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IN THE MATTER OF THE SECURITIES ACT
R.S.O. 1990, CHAPTER S.5, AS AMENDED (the Act)

AND

IN THE MATTER OF
FALCONBRIDGE LIMITED

Hearing:	June 27, 2006		
Order:	June 30, 2006		
Reasons:	August 17, 2006		
Panel:	Wendell S. Wigle, Q.C.	-	Chair of the Panel
	Suresh Thakrar	-	Commissioner
	David L. Knight, FCA	-	Commissioner
Counsel:	Kent Thomson William Ainley James Doris Kenneth Klassen	-	for Xstrata plc and Xstrata Canada Inc.
	R. Paul Steep Gary Girvan Dana Peebles Eric Block	-	for Falconbridge Limited
	Larry Lowenstein Laura Fric Don Gilchrist Sarah Millar	-	for Inco Limited
	Johanna Superina Naizam Kanji Shannon O'Hearn	-	for Staff of the Ontario Securities Commission

REASONS

TABLE OF CONTENTS

THE APPLICATIONS

[1] The applications arose from a take-over bid contest for Falconbridge Limited (**Falconbridge**), between an offer by Inco Limited (**Inco**) supported by the Falconbridge Board of Directors (the **Falconbridge Board** or **Board**) and an unsolicited offer by Xstrata Canada Inc.

[2] On May 18, 2006, Xstrata plc and Xstrata Canada Inc. (together, **Xstrata**) applied to the Commission for an order under section 127 of the *Securities Act* (the **Act**) that trading cease immediately in respect of any securities issued, or to be issued, under or in connection with the shareholder rights plan adopted by the Falconbridge Board on March 21, 2006 (the **Replacement Rights Plan)** and that exemptions from the prospectus and registration requirements shall not apply to any trades in securities of Falconbridge pursuant to or in connection with that rights plan.

[3] On June 20, 2006, Falconbridge filed a cross-application for an order under section 127 of the Act prohibiting Xstrata from acquiring any Falconbridge common shares (the **Falconbridge Shares**) under the exemption in section 94(3) of the Act until the expiry of the Xstrata Offer, defined below.

[4] At the same time, Inco applied for intervenor standing. At the hearing of this matter, after considering the submissions and on consent of all parties, we granted Inco full standing with the proviso that we would not allow Inco to make repetitive contributions to the hearing in its affidavit evidence, cross-examinations, or submissions. Inco supported Falconbridge's cross-application.

HEARING AND DECISION

[5] We heard the applications on June 27, 2006, following which we reserved our decision.

[6] By Order issued June 30, 2006, with reasons to follow, we ordered that:

1. pursuant to clause 2 of subsection 127(1) of the Act, trading in any securities issued, or to be issued, under or in connection with the Replacement Rights Plan shall cease on the earlier of:

    (a) the date Xstrata takes up sufficient Falconbridge shares to meet its majority of the minority condition,
    (b) July 28, 2006; and

2. pursuant to clause 3 of subsection 127(1) of the Act, the exemption created by subsection 94(3) to the restrictions on purchases during a take-over bid found in section 94(2) of the Act shall not apply to Xstrata until the earlier of the following dates:

    (a) the date Xstrata takes up sufficient Falconbridge shares to meet its majority of the minority condition,
    (b) July 28, 2006.

[7] The following are the reasons for our decision.

BACKGROUND

Falconbridge and Noranda

[8] Falconbridge as it exists today resulted from an amalgamation with its parent Noranda Inc. (**Noranda**) in June 2005. Brascan Corporation (**Brascan**) owned 41% of Noranda before that date. The impetus for the amalgamation was the announcement by Brascan to the management of Noranda and the old Falconbridge company in February 2004 of its intention to divest its holdings in Noranda.

[9] The Noranda board pursued the sale of Noranda in early 2004, but was not successful. On June 16, 2004, Noranda announced that it was conducting a review of various means of maximizing shareholder value. Over the summer of 2004, Noranda and its advisors negotiated with a number of parties – including Inco and Xstrata – respecting their interest in acquiring Noranda.

[10] Because negotiations in 2004 did not lead to any transactions, Noranda's management pursued other alternatives. On June 30, 2005, Noranda and the old Falconbridge company were amalgamated to form the new Falconbridge company, the target of the take-over bids in this hearing.

Xstrata Acquires Almost 20% of Falconbridge

[11] On August 15, 2005, Xstrata acquired Brascan's interest in Falconbridge, resulting in Xstrata initially holding a 19.9% stake in Falconbridge at a cost of $28 per share. Xstrata acquired additional Falconbridge Shares in three separate private transactions in an attempt to increase its holdings in Falconbridge above 20%. Following additional share issuances by Falconbridge, however, Xstrata's ownership level dropped to its current 19.8%.

[12] A condition of its deal with Brascan was Xstrata's obligation to top-up the purchase price paid to Brascan if, within nine months of the deal, Xstrata or any of its affiliates made an offer or announced the intention to acquire a majority or more of the Falconbridge Shares at a price per share in excess of C$28.

[13] On August 25, 2005, the Falconbridge Board heard a presentation from Xstrata, which included a discussion about, among other things, the possible combination of Xstrata and Falconbridge and a request by Xstrata for board representation. Discussions continued but broke down by mid-September.

Falconbridge and Inco Negotiations

[14] On September 9, 2005, the CEOs of Falconbridge and Inco met to determine whether Inco would be interested in pursuing a transaction involving Falconbridge. Inco and Falconbridge entered into a confidentiality and standstill agreement dated September 13, 2005 and began exchanging confidential information.

The First Rights Plan – September 2005

[15] On September 22, 2005, the Falconbridge Board adopted a shareholder rights plan (the **First Rights Plan**). The First Rights Plan would be triggered in the event that a party, acting alone or together with related parties, acquired or announced its intention to acquire more than 20% of the Falconbridge Shares unless the acquisition was made by way of a "permitted bid" or with the approval of the Falconbridge Board. A "permitted bid" had to (i) be a bid made for all Falconbridge Shares, (ii) be open for 60 days from the date of announcement and extended for 10 days after the bidder first took up shares under the bid, and (iii) have an irrevocable condition that a majority of the Falconbridge Shares, other than those held by the bidder, be tendered under the bid. If the Rights Plan were triggered, rights holders – other than the acquiring party(ies) – could purchase Falconbridge Shares at half the prevailing market price at the time the rights became exercisable.

The Inco Offer and the Support Agreement

[16] On October 7, 2005, Inco's CEO presented a proposed offer to the CEO and the President of Falconbridge. On October 10, 2005, Inco made a formal offer (the **Inco Offer**) under which Falconbridge shareholders could elect to receive a combination of cash and Inco stock, subject to proration, in exchange for their Falconbridge Shares. The Inco Offer was subject to several conditions, including (a) obtaining certain regulatory approvals, (b) an irrevocable condition that not less than 50.01% of Falconbridge Shares held by shareholders independent of Inco be tendered under the offer, (c) a waivable condition that at least 66 ⅔% of Falconbridge Shares be tendered under the offer, and (d) reaching agreement on the terms of a support agreement. The purpose of the minimum tender conditions was to allow Inco to undertake a second step transaction to acquire any Falconbridge Shares not tendered under the Inco Offer.

[17] Inco and Falconbridge executed a support agreement on October 10, 2005 (the **Support Agreement**) in connection with the Inco Offer. The Support Agreement protected and supported the Inco Offer through deal protection provisions, including: (a) covenants by Falconbridge not to solicit or facilitate offers to acquire Falconbridge, (b) a covenant that Falconbridge would not redeem rights or otherwise waive, amend, suspend or terminate its shareholders rights plan without Inco's prior written consent, (c) an agreement to allow Inco to match any competing offers, and (d) a requirement that Falconbridge pay Inco a U.S. $320 million break fee in certain circumstances, including in the event Falconbridge withdrew its recommendation of the Inco Offer. The Support Agreement also contained a standard "fiduciary out" clause, which allowed Falconbridge to terminate the Support Agreement in the event of: (a) a competing offer or proposal that the Falconbridge Board determined was a "superior proposal" for the purposes of the Support Agreement, and (b) upon expiry of Inco's right to match the competing offer. Termination fees were still payable by Falconbridge under the "fiduciary out " clause.

[18] The Inco Offer was extended three times: on December 8, 2005, expiring January 27, 2006; on January 12, 2006, expiring February 28, 2006; and on February 21, 2006, expiring June 30, 2006. The purpose of the extensions was to give Inco more time to obtain regulatory approvals, including approval by the European Union.

The Replacement Rights Plan – March 2006

[19] The First Rights Plan required shareholder approval within six months of its adoption – by March 22, 2006 – failing which the plan would terminate in accordance with its terms. Falconbridge did not seek shareholder approval of the First Rights Plan.

[20] On March 21, 2006, the Falconbridge Board executed the Replacement Rights Plan, which was substantially similar to the First Rights Plan. The stated purpose of the Replacement Rights Plan was:

> to prevent a creeping takeover of Falconbridge and ensure that any offer to acquire Falconbridge is made to all shareholders for all their Falconbridge Shares and that such an offer could not be completed unless shareholders holding at least 50% of the Falconbridge Shares [other than the offeror or related parties] are tendered in favour of the offer…The Plan is also designed to ensure that all Shareholders are treated fairly in any transaction involving a change in control of Falconbridge and have an equal opportunity to participate in the benefits of a take-over bid.

[21] A "permitted bid" under the Replacement Rights Plan would be an offer to all Falconbridge shareholders to acquire all of their Falconbridge Shares that would contain an irrevocable condition that a majority of Falconbridge Shares, other than those held by the bidder, be tendered under the bid (a "majority of the minority").

Inco Improves Its Offer

[22] On May 13, 2006, Inco advised Falconbridge that it was prepared to make an improved offer upon negotiation of satisfactory amendment to the Support Agreement, including an increase in the break fee to U.S. $450 million. The Falconbridge Board approved the amendment to the Support Agreement to recommend acceptance of the amended Inco Offer to its shareholders. Inco increased its Offer for the Falconbridge Shares.

The Xstrata Offer

[23] Xstrata's top-up obligation to Brascan, now known as Brookfield Asset Management Inc., expired on May 15, 2006.

[24] On May 18, 2006, Xstrata made a formal offer to acquire all the Falconbridge Shares that it did not own (the **Xstrata Offer**). The Xstrata Offer was an all-cash offer of C$52.50 per share for all Falconbridge Shares, expiring July 7, 2006. It was conditional upon, among other things: (a) obtaining certain regulatory approvals, (b) the Replacement Rights Plan not being effective at the time of take-up and payment, and (c) waivable minimum tender conditions: (i) 66 ⅔% of Falconbridge Shares and (ii) a majority of Falconbridge Shares held by shareholders independent of Xstrata. The purpose of the minimum tender conditions, as in the Inco Offer, was to facilitate a second step transaction to acquire any Falconbridge Shares not tendered under the Xstrata Offer.

[25] Although both the Inco Offer and the Xstrata Offer included a majority of the minority minimum tender condition, only the Inco Offer was a permitted bid under the Replacement Rights Plan because its condition was irrevocable. Xstrata could waive its condition.

[26] In its Directors' Circular issued May 31, 2006, the Falconbridge Board stated its conclusion that the Xstrata Offer was: highly conditional, with most conditions in Xstrata's discretion to determine; not a permitted bid and could be coercive; and not a "Superior Proposal" as defined in the Support Agreement. The Falconbridge Board determined not to make a recommendation to shareholders with respect to the Xstrata Offer, but continued to recommend that shareholders accept the Inco Offer.

The Falconbridge Proposal regarding the Applications

[27] On Sunday, June 25, 2006, Falconbridge served on Xstrata and Inco and filed with the Commission a letter stating conditions under which it would consent to the Replacement Rights Plan ceasing to apply to the Xstrata Offer (the **Falconbridge Proposal**):

> We are writing on behalf of Falconbridge to advise you that Falconbridge is prepared to have the [Replacement Rights Plan] cease to apply to Xstrata's take-up of Falconbridge Shares under the Xstrata Offer, in the following circumstances:
>
> 1. The earlier of the following dates have occurred:
> (a) the date Xstrata takes up sufficient Falconbridge shares to meet its majority of the minority condition; and
> (b) July 28, 2006.
>
> 2. Xstrata will have amended the Xstrata Offer to provide that in the event it takes up and pays for any Falconbridge shares under the Xstrata Offer, Xstrata will extend its offer for at least ten days on the same terms and conditions contained in the Xstrata Offer, in order to allow those Falconbridge shareholders who may not have tendered to the Xstrata Offer to do so.
>
> 3. Xstrata will not make use of the exemption set forth in Section 94(3) of the Act until the earlier of the following dates:
> (a) the date Xstrata takes up sufficient Falconbridge shares to meet its majority of the minority condition; and
> (b) the date the Inco offer expires.

[28] Inco responded that it was prepared to accept the terms of the Falconbridge Proposal and proceed on the basis of those terms. Xstrata rejected the Falconbridge Proposal.

Inco Announces a Combination with Phelps Dodge and Further Improves Its Offer

[29] On the evening of June 25, 2006, Phelps Dodge Corporation (**Phelps Dodge**), Inco and Falconbridge jointly announced that they had agreed to combine in a US$56 billion transaction. Under the terms of the transaction, Phelps Dodge would acquire all of the outstanding common shares of Inco for a combination of cash and common shares of Phelps Dodge. Each shareholder of Inco would receive 0.672 shares of Phelps Dodge stock plus C$17.50 per share in cash for each share of Inco.

[30] The day before the hearing, on June 26, 2006, Inco announced a further variation of its Offer and extended the expiry date to July 13, 2006. Simultaneous with its entry into the combination agreement with Phelps Dodge, Inco entered into an agreement with Falconbridge to increase its previously recommended offer for Falconbridge. Financing from Phelps Dodge

allowed Inco to raise its offer price and keep the auction alive. Under the terms of this enhanced offer, Inco offered Falconbridge shareholders, at their election, C$53.83 in cash, or 0.82419 of an Inco common share plus C$0.05 in cash, for each Falconbridge share subject to pro ration. Assuming full pro ration, Falconbridge shareholders would receive C$17.50 in cash and 0.55676 of an Inco common share for each share of Falconbridge. The Falconbridge Board unanimously agreed to recommend this revised offer and approved an amendment of the Support Agreement with Inco to reflect the revised price.

THE ISSUES

[31] The applications raised two main issues: (A) whether it was time for the Replacement Rights Plan to be cease traded, and (B) whether Xstrata should be prohibited from making market acquisitions of up to 5% of Falconbridge Shares as otherwise permitted by section 94(3) of the Act during the course of the Xstrata Offer.

ISSUE A: The Replacement Rights Plan

Law

[32] The objectives of the take-over bid provisions of the Act are well-stated in National Policy 62-202:

> 2. The primary objective of the take-over bid provisions of Canadian securities legislation is the protection of the bona fide interests of the shareholders of the target company. A secondary objective is to provide a regulatory framework within which take-over bids may proceed in an open and even-handed environment. The take-over bid provisions should favour neither the offeror nor the management of the target company, and should leave the shareholders of the target company free to make a fully informed decision. The Canadian securities regulatory authorities are concerned that certain defensive measures taken by management of a target company may have the effect of denying to shareholders the ability to make such a decision and of frustrating an open take-over bid process.
>
> 5. The Canadian securities regulatory authorities consider that unrestricted auctions produce the most desirable results in take-over bids and they are reluctant to intervene in contested bids. However, they will take appropriate action if they become aware of defensive tactics that will likely result in shareholders being deprived of the ability to respond to a take-over bid or to a competing bid.
>
> 6. The Canadian securities regulatory authorities appreciate that defensive tactics, including those that may consist of some of the actions listed in subsection (4), may be taken by a board of directors of a target company in a genuine attempt to obtain a better bid. Tactics that are likely to deny or limit severely the ability of the shareholders to respond to a take-over bid or a competing bid may result in action by the Canadian securities regulatory authorities.

[33] In past matters dealing with shareholder rights plans, the Commission has balanced the public interest regarding the right of the shareholders of the target to tender their shares to the bidder of their choice against the duties of the target board to maximize shareholder value. In *Lac Minerals*, for example, the Commission said:

> The Commission will only make an order under section 127 of the Act when it is in the public interest to do so. In considering whether to make an order in this case, the real issue the

> Commission had to determine was whether, the extent to which, and when the Commission should interfere with the conduct of the Lac Board, professed to be directed at maximizing shareholder value, in the interests of allowing the shareholders of Lac to respond to one of the two outstanding take-over bids.
>
> *Re Lac Minerals Ltd.* (1994), 17 O.S.C.B. 4963 (*Lac Minerals*) at pages 4968-4969.

[34] While the Commission has been reluctant to intervene where the target board, acting reasonably, has expressed its confidence that it can increase shareholder value "within a limited period of time", it will intervene to the extent necessary to protect the interest of target shareholders. In *Royal Host*, the Ontario, British Columbia and Alberta securities commissions noted that the challenge was:

> in finding the appropriate balance between permitting the directors to fulfil their duty to maximize shareholder value in the manner they see fit and protecting the right of the shareholders to decide whether to tender their shares to the bid.
>
> *Re Royal Host Real Estate Investment Trust and Canadian Hotel Income Properties Real Estate Investment Trust* (1999), 22 O.S.C.B. 7819 (***Royal Host***)

[35] The commissions in *Royal Host* acknowledged that all shareholder rights plan proceedings are fact specific. Accordingly, there is no "holy grail" of a specific test or series of tests that can be applied to all circumstances where a commission is called upon to rule on a shareholder rights plan. The commissions in *Royal Host* "simply considered all the relevant factors rather than attempting to establish and apply a comprehensive and conclusive test". They said:

> While it would be impossible to set out a list of all of the factors that might be relevant in cases of this kind, they frequently include:
>
> - whether shareholder approval of the rights plan was obtained;
> - when the plan was adopted;
> - whether there is broad shareholder support for the continued operation of the plan;
> - the size and complexity of the target company;
> - the other defensive tactics, if any, implemented by the target company;
> - the number of potential, viable offerors;
> - the steps taken by the target company to find an alternative bid or transaction that would be better for the shareholders;
> - the likelihood that, if given further time, the target company will be able to find a better bid or transaction;
> - the nature of the bid, including whether it is coercive or unfair to the shareholders of the target company;
> - the length of time since the bid was announced and made;
> - the likelihood that the bid will not be extended if the rights plan is not terminated.
>
> *Royal Host* at page 7828

Analysis

[36] Shareholder rights plans and support agreements are neither novel nor exotic. They are, however, unique to the circumstances of each transaction. Accordingly, the reasoning applied to determine one matter may be wholly or partially inappropriate in another.

[37] The unique circumstances of this case are worth summarizing here:

(a) the unsolicited bidder – Xstrata – is the target company – Falconbridge's – largest shareholder, holding 19.8% of the Falconbridge Shares, and relations between the target and its largest shareholder are strained;

(b) the Falconbridge Board was concerned that Xstrata could potentially buy only enough shares to attain a blocking position via permitted market purchases (i.e, it could "creep" into a blocking position) or a partial bid, thereby deterring other potential offerors for the Falconbridge Shares;

(c) the current competing offer by Inco had an irrevocable minimum tender condition, and was supported by a support agreement between Inco and Falconbridge;

(d) Xstrata was under an obligation to pay Brascan a "top-up" on the purchase price in the event that Xstrata made an offer for a majority or more of Falconbridge Shares at a higher price before May 15, 2006;

(e) the Falconbridge Board did not seek shareholder approval of either the First or the Replacement Rights Plan (together or in general, the **Rights Plans**) because of its fear that they could not obtain shareholder approval, and the adoption of overlapping Rights Plans;

(f) the restrictions on Falconbridge Board and its commitment to the Inco Offer under the Support Agreement;

(g) the dispersed and changing nature of the Falconbridge shareholders;

(h) the fact that Falconbridge is a global player competing in the metals and commodities markets worldwide, and that the sale of Falconbridge attracted international interest and offers;

(i) the complex domestic and foreign regulatory environment; and

(j) the extended period that Falconbridge, in one form or another, has been "in play".

[38] The *Royal Host* approach provides a useful framework for reviewing and evaluating the relevant factors of this case.

• *when the plan was adopted*
• *whether shareholder approval of the rights plan was obtained*
• *whether there is broad shareholder support for the continued operation of the plan*

[39] The First Rights Plan and Replacement Rights Plan were clearly tactical in nature. The First Rights Plan was adopted only one month after Xstrata purchased Brascan's shares in Falconbridge in August 2005. Xstrata's purchase instantly made it Falconbridge's largest single

shareholder. There should have been no doubt that Falconbridge was "in play" – it was apparent there would be a sale of equity and/or voting control.

[40] During discussions for Board representation for Xstrata in August and September 2005, Falconbridge expressed concerns about Xstrata's intentions and ability to creep. Falconbridge invited Xstrata to make an offer for Falconbridge Shares on terms similar to those of the permitted bids under the Rights Plans, including a condition that no shares will be taken up unless a majority of shares not owned by Xstrata were tendered (waivable only with consent of Falconbridge). Xstrata declined to make such an offer, assuring the Falconbridge Board that shareholders were protected by anti-creep provisions of securities laws.

[41] The negotiations broke down in mid-September 2005; however, by then Falconbridge had begun new discussions with Inco. We note that both Falconbridge and Inco submitted affidavit evidence that Falconbridge did not consult Inco at the time it adopted the First Rights Plan. We heard no evidence to the contrary.

[42] In its press release dated September 22, 2005, Falconbridge stated the First Rights Plan was adopted to address the possibility of a "creeping take-over", to allow the Falconbridge Board to prevent an attempt to acquire control of Falconbridge other than by means of an offer made to all shareholders.

[43] We do not make a finding about the legality of the Rights Plans under corporate law or whether the Board has failed in its fiduciary duty under corporate law to act in the best interests of the shareholders by failing to put the Rights Plans to a shareholder vote. However, we can consider whether shareholder approval was obtained for the purpose of determining whether the Rights Plans were in the public interest – the shareholders' interest in tendering their shares to the bid of their choice.

[44] Neither Rights Plan was put to the Falconbridge shareholders for their approval. Section 5.18 of each Rights Plan required ratification by a majority of Falconbridge shareholders within six months of the Rights Plan being executed.

[45] Falconbridge submitted that, because of the dispersed nature of shareholdings in Falconbridge, the Falconbridge Board determined there was a real risk that Xstrata could have used its 19.8% ownership at a meeting of the shareholders to defeat the Rights Plans even if these were otherwise in the best interest of the remaining Falconbridge shareholders. One day before the First Rights Plan was to due to expire the Board adopted the Replacement Rights Plan.

[46] Shareholder approval alone is not determinative, but it can be seen as a component of any broad-based shareholder support for the continuation of the Plan. In *Cara*, the Commission stated:

> If a plan does not have shareholder approval, it generally will be suspect as not being in the best interest of the shareholders; however, shareholder approval by itself will not establish that a plan is in the best interest of the shareholders. *Re: Cara Operations Ltd. (2002), 25 O.S.C.B. 7997(**Cara**) at 8003.*

[47] The evidence we heard was insufficient to allow us to determine whether there was broad shareholder support for the continued operation of the Replacement Rights Plan. We know

Xstrata's position. We also have form letters of support for each party from minor shareholders, but we agree with the submissions of Staff and Xstrata that little weight should be accorded to these letters. The absence of shareholder approval in this case makes it difficult to determine the level of shareholder support in such a widely held company.

• *the length of time since the bid was announced and made*

[48] The Xstrata Offer was open for 50 days. Although this is longer than the statutory minimum of 35 days, the absolute number of days a bid has been outstanding is not a determinative factor. Again, the Commission said in *Cara*:

> While absolute numbers of days, on their own, should not be the deciding factor in determining whether a rights plan no longer serves the interest of shareholders, the longer the period the higher the onus is on those alleging the rights plan still serves the interest of shareholders. *Cara*, at 8003..

[49] Falconbridge submitted that the Replacement Rights Plan should remain in place until Falconbridge shareholders could consider the Inco Offer and the Xstrata Offer on their own merits. We agree with this submission insofar as it promotes the secondary objective stated in National Policy 62-202, providing a framework within which take-over bids may proceed in an open and even-handed environment. However, we do not agree with the submission if it implies a requirement for the "equalization of timing" between friendly and unsolicited bids as a basis for keeping a rights plan in place.

• *the size and complexity of the target company*

[50] A target that is not large or complex in nature may be easily and quickly assessed by potential bidders. In this case, even if the structure of Falconbridge were relatively straightforward, Falconbridge operates in a complex domestic and foreign regulatory environment. Such complexity could lengthen the time a target company's board would require to create or sustain an auction.

• *the other defensive tactics, if any, implemented by the target company*

[51] We considered the effect of unusual terms of the Support Agreement. The Support Agreement constrained the ability of the Falconbridge Board to solicit and facilitate or effectively take any action affecting Inco's bid without Inco's consent. Inco's consent was required before the Falconbridge Board could waive the Replacement Rights Plan for competing bids. That term of the Support Agreement could discourage competing bids and severely limit the ability of the shareholders to benefit from a competing bid. We consider it to have been a further defensive factor, although we note that a bid that met the provisions for a "permitted bid" in the Support Agreement would be allowed to proceed.

• *the steps taken by the target company to find an alternative bid or transaction that would be better for the shareholders*
• *the likelihood that, if given further time, the target company will be able to find a better bid or transaction*
• *the number of potential, viable offerors*

[52] If given further time, Falconbridge would likely not be able to find a better bid or transaction because its management's hands were tied by the Support Agreement. No evidence was presented that Falconbridge was taking steps to find a superior offer or transaction that would be better for its shareholders. Indeed, Falconbridge was constrained by the Support Agreement from soliciting or facilitating competing offers. Only unsolicited offers that were determined to be "superior offers" stood a chance of being put to the shareholders.

[53] That does not mean that further unsolicited bids or better bids by the current offerors were unlikely. The Xstrata offer itself was made in the face of the Replacement Rights Plan and the Support Agreement. Inco enhanced its bid twice, once in anticipation of the Xstrata Offer, and most recently through the involvement of a new player, Phelps Dodge.

[54] This case differs markedly from the situation in *Chapters*. There, the offeror and the target were the two major players in Canadian retail book industry. The Commission found that the likely absence of synergies with companies outside the Canadian book industry would result in few potential, viable offers. There are no such inherent limitations in this case. Falconbridge and its competitors operate internationally. The involvement of a major, global industry player like Phelps Dodge, two days before the hearing of this matter, indicated that there might have been other potential, viable offerors out there for Falconbridge at the time of the hearing. The fact that the market price of Falconbridge Shares was higher than both the Xstrata and Inco Offers suggested that the market continued to believe the auction was not over.

• *the nature of the bid, including whether it is coercive or unfair to the shareholders of the target company*

[55] Falconbridge submitted that the Xstrata Offer was coercive because Xstrata's majority of minority tender condition was not irrevocable. Xstrata could acquire only enough Falconbridge Shares through its bid or its subsection 94(3) purchases to block the Inco Offer and thereby end the auction.

[56] Xstrata submitted that its offer was not coercive for several reasons:

(a) the Xstrata Offer was an all-cash offer to all the Falconbridge shareholders for all their Falconbridge Shares;

(b) the reservation of a right to waive the minimum tender condition was consistent with virtually every unsolicited take-over bid in Canada since 1999;

(c) unsolicited bids are exposed to risks of unexpected facts, actions, or events that may arise as a result of efforts by a target company to resist an unsolicited offer;

(d) the Act does not prevent a bidder from reserving its right to waive minimum tender conditions. Moreover the Act does not prohibit partial bids; and

(e) neither the Commission nor any other securities commission in Canada has ever required, as a condition of setting aside or terminating a rights plan, that a bidder include in its offer an irrevocable tender condition.

[57] The Commission has found that a bid can be coercive if the bidder does not provide any assurance that it will bid for the remaining shares or acquire them in a second step transaction. In *Regal*, the Commission concluded that the target company shareholders might have been inclined to tender to the hostile bid "out of fear of being left as minority shareholders in a company controlled by MDC, having little liquidity for their shares". In *Ivanhoe*, the Commission also found evidence of a "fear factor" where the hostile bid was a partial bid for an entity with relatively illiquid shares.

Re: MDC Corporation and Regal Greetings and Gifts Inc. (1994), 17 O.S.C.B. 4971 (***Regal***) at 4981
Re: Ivanhoe III Inc. and Cambridge Shopping Centres Limited (1999), 22 O.S.C.B. 1327 (***Ivanhoe***) at 1329.

[58] We agree with Xstrata's submissions that the risk of a "fear factor" in this case is not the same as there may have been in the *Regal* or *Ivanhoe* matters. In both *Regal* and *Ivanhoe*, the targets' shares were held by a small number of institutional shareholders – sixteen and six, respectively. In *Ivanhoe*, the unsolicited bidder already owned 43% of the shares and was making a partial bid for another 25%. It is not difficult to consider the bids in those cases coercive.

[59] In the matter before us, given Xstrata's current shareholdings, these was some risk that Xstrata would be able to entrench itself by acquiring any tendered shares and either (a) extending its offer with a significant blocking position that would make it practically impossible for the Inco Offer to succeed or (b) abandoning its offer. Xstrata's ability to waive its majority of minority tender condition in the unique circumstances of this case could have a detrimental impact on the auction process, regardless of whether the Xstrata Offer is or is not coercive in the manner of *Ivanhoe* or *Regal.* We will consider Xstrata's ability to entrench itself by making permitted market purchases during its bid under section 94(3) of the Act in our discussion of Issue B, below.

[60] Could Xstrata achieve a blocking position if the Replacement Rights Plan were cease-traded? We considered the affidavit and *viva voce* cross-examination evidence of the financial advisors to Xstrata and Falconbridge: William Quinn, Managing Director and Head of Mergers and Acquisitions of TD Securities Inc. and Paul Spafford, Managing Director and Vice-Chairman of CIBC World Markets Inc., respectively. Mr. Quinn and Mr. Spafford reached opposing conclusions on the Xstrata's ability to block Inco's bid. Their evidence was based more on Xstrata's purchases under subsection 94(3) of the Act rather than the hypothetical scenario of Xstrata taking up less than a "majority of minority" of shares.

[61] Nevertheless, after reviewing the evidence of Mr. Quinn and Mr. Spafford, and hearing the submissions of counsel, we find that there was insufficient evidence to determine the minimum number of shares that Xstrata would have to take up before it achieved a *de facto* blocking position in the context of present market conditions.

[62] However, it was not necessary for us to make such a finding. We did make the finding that, in the unique circumstances of this case, there was a significant risk that any substantial take up by Xstrata following a waiver of its minimum condition would likely end the auction early and end the opportunity of the majority of the Falconbridge shareholders to tender their shares to any bidder. Such a result is, in our opinion, contrary to the public interest.

• *the likelihood that the bid will not be extended if the rights plan is not terminated*

[63] Xstrata submitted that it "**will not proceed with its all cash, fully financed Offer to the shareholders of Falconbridge unless the [Replacement] Rights Plan is cease traded or terminated.**" [emphasis in the original]. However, we heard little probative evidence that Xstrata would not extend its offer if the Replacement Rights Plan was maintained to some fixed date.

Conclusion

[64] Upon reviewing all of the factors as a whole and in light of the evidence and the unique circumstances of this case, we concluded that it would be in the public interest for the Replacement Rights Plan to continue to operate for a brief period. Doing so would reduce the risk to the Falconbridge Shareholders that the current auction might be ended prematurely.

[65] After considering the submissions of Xstrata, Falconbridge, Inco, and Staff we concluded that the outside date of July 28, 2006 found in the Falconbridge Proposal provided a reasonable period of time to allow the Replacement Rights Plan to continue before a cease-trade order came into effect. Should Xstrata have taken up sufficient Falconbridge shares to meet its majority of the minority condition before July 28, 2006, the cease-trade order would immediately take effect. On that date, Xstrata would have substantively fulfilled the requirement for a permitted bid under the Replacement Rights Plan. The risk that Falconbridge Shareholders could lose the opportunity to tender their shares to the bid of their choice in an open auction would have been eliminated.

[66] Counsel for Inco suggested that our Order explicitly permit Falconbridge to return to the Commission prior to July 28 for a variation of our Order if it could establish continuing utility of the Replacement Rights Plan at that time to maximize value to Falconbridge shareholders. In our view such a term was inappropriate and unnecessary. It was inappropriate because it would drag out the uncertainty and risk to the interests of the Falconbridge Shareholders. It was unnecessary because any interested party may apply for revocation or variation of our Order under section 144 of the Act. In circumstances of this case the application would likely be heard on expedited basis.

ISSUE B: The 5% Exemption

Application and Issues

[67] In its Cross-Application, Falconbridge requested that an order be issued under s.127(1)(2.1) or 127(1)(3) of the Act, prohibiting Xstrata from acquiring Falconbridge Shares under subsection 94(3) of the Act while its bid remains outstanding, because Xstrata's exercise of the subsection 94(3) exemption, even if lawful, would contravene the policy objectives of the take-over bid regime in the Act – and breach the principles in *Re: H.E.R.O. Industries Ltd. et al.* (1990), 13 O.S.C.B. 3777 (***HERO***) – rather than provide the benefit to shareholders which the exemption was meant to provide.

[68] Falconbridge's Cross-Application raised two broad issues. First, had Xstrata complied

with the Act and brought itself within the narrow scope of the exemption under subsection 94(3)? Second, even if we had assumed that Xstrata had complied with the Act, in the unusual circumstances of this case was it in the public interest for us to order under subsections 127(3) that the exemption did not apply to Xstrata?

Law and Policy

[69] We will begin with the second issue first.

[70] Subsection 94(2) of the Act prohibits an offeror from acquiring target company shares during a take-over bid. This subsection reinforces the fundamental principle of securities legislation that all shareholders of a target company receive equal treatment. However, subsection 94(3) provides a limited exemption to the 94(2) prohibition (the **5% Exemption**).

[71] The 5% Exemption allows a bidder to purchase up to 5% of the target's outstanding shares provided that:

(a) the bidder states its intent to make such purchases in the take-over bid circular;

(b) the purchases are made through the facilities of a recognized stock exchange; and

(c) the bidder issues and files a press release at the end of each day on which it makes such purchases.

[72] Ontario Securities Commission Rule 62-501 *Prohibited Stock Market Purchases of the Offeree's Securities by the Offeror During a Take-Over Bid* (OSC Rule 62-501) varies the conditions under which a bidder can make market purchases under the 5% Exemption to ensure that such purchases apply only to normal course, unsolicited stock exchange trades, and not to trades privately arranged and subsequently "crossed" on a stock exchange.

[73] From a policy perspective, the purchases under the 5% Exemption contribute to liquidity in the target company's shares, provide all target shareholders with an equal opportunity to sell their target shares prior to conclusion of the bid, raise the market price of the shares, and encourage bidders to raise their offer prices.

Analysis

[74] The policy considerations of the 5% Exemption were not particularly compelling in this case. We heard evidence that: over four million shares of Falconbridge changed hands every day; the market price of Falconbridge shares had been rising and exceeded both the Inco and Xstrata offer prices; and Inco had already raised its offer price.

[75] If we assumed that Xstrata was in technical compliance with subsection 94(3), could this Panel nonetheless order that the 5% Exemption should not apply to Xstrata? Falconbridge submitted that there is ample authority to make such an order. In *HERO* the Commission concluded that a transaction which was technically compliant with the Act, but in violation of its purpose and spirit, should be cease-traded in order to protect the integrity of capital markets, and in particular investors who were solicited in the course of a bid. Xstrata vigorously sought to

distinguish *HERO* from the case before us. Xstrata also submitted that the Commission has repeatedly emphasized the need proceed with extreme caution in cases where a breach of securities law has not been shown.

[76] While the facts of *HERO* differ from this case, it is a settled principle that the Commission may make an order under section 127 of the Act even where no violation of securities law has been shown if it is in the public interest to make such an order. We agree with Xstrata's submission that in such cases the Commission must proceed with caution in making an order. However, for the reasons set out in our analysis of the Replacement Rights Plan issue, above, we concluded that, in the unique circumstances of this case, it was in the public interest to make such an order under subsection 127(3) of the Act. We placed the same restrictions on this order as we placed on the cease-trade order respecting the Replacement Rights Plan.

[77] The above analysis assumes that Xstrata complied fully with the requirements of subsection 94(3) of the Act. We were concerned that Xstrata may have failed to comply with the Act, particularly with paragraph 94(3)(a), "the offeror states its intent to make such purchases in the take-over bid circular". The evidence was that Xstrata stated the opposite: that it had no present intention to make market purchase, but retained the right to do so in the future. Xstrata argued that the language used in its Circular has been used for decades by every unsolicited offeror in Ontario. Staff did not object to the language. Falconbridge submitted that the wording of the intention must be interpreted in the particular facts of the case; in this case, the wording was inappropriate because the ambiguity could be potentially decisive to the auction. Inco submitted that Xstrata's intention was diametrically opposed to the requirements of the statute. Inco submitted the reason the language used by Xstrata was commonplace was that market purchases under the 5% Exemption are *de minimis* in most cases and are not potentially decisive to an auction as they were in this case.

[78] It was not necessary for us to rule on the adequacy of the wording used by Xstrata, because we based our decision on the availability of subsection 94(3) to Xstrata on the second issue. Nevertheless, the Commission should review, as a matter of policy, what is appropriate wording in an take-over bid circular in circumstances where an offeror might wish to use the subsection 94(3) exemption.

Conclusion

[79] Our analysis of this issue was conducted in light of the unique circumstances of this case. Market purchases made by Xstrata during its Offer, in combination with Xstrata's ability to waive its minimum tender condition, would have had the potential to end the take-over bid auction early. The majority of Falconbridge Shareholders would thereby have been deprived of their right to respond to the then current and future take-over bids. We therefore concluded that it was in the public interest to order, pursuant to subsection 127(3), that the 5% Exemption would not apply to Xstrata until the date Xstrata took up sufficient Falconbridge shares to meet its majority of the minority condition or July 28, 2006 – whichever date was earlier.

Dated at Toronto, this 17th day of August, 2006

"Wendell S. Wigle"

Wendell S. Wigle, Q.C.

"Suresh Thakrar"

Suresh Thakrar

"David L. Knight"

David L. Knight, FCA