this decision.

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