Ontario Securities Commission
Commission des valeurs mobilières de l'Ontario
P.O. Box 55, 19th Floor
20 Queen Street West
Toronto ON M5H 3S8
CP 55, 19e étage
20, rue queen ouest
Toronto ON M5H 3S8

**IN THE MATTER OF THE *SECURITIES ACT***
**R.S.O. 1990, c. S.5, AS AMENDED**

**- AND -**

**IN THE MATTER OF**
**NEO MATERIAL TECHNOLOGIES INC. AND PALA INVESTMENTS HOLDINGS LIMITED AND ITS WHOLLY-OWNED SUBSIDIARY 0833824 B.C. LTD.**

**REASONS FOR DECISION**
**Section 127 of the *Securities Act*, R.S.O. 1990 c. S.5**

| | | |
|---|---|---|
| **Hearing:** | May 7, 2009 | |
| **Decision:** | September 1, 2009 | |
| **Panel:** | Lawrence E. Ritchie | - Vice-Chair (Chair of the Panel) |
| | David L. Knight, FCA | - Commissioner |
| **Counsel:** | Tom Friedland<br>Grant McGlaughlin<br>Rebecca Burrows<br>Melanie Ouanounou | - Pala Investments Holdings Limited and its wholly-owned subsidiary 0833824 B.C. Ltd. |
| | Peter F.C. Howard<br>Edward J. Waitzer<br>David Weinberger<br>Samaneh Hosseini | - Neo Material Technologies Inc. |
| | James Sasha Angus<br>Shannon O'Hearn<br>Paul Hayward<br>Konata Lake | - Staff of the Ontario Securities Commission |

# TABLE OF CONTENTS

## REASONS FOR DECISION

## I. BACKGROUND

### A. Introduction

[1] In this proceeding, we have been asked to exercise the "public interest" jurisdiction of the Ontario Securities Commission (the "**Commission**") to set aside a shareholder rights plan established by the board of directors of the target of a hostile take-over bid. This request has invited us to consider some of the factors which influence this Commission's discretion as to whether to interfere with the decision of a board of directors relating to the establishment, as well as the longevity, of a shareholder rights plan, or "poison pill". In the case before us, we have specifically been asked to consider the circumstances under which the shareholder rights plan was proposed and adopted, and the impact of shareholder ratification of the plan.

[2] This matter arises out of an application brought by Pala Investments Holdings Limited ("**Pala**") and 0833824 B.C. Ltd. ("**083**") with respect to an offer by 083 to purchase for cash up to a maximum of 23 million (or approximately 20%) of the outstanding shares of Neo Material Technologies Inc. ("**Neo**") not already held by 083 and its affiliates at a price of $1.40 for each common share (the "**Pala Offer**"). The Pala Offer was subsequently amended on April 27, 2009 to: (i) increase the offer price to $1.70 per share; (ii) decrease the maximum number of shares to be taken up to 10.6 million (or approximately 9.5%); and (iii) extend the expiry time of the Pala Offer to May 15, 2009.

[3] Neo had a shareholder rights plan in place (the "**First Shareholder Rights Plan**") at the time that Pala announced its intention to make the Pala Offer. Neo subsequently adopted a second shareholder rights plan (the **"Second Shareholder Rights Plan"**) in the face of the Pala Offer.

### B. Relief Sought by Pala

[4] On April 16, 2009 Pala and 083 made an application (the "**Application**") to the Commission pursuant to section 127 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "*Act*") in connection with the Pala Offer. Specifically, in the Application, 083 and Pala seek a permanent order pursuant to subsection 127(1) of the Act that:

(a) trading cease in respect of any securities issued, or to be issued, under or in connection with the Second Shareholder Rights Plan; and

(b) trading cease in respect of any securities issued, or to be issued, under or in connection with the First Shareholder Rights Plan.

[5] In argument, Neo and Staff of the Commission ("**Staff**") take the position that our focus need be only on the Second Shareholder Rights Plan. All parties agree that if we do not grant the

relief sought in respect of the Second Shareholder Rights Plan, the relief sought in respect of the First Shareholder Rights Plan is unnecessary.

[6] In essence, the bidder, Pala, has asked this panel to remove the impediment to shareholders' ability to tender their shares to the Pala Offer posed by the Second Shareholder Rights Plan. As set out in detail below, the Second Shareholder Rights Plan was adopted by Neo's Board of Directors (the "**Neo Board**") in the context of the Pala Offer, and can be seen as a tactical defensive pill. As well, in the context of the unsolicited Pala Offer, a significant majority of Neo's shareholders recently voted to retain the Second Shareholder Rights Plan.

### C. The Commission's Decision

[7] On May 7, 2009, we held a hearing to determine the merits of the Application at which we heard evidence and received submissions from Pala, Neo and Staff.

[8] On May 11, 2009, we issued our decision in this matter with full reasons to follow. We took this approach because the outcome of the Application was of some urgency as the Pala Offer was set to expire on May 15, 2009.

[9] After hearing extensive and well articulated argument from all parties, we dismissed the Application. In all of the circumstances, we were not satisfied that it was in the public interest to grant the relief sought at that time. A copy of our decision dated May 11, 2009 is attached as Schedule A to these Reasons.

[10] These are the full Reasons for our decision in this matter. We note that since we concluded that the Second Shareholder Rights Plan should be allowed to stand, our Reasons will not address the arguments raised by the parties with respect to the First Shareholder Rights Plan.

## II. FACTS

[11] The parties to the Application helpfully provided us with an agreed statement of facts, as well as affidavit materials relied on respectively by each party. The extent to which agreement was reached on many of these facts, and that this matter was not unduly side tracked by disputes over the relevant facts, was greatly appreciated by this panel. For this, counsel, and their clients, are commended.

### A. The Parties

#### 1. Pala

[12] Pala is a multi-strategy investment company launched in 2006 and registered in Jersey, Channel Islands. It has a particular focus on mining and resource companies in both developed and emerging markets. Pala is advised on an exclusive basis by Pala Investments AG.

[13] Pala has been an investor in Neo since 2007. At the date of the Pala Offer, Pala had beneficial ownership of, or exercised control or direction over 23,640,000 common shares of

Neo, representing approximately 20.46% of the 115,521,000 outstanding common shares of Neo. Since that time, Pala has not increased its interest in Neo.

### 2. 083

[14] 083 is a wholly-owned subsidiary of Pala. 083 was incorporated on August 29, 2008 under the laws of the Province of British Columbia. It was incorporated for the purpose of acquiring or investing in Canadian businesses, and as of the date of the Application, had made no such investment or acquisition. 083's head office and principal place of business is located in the City of Vancouver in the Province of British Columbia.

### 3. Neo

[15] Neo is a public corporation continued under the laws of Canada. Neo is headquartered in Toronto and has approximately 1,300 employees in 15 locations, across 10 countries. Neo's shares are listed on the Toronto Stock Exchange.

[16] Neo is a producer, processor and developer of neodymium-iron-boron magnetic powders, rare earths and zirconium based engineered materials and applications through its Magnequench and AMR Performance Materials business divisions. Neo's products are processed at plants in China and Thailand into products used in the manufacture of a wide range of products such as micro motors, precision motors, sensors, catalytic converters, computers, television display panels, optical lenses, mobile phones and electronic chips.

## B. The Transaction

[17] The First Shareholder Rights Plan was effective immediately upon approval by the Neo Board on February 5, 2004, subject to receipt of all regulatory approvals and shareholder approval. The First Shareholder Rights Plan was approved by Neo's shareholders at the annual and special meeting of shareholders held June 28, 2004 and reconfirmed on April 18, 2007. It contains a minimum tender condition requiring that at least 50% of the independently held common shares of Neo must be tendered in order for a bidder to take up and pay for any of the shares deposited under the offer (the "**Minimum Tender Condition**").

[18] On February 9, 2009, Pala announced that, through a wholly-owned subsidiary, it intended to acquire up to a maximum of 23 million of the outstanding common shares of Neo, representing approximately 20% of Neo's shares at a price of $1.40 per share. The Pala Offer, if completed, would have brought Pala's aggregate ownership interest to approximately 40% of the issued and outstanding Neo shares. Pursuant to the Pala Offer, if more than 23 million of the outstanding Neo shares were to be deposited, the shares to be purchased from each depositing shareholder would be taken up on a *pro rata* basis.

[19] The Pala Offer was structured to comply with the definition of a permitted bid contained in the First Shareholder Rights Plan by remaining open for at least 60 days, and, in the event that the Minimum Tender Condition was met, by remaining open for another 10 days from the date

of the announcement that 50% had been tendered. The Pala Offer was formally launched on February 25, 2009 by means of a Take-over Bid Circular.

[20] In a letter to Neo's management dated February 9, 2009, Pala asked Neo to waive the Minimum Tender Condition contained in the First Shareholder Rights Plan.

[21] On February 12, 2009, the Neo Board adopted a second shareholder rights plan. The Second Shareholder Rights Plan is substantially similar to the First Shareholder Rights Plan except that it requires that any take-over bid be made to all Neo shareholders for *all* of their shares. In a press release announcing the adoption of the Second Shareholder Rights Plan, the Neo Board articulated the purpose of the Second Shareholder Rights Plan as follows:

> to prevent the acquisition of control of, or a creeping takeover bid for, the Company by means of a partial bid. The [Second Shareholder Rights Plan] requires that any offer to acquire shares of the Company be made to all shareholders for all of their shares to ensure that all shareholders of the Company are treated equally and fairly in connection with any take-over bid for the company. The [Second Shareholder Rights Plan] is being adopted to discourage discriminatory, coercive or unfair attempts to take over the Company.

[22] On February 24, 2009, Pala submitted a shareholder proposal (pursuant to section 137 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, as amended (the "*CBCA*")) which sought the termination of the First Shareholder Rights Plan. On March 10, 2009, the Neo Board declined Pala's request to put the First Shareholder Rights Plan to a shareholder vote on the grounds, among others, that the request had not been made in a timely manner.

[23] On March 9, 2009, the Neo Board issued a press release announcing its Directors' Circular, dated March 9, 2009 and its accompanying recommendation that Neo shareholders reject the Pala Offer. On March 24, 2009 Neo filed its Notice of Annual and Special Meeting of the shareholders and Management Information Circular with a meeting date of April 24, 2009. One of the agenda items was the adoption of the Second Shareholder Rights Plan.

[24] On April 8, 2009, Pala proposed to limit the Pala Offer to a maximum of 13.8 million shares or 12% of the issued and outstanding shares of Neo. This proposal was conditional on: (i) Neo waiving the application of the First Shareholder Rights Plan; and (ii) Neo removing the Second Shareholder Rights Plan from the Agenda of the Special Meeting. The proposal was open until April 14, 2009. On April 14, 2009, Neo responded to Pala and the proposed amendment to the Pala Offer, and rejected the proposal on the basis that its board believed the Pala Offer to be inadequate from a financial point of view.

[25] On April 21, 2009, Neo issued a release providing an update on the Second Shareholder Rights Plan. The press release stated that the Second Shareholder Rights Plan was adopted in direct response to the Pala Offer and "will remain in effect until the 2010 annual meeting of the shareholders".

[26] On April 21, 2009, Pala issued a press release announcing its intention to vary and extend the Pala Offer to: (i) increase the offer price to $1.70 per share; (ii) decrease the maximum number of shares to be taken up to a maximum of 10.6 million; and (iii) extend the expiry time of the Pala Offer.

[27] At Neo's Annual and Special Meeting on April 24, 2009, Neo Shareholders passed a resolution to approve, ratify and confirm the adoption of the Second Shareholder Rights Plan. In a report of the voting results for the Annual and Special Meeting filed on SEDAR on April 30, 2009 pursuant to section 11.3 of National Instrument 51-102 – *Continuous Disclosure Obligations*, Neo indicated that excluding Pala's holdings, 56,199,241 shares representing 81.24% of the shares voted were in favour of the Second Shareholder Rights Plan and 12,976,593 shares representing 18.76% of the shares voted were against the Second Shareholder Rights Plan. Although not in the agreed statement of facts, it was not contested that 82.74% of Neo's shares were represented in person and by proxy at the meeting.

[28] On April 27, 2009, Pala filed its Notice of Variation and Extension which: (i) increased the offer price to $1.70 per share; (ii) extended the offer to May 15, 2009; and (iii) decreased the maximum number of shares to be taken up to 10.6 million.

## III. ISSUES

[29] The Application raises the following legal issues:

1. Under what circumstances generally should the Commission exercise its public interest jurisdiction to cease trade a shareholder rights plan?

2. In the circumstances of this case, including the fact that the Second Shareholder Rights Plan was adopted as a tactical and strategic defense aimed at the Pala Offer, are there good and sufficient reasons for the Commission to exercise its jurisdiction to set aside Neo Board's adoption of the Second Shareholder Rights Plan?

3. If the Second Shareholder Rights Plan is allowed to stand, has the time come for it to be terminated by the Commission?

## IV. SUMMARY OF CONCLUSION

[30] In this case, the applicants assert that Neo's "pill must go", and urge us to exercise our public interest jurisdiction to "cease trade" the Second Shareholder Rights Plan. In all of the circumstances, we are not satisfied that it is in the public interest to grant the relief sought at this time.

[31] While we will expand on these points below, we are influenced by the following considerations, as we noted in our decision of May 11, 2009:

(a) the Second Shareholder Rights Plan was adopted by the Neo Board in the context of, and in response to the Pala Offer;

(b) there is no evidence that the process undertaken by the Neo Board to evaluate and respond to the Pala Offer, including the decision to implement the Second Shareholder Rights Plan, was not carried out in what the Neo Board determined to be the best interests of the corporation and of Neo's shareholders, as a whole;

(c) an overwhelming majority of Neo's shareholders (excluding Pala) approved the Second Shareholder Rights Plan while the Pala Offer remained outstanding;

(d) the evidence supports a finding that Neo's shareholders were, or were provided with a reasonable opportunity to be, sufficiently informed about the Second Shareholder Rights Plan prior to casting their votes, and there is no evidence that Neo's shareholders were insufficiently informed; and

(e) there is no evidence to suggest that management or the Neo Board coerced or unduly pressured Neo's shareholders to approve the Second Shareholder Rights Plan.

## V. LAW AND ANALYSIS

### A. Under what circumstances generally should the Commission exercise its public interest jurisdiction to cease trade a shareholder rights plan?

[32] At the outset, it is important for us to keep in mind that we, as a Commission, are being asked to proactively intervene with, and, in fact, reverse the manifest intention of the Neo Board, which is accountable to the shareholders as a whole. The request in our view, must be considered carefully and with due caution.

[33] It is well established that the Commission has broad discretion in determining whether to exercise its public interest jurisdiction in a given matter. As the Supreme Court noted in *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132 ("*Asbestos*") at para. 39:

> [s]ection 127(1) of the Act provides the OSC with the jurisdiction to intervene in activities related to the Ontario capital markets when it is in the public interest to do so. The legislature clearly intended that the OSC have a very wide discretion in such matters. The permissive language of s. 127(1) expresses an intent to leave it for the OSC to determine whether and how to intervene in a particular case:
>
> > **127.** (1) The Commission may make one or more of the following orders if in its opinion it is in the public interest to make the order or orders . . . . [emphasis in original]

[34] The scope of the Commission's public interest jurisdiction, however, must be interpreted in the context of the purpose of the *Act* as a whole. As the Supreme Court stated in *Asbestos* at para. 41:

> … the public interest jurisdiction of the OSC is not unlimited. Its precise nature and scope should be assessed by considering s. 127 in context. Two aspects of the public interest jurisdiction are of particular importance in this regard. First, it is important to keep in mind that the OSC's public interest jurisdiction is animated in part by both of the purposes of the Act described in s. 1.1, namely "to provide protection to investors from unfair, improper or fraudulent practices" and "to foster fair and efficient capital markets and confidence in capital markets". Therefore, in considering an order in the public interest, it is an error to focus only on the fair treatment of investors. The effect of an intervention in the public interest on capital market efficiencies and public confidence in the capital markets should also be considered. [emphasis in original]

[35] While the Commission has broad discretion in exercising its public interest jurisdiction, and it will not hesitate to do so in the appropriate circumstances, we are mindful of the fact that a degree of deference is owed to the decision of the board of directors of a market participant with respect to the issue under review. As the Commission noted in *Re Canadian Tire Corp.* (1987), 10 O.S.C.B. 857 at paras.154-155:

> … it would wreak havoc in the capital markets if the Commission took to itself a jurisdiction to interfere in a wide range of transactions on the basis of its view of fairness through the use of the cease-trade power under s. 123 [now s. 127]… The Commission's mandate under s. 123 is not to interfere in market transactions under some presumed rubric of insuring fairness.
>
> The Commission was cautious in its wording in *Cablecasting* and we repeat that caution here. To invoke the public interest test of s. 123, particularly in the absence of a demonstrated breach of the Act, the regulations or a policy statement, the conduct or transaction must clearly be demonstrated to be abusive of shareholders in particular, and of the capital markets in general. A showing of abuse is something different from, and goes beyond, a complaint of unfairness. A complaint of unfairness may well be involved in a transaction that is said to be abusive, but they are different tests. Moreover, the abuse must be such that it can be shown to the Commission's satisfaction that a question of the public interest is involved. That almost invariably will mean some showing of a broader impact on the capital markets and their operation.

[36] The Commission has the power to order that trading cease in respect of any securities issued under, or in connection with, a shareholder rights plan, if, in the Commission's opinion, it is in the "public interest" to make such an order, pursuant to section 127 of the Act. Subsection 1.1(1) of National Policy 62-202 – *Take-Over Bids – Defensive Tactics* ("NP 62-202") states:

> [t]he Canadian securities regulatory authorities recognize that take-over bids play an important role in the economy by acting as a discipline on corporate management and as a means of reallocating economic resources to their best uses. In considering the merits of a take-over bid, there is a possibility that the interests of management of the target company will differ from those of its shareholders. Management of a target company may take one or more of the following actions in response to a bid that it opposes:
>
> 1. Attempt to persuade shareholders to reject the bid.
>
> 2. Take action to maximize the return to shareholders including soliciting a higher bid from a third party.
>
> 3. Take other defensive measures to defeat the bid.

[37] In determining how the Commission exercises its public interest jurisdiction in the circumstances of a hostile take-over bid, this panel has regard to the objectives of the take-over bid provisions as stated in section 1.1 of NP 62-202. That section provides that:

> …
>
> (2) [t]he 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… 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....

[38] It is worth emphasizing that the language in subsection 1.1(6) of NP 62-202 is permissive; it recognizes that the Commission retains a discretion to intervene, in appropriate circumstances, where the Commission has formed the view that it is in the public interest to do so.

[39] When dealing specifically with shareholder rights plans, the Commission has historically taken the approach of balancing 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 (*Re Falconbridge Limited* (2006), 29 O.S.C.B. 6783 ("*Falconbridge*") at para. 33).

[40] In *Lac Minerals*, the Commission stated:

> [t]he 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 has 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.
>
> This issue involved interesting questions about the relationship between securities law and corporate law. It raised the tension between (i) the board's duty to manage the corporation honestly and in good faith with a view to the best interests of the corporation; and (ii) the shareholders' "right" to decide whether to sell their shares in response to a take-over bid.
>
> (*Re Lac Minerals Ltd. and Royal Oak Mines Inc.* (1994), 17 O.S.C.B. 4963 ("*Lac Minerals*") at 4968-4969)

[41] Similarly, in *Royal Host*, the Ontario, British Columbia and Alberta securities commissions noted that the challenge was:

> … finding the appropriate balance between permitting the directors to fulfill 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 Income Properties Real Estate Investment Trust* (1999), 22 O.S.C.B. 7819 ("*Royal Host*") at 7828)

[42] In deciding whether interference with a decision of a board of directors is necessary to protect the *bona fide* interests of target shareholders, the Commission may consider any number of factors. These factors include but are not limited to:

> (a) whether shareholder approval of the rights plan was obtained;
>
> (b) when the plan was adopted;
>
> (c) whether there is broad shareholder support for the continued operation of the plan;
>
> (d) the size and complexity of the target company;
>
> (e) the other defensive tactics, if any, implemented by the target company;
>
> (f) the number of potential, viable offerors;
>
> (g) the steps taken by the target company to find an alternative bid or transaction that would be better for the shareholders;
>
> (h) the likelihood that, if given further time, the target company will be able to find a better bid or transaction;
>
> (i) the nature of the bid, including whether it is coercive or unfair to the shareholders of the target company;
>
> (j) the length of time since the bid was announced and made;
>
> (k) the likelihood that the bid will not extend if the rights plan is not terminated.
>
> (*Royal Host* at 7828)

[43] Which factors are relevant will vary from case to case since all shareholder rights plans are unique to the circumstances of the bid (*Falconbridge* at para. 36). The Commission has made it clear that:

> … it is fruitless to search for the "holy grail" of a specific test, or series of tests, that can be applied in all circumstances. Take over bids are fact specific; the relevant factors, and the relative importance to be attached to each, will vary from case to case. As a result, a test that focuses on certain factors to the exclusion of others will almost certainly be inappropriate in some cases to which we attempt to apply it.
>
> (*Royal Host* at 7828)

[44] The Commission has consistently considered shareholder support of a rights plan as relevant when evaluating whether to "cease trade" a rights plan. In addition to being one of the

*Royal Host* factors, the Commission specifically acknowledges in subsection 1.1(3) of NP 62-202 that it is "prepared to examine target company tactics in specific cases to determine whether they are abusive of shareholder rights. Prior shareholder approval of corporate action would, in appropriate cases, allay such concerns". This Commission stated in *Falconbridge* that shareholder approval was a relevant consideration. As counsel for Pala properly point out, however, shareholder approval does not necessarily mean that a rights plan is protected from the Commission's "public interest" jurisdiction.

[45] As the Commission stated in *Re Cara Operations Ltd.* (2002), 25 O.S.C.B. 7997 ("*Re Cara"*) at para. 65:

> [i]f 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 of itself will not establish that a plan is in the best interests of shareholders.

[46] Further, it is not simply that shareholder approval has been given that is an influential factor; rather, such approval ought to be informed, provided freely and fairly, and in the absence of coercion or undue pressure (*Re Pulse Data Inc.*, 2007 ABASC 895 ("*Pulse Data*") at para. 101 and *Re MDC Corporation and Regal Greetings & Gifts Inc.* (1994), 17 O.S.C.B. 4971 ("*Regal*") at para. 11).

[47] In summary, the Commission should examine all of the circumstances surrounding the establishment of a shareholder rights plan, including whether informed shareholder approval was given, and the context of such shareholder approval.

**B. In the circumstances of this case, are there good and sufficient reasons for this Commission to exercise its public interest jurisdiction to set aside Neo Board's adoption of the Second Shareholder Rights Plan?**

[48] In this case, our analysis is guided by the factors discussed above. However, given the unique fact scenario which has been presented to us, we will only make reference to those factors which are relevant to disposing of the issues at hand.

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

1. Pala is Neo's largest shareholder, holding 20.46% of the issued and outstanding Neo shares.

2. The Pala Offer is an unsolicited partial bid, for up to 10.6 million shares of Neo (approximately 9.5%). If the Pala Offer were to be successful, Pala would hold a 29.9% interest in Neo.

3. The Second Shareholder Rights Plan was adopted by the Neo Board in the context of, and in direct response to the Pala Offer.

4. An overwhelming majority of Neo's shareholders (excluding Pala) approved the Second Shareholder Rights Plan. The record shows that: (i) excluding Pala's holdings, 81.24% of the shares voted at Neo's Annual and Special Meeting on April 24, 2009 were in favour of the Second Shareholder Rights Plan; and (ii) 82.74% of Neo's shares were represented in person and by proxy at the meeting.

5. Prior to casting a vote on the approval of the Second Shareholder Rights Plan, Neo's shareholders were provided with a number of documents which contained detailed information about Neo's financial position at the time of the Pala Offer, the Pala Offer itself and the Second Shareholder Rights Plan, including: (i) the Take-Over Bid Circular; (ii) the Directors' Circular rejecting the Pala Offer; (iii) the Management Information Circular; and (iv) a press release dated April 16, 2009 issued by Pala for the benefit of Neo's shareholders discussing the impact of adopting the Second Shareholder Rights Plan which contains a link to an online presentation made by Pala for Neo's shareholders outlining the benefits of the Pala Offer.

[50] Against this background, we turn to the consideration of the impact of shareholder approval and support of a rights plan.

### 1. Was the Shareholder Approval Informed?

#### a. Position of the Parties

**(i) Neo**

[51] Neo submits that it is trite law that corporations are governed by a majority of their shareholders and the Commission has never second-guessed the judgment of such an overwhelming majority of shareholders as to their own interests and ought not do so in this case.

[52] Neo takes the position that the premise of take-over bid legislation in Canada is based on shareholder choice (*Re Chapters Inc.* (2001), 24 O.S.C.B. 1657 at 1662). According to Neo, shareholder approval is an important and highly relevant consideration in determining whether a rights plan is in the public interest, particularly when such approval is informed (*Royal Host* at 7828; *Pulse Data* at para. 101; and *Regal* at 4980).

[53] In Neo's view, the overwhelming shareholder ratification of the Second Shareholder Rights Plan at the Annual and Special Meeting held on April 24, 2009 is determinative and it cannot be argued that Neo's shareholders have been precluded unreasonably from considering or responding to the Pala Offer. According to Neo, the vote to approve the tactical pill was clearly a vote to reject the Pala Offer since: (i) the vote was informed; (ii) all shareholders knew that no competing or alternative bid was imminent; and (iii) the vote was active. As such, there is no need for the Commission to provide shareholders with another opportunity to do so.

[54] In support of its position, Neo relies on the Alberta Securities Commission decision in *Pulse Data*, which, in Neo's submissions is the only case involving shareholder rights plans that is directly on point and, as such, should be determinative. In *Pulse Data,* the Alberta Securities

Commission dismissed the bidder's application to cease trade the rights plan where approximately 74% of the shares voted at the shareholders' meeting were voted in favour of the rights plan. The Alberta Securities Commission stated, in *Pulse Data* at para. 87, that there is no "…public interest reason to override the clear expression of shareholder democracy manifested by the very recent and fully informed shareholder approval of the Rights Plan in the face of the Offer".

**(ii) Pala**

[55] Pala contends that Neo's position overemphasizes the impact of shareholders under Canadian corporate and securities law and oversimplifies the role of the Commission in the context of "cease trade" applications. In Pala's view, rather than being governed by a majority of its shareholders, the business and affairs of a corporation are managed or supervised by its directors who, in turn, are subject to fiduciary duties owed to the corporation.

[56] Pala takes the position that while shareholder approval is a relevant consideration for the Commission, such approval of itself will *not* establish that a plan is in the best interest of the shareholders. It is only one of the many indicia the Commission must consider when deciding whether a pill should be allowed to continue.

[57] Pala submits that the Alberta Securities Commission decision in *Pulse Data* is distinguishable on various grounds. Moreover, it argues that the *Pulse Data* decision is troubling in many respects and, in Pala's view, is wrongly decided. Lastly, Pala contends that even if *Pulse Data* was rightfully decided, it does not represent Ontario law and has only persuasive value.

[58] In support of its position, Pala relies on the Commission's decision in *Re Cara* at para. 65, where the Commission stated that:

> [i]f 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 of itself will not establish that a plan is in the best interest of the shareholders.

[59] Pala further contends that the best interpretation of the shareholder ratification of Neo's Second Shareholder Rights Plan is that Neo's shareholders simply voted to give management more time to pursue value-enhancing transactions. Since affirmation of the Second Shareholder Rights Plan by Neo's shareholders is but one consideration for the Commission in determining whether to exercise its public interest jurisdiction, Pala takes the position that the Commission should give little or no weight to the shareholder vote.

**(iii) Staff**

[60] Staff argues that the overwhelming shareholder ratification of the Second Shareholder Rights Plan on April 24, 2009 is determinative of the entire issue of whether the Commission should exercise its public interest jurisdiction to cease trade the Second Shareholder Rights Plan. According to Staff, the Commission should not intervene and cease trade the Second Shareholder Rights Plan unless the Commission is of the view that:

(i) in approving the Second Shareholder Rights Plan, Neo shareholders were insufficiently informed about the Second Shareholder Rights Plan and the Pala Offer;

(ii) there is evidence to suggest that management or the Neo Board coerced or unduly pressured Neo's shareholders to approve the Second Shareholder Rights Plan; or

(iii) there is evidence that Neo Board's process in evaluating and responding to the Pala Offer, including the decision to implement the Second Shareholder Rights Plan, was not done in the best interest of Neo's shareholders.

[61] Staff refers to two decisions in which informed shareholder approval of a rights plan was found to be strongly persuasive or determinative. In *Regal*, in deciding to maintain a rights plan in the face of a hostile bid, the Commission placed substantial weight on the fact that 71% of shareholders had approved the board's decision to implement the plan one week before the hostile bid was launched. Similarly, as discussed above, the Alberta Securities Commission in *Pulse Data* found it determinative that 74% of the shares voted at the shareholders' meeting were voted in favour of the rights plan, allowing the plan to stand.

[62] Furthermore, Staff's submissions point to subsection 1.1(3) of NP 62-202, which states that the Commission is "…prepared to examine the target company tactics in specific cases to determine whether they are abusive of shareholder rights. Prior shareholder approval of corporate action would, in appropriate cases, allay such concerns".

[63] Staff submits that Neo's shareholders made an informed decision when they voted on the Second Shareholder Rights Plan. This vote in favour of the Second Shareholder Rights Plan went against the recommendation of RiskMetrics, an institution whose voting guidelines are used in Canada by institutional shareholders, which, in Staff's view, strongly suggests a fully informed decision on the part of Neo's shareholders. According to Staff, by voting for the Second Shareholder Rights Plan, Neo's shareholders knew, or ought reasonably to have known, that they were voting against the Pala Offer. As such, any concerns that the Second Shareholder Rights Plan may be abusive of shareholder rights should be allayed.

**b. Analysis**

[64] We have been provided with, referred to, and considered more than a dozen cases involving shareholder rights plans decided in the last two decades. While all were informative, of these cases, we have found two decisions to be of particular assistance.

[65] In *Regal*, the board of directors of the target, Regal Greetings & Gifts ("**Regal**") adopted a shareholder rights plan on March 4, 1994. The plan was ratified by Regal's shareholders at the first annual and special meeting held on July 20, 1994, one week before the bidder, MDC, announced its intention to make an all-cash take-over bid for all of the issued and outstanding common shares of Regal, not including the shares already owned by MDC or its affiliates or associates.

[66] In deciding to maintain the rights plan, the Commission put substantial weight on: (i) the fact that 71% of shareholders had approved the board's decision to implement the plan one week before the hostile bid was launched; and (ii) the fact that the decision was informed by the management information circular which notified the shareholders of the plan's purpose (to pursue alternatives to maximize shareholder value in the event of an unsolicited bid). In addition, the Commission noted that around 80% of Regal's shares were held by 15 or 16 institutional shareholders, who were not unfamiliar with rights plans. The Commission therefore concluded that the views of the holders of the majority of the common shares could be ascertained at the time of the application. The Commission stated:

> … [n]o shareholders, other than MDC, came forward to ask us to terminate the Plan so as to allow the RGG bid to be completed. Two substantial shareholders (or representatives of shareholders) told us that the "time had not yet come". No other evidence was led on the subject by MDC. Accordingly, we had no reason to believe that the shareholders of Regal, other than MDC, wanted us to terminate the Plan as against MDC at the time of the hearing.
>
> (*Regal* at 4980)

[67] In *Pulse Data*, the Alberta Securities Commission considered whether it is appropriate to take action against a "tactical pill", which had been approved by the shareholders during the course of a pending hostile offer in the absence of any competing or alternative offer. *Pulse Data* involved an offer for all the shares of the target which was not supported by a "majority of the minority" and thus prevented the offeror from acquiring a control position. In dismissing the offeror's application to cease trade the rights plan, the Alberta Securities Commission found it determinative that: (i) a substantial majority of the target's shareholders representing approximately 74% of the shares voted at the shareholders' meeting voted in favour of the rights plan; (ii) the ratification vote took place in the face of the take-over bid which was the focus of the recently adopted rights plan; and (iii) the shareholders' approval was informed. The Alberta Securities Commission stated:

> [i]n our view, this very recent and informed Pulse Shareholder approval, given in the absence of any imminent alternatives to the Offer, demonstrated that the continuation of the Rights Plan as at 27 September 2007 was in the *bona fide* interests of Pulse Shareholders…
>
> (*Pulse Data* at para. 102)

[68] It is noteworthy that the Alberta Securities Commission placed great emphasis on the fact that, in order to be determinative, any shareholder approval in the face of a hostile bid must be informed. In concluding that the shareholder vote represented an informed decision of the target shareholders, the Alberta Securities Commission pointed to the following considerations:

1. Prior to voting, shareholders had disclosure of all relevant information about the offer, the rights plan and the effect of the plan on the offer.

2. This information came from multiple documents including the Offer to Purchase and Circular, a Notice of Variation, the Directors' Circular, the Management Information Circular in connection with the shareholders' meeting called to seek approval of the plan, and four valuation analyses referred to in the Directors' Circular.

3. This information included details about alternative transactions, the board's plans going forward, the value of the offer and the effect the rights plan would have on the offeror's ability to make a creeping take-over of the company.

4. Collectively, the various disclosure documents gave Pulse shareholders the necessary information to evaluate the rights plan in the face of a hostile bid.

   (See *Pulse Data* at para. 101)

[69] We are in agreement with the position taken by the Alberta Securities Commission that, as a general matter, recent and informed shareholder ratification of a rights plan, erected in the face of the hostile take-over bid is suggestive of a finding that the continuation of the shareholder rights plan is in the *bona fide* interest of a target's shareholders.

[70] Turning to the case at hand, in deciding that it is not in the public interest to cease trade the Second Shareholder Rights Plan at this time, we were influenced by the following considerations:

1. The Second Shareholder Rights Plan was adopted by the Neo Board in the context of, and in direct response to the Pala Offer.

2. An overwhelming majority of Neo's shareholders (excluding Pala) approved the Second Shareholder Rights Plan. The record shows that (i) excluding Pala's holdings, 81.24% of the shares voted at Neo's Annual and Special Meeting on April 24, 2009 were in favour of the Second Shareholder Rights Plan.

3. 82.74% of Neo's shares were represented in person and by proxy at the meeting. The record indicates that this was the highest voting level in five years.

4. The evidence supports a finding that Neo's shareholders were sufficiently informed about the Second Shareholder Rights Plan prior to casting their votes (At the very least, shareholders were provided with a reasonable opportunity to be informed, and there is no evidence that the shareholders were insufficiently informed.).

[71] In support of the finding that Neo's shareholders were sufficiently informed when they voted to ratify the Second Shareholder Rights Plan, we note the following:

1. Neo's shareholders had the benefit of disclosure of all relevant information by virtue of having sufficient time to review and consider the following sources: (i) the Take-Over Bid Circular; (ii) the Directors' Circular rejecting the Pala Offer; (iii) the Management Information Circular; and (iv) a press release dated April 16, 2009 issued by Pala for the benefit of Neo's shareholders, discussing the impact of adopting the Second Shareholder Rights Plan, which contains a link to an online presentation made by Pala to Neo's shareholders outlining the benefits of the Pala Offer.

2. Specifically,

   (a) The Directors' Circular dated March 9, 2009 contained the recommendation that Neo's shareholders reject the Pala Offer for, among others, the following reasons: (i) the Pala Offer is financially inadequate; (ii) the Pala Offer seeks to provide Pala with effective control of Neo, without offering an appropriate control premium for the shares purchased and no premium for the shares not purchased; (iii) if successful, the Pala Offer will have an adverse effect on the liquidity of the shares; (iv) the Pala Offer significantly undervalues Neo's assets and businesses; (v) the Pala Offer does not reflect Neo's strong financial position, the value of Neo's recent strategic initiatives and Neo's future growth and acquisition opportunities; (vi) the timing of the Pala Offer is opportunistic; and (vii) the Pala Offer is not a permitted bid under the Second Shareholders Rights Plan.

   (b) The Management Information Circular dated March 24, 2009 (prepared in connection with the Annual and Special Meeting of the Shareholders of Neo which took place on April 24, 2009) provided an overview of the Second Shareholder Rights Plan, including its stated purpose to "prevent unfair attempts to make a creeping take-over of the Corporation (such as the Pala Partial Offer)".

   (c) The Pala press release issued on April 16, 2009 specifically advises Neo shareholders that the Second Shareholder Rights Plan strips Neo Shareholders of a fundamental investment right: the ability to sell their shares at the time of their choosing. Moreover, the press release contains a link to an online presentation prepared by Pala for the benefit of Neo's shareholder which outlines the advantages to tendering to the Pala Offer and the impact of adopting the Second Shareholder Rights Plan. The presentation clearly states at page 15 that "the [Second Shareholder Rights Plan] prevents Neo shareholders from being [able] to participate in Pala's Partial Offer".

3. There is further evidence of an informed shareholder decision as evidenced by the fact that several Neo institutional shareholders voted in favour of the Second Shareholder Rights Plan, despite their normal policy of voting against rights plans that ban partial bids. This vote in favour of the Second Shareholder Rights Plan went against the

recommendation of RiskMetrics. We agree with Staff's submission that such a vote suggests a fully informed decision on the part of Neo's shareholders in this instance.

[72] We are therefore of the opinion that by voting for the Second Shareholder Rights Plan, Neo's shareholders knew, or ought reasonably to have known, that they were voting against the Pala Offer and we have not been presented with any evidence to suggest otherwise.

[73] This being said, we endorse Staff's position that a fully informed shareholder approval of a rights plan implemented in the face of a hostile bid is not determinative where:

1. there is evidence that the board process in evaluating and responding to the bid, including the decision to implement a shareholder rights plan, was not carried out in the best interest of the corporation and the target's shareholders, as a whole; or

2. there is evidence to suggest that management or the board of directors coerced or unduly pressured the target's shareholders to approve the shareholder rights plan.

[74] We consider these two issues below and assess whether any factors exist which would counter-balance the impact of shareholder approval for the continuation of the Second Shareholder Rights Plan.

### 2. Is there Evidence that the board process in evaluating and responding to the bid, including the decision to implement a shareholder rights plan, was not carried out in the best interest of the corporation and the target's shareholders, as a whole?

#### a. Position of the Parties

#### (i) Pala

[75] According to Pala, securities commissions have exercised, and should exercise their discretion to set aside shareholder rights plans that have been approved by shareholders. When they have not done so, it is because they see a continued legitimate purpose to the operation of the pill at least for a further limited period of time (*Re Cara, Royal Host*, *Lac Minerals* and *Regal*).

[76] Pala takes the view that an implicit but vitally important prerequisite to allowing a rights plan to continue is a determination that the board is, in fact, fulfilling its fiduciary duty by pursuing alternative value-enhancing transactions. According to Pala, the only proper use of a shareholder rights plan in the face of a take-over bid is to allow a board of directors sufficient time to seek out alternative bidders and only for the amount of time necessary to accomplish that task.

[77] In support of this proposition, Pala makes reference to subsection 1.1(6) of NP 62-202 which states that defensive tactics "…may be taken by a board of directors of a target company in a *genuine attempt to obtain a better bid*". [emphasis added]

[78] Pala further submits that Canadian law does not permit the Neo Board to permanently "just say no" to the Pala Offer. Pala refers to the Ontario Court of Appeal decision in *Maple Leaf Foods Inc. v. Schneider Corp.*, where the Court stated:

> [a]n auction is merely one way to prevent the conflicts of interest that may arise when there is a change of control by requiring that directors act in a neutral manner toward a number of bidders: *Barkan v. Amstead Industries Inc.* 567 A.2d 1279 (Del. 1989). The more recent *Paramount* decision in the United States … has recast the obligation of directors when there is a bid for change of control as an obligation to seek *the best value reasonably available to shareholders in the circumstances*… [emphasis added]
>
> When it becomes clear that a company is for sale and there are several bidders, an auction is an appropriate mechanism to ensure that the board of a target company acts in a neutral manner to achieve the best value reasonably available to shareholders in the circumstances. When the board has received a single offer and has no reliable grounds upon which to judge its adequacy, *a canvass of the market to determine if higher bids may be elicited is appropriate, and may be necessary...* [emphasis added.]
>
> (*Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (Ont. C.A.) ("*Schneider*") at paras. 62 and 63)

[79] In Pala's submission, in the face of a take-over bid, the duty of directors is to "achieve the best value available to shareholders in the circumstances". At the very least, the Neo Board should be canvassing the market to determine whether higher bids may be elicited. According to Pala, the failure of the Neo Board to take any such steps, since the date the Pala Offer was announced, is a failure to properly discharge the fiduciary obligations owed by the Neo Board to Neo's shareholders.

[80] Pala further submits that there can be no doubt that a fundamental right of share ownership includes the right to freely alienate shares of a publicly traded corporation, subject only to very limited statutory exceptions. Pala makes reference to subsection 49(9) of the *CBCA*, which explicitly makes transferability a fundamental characteristic of a share:

> 49(9) A distributing corporation, any of the issued shares of which remain outstanding and are held by more than one person, *shall not have a restriction on the transfer of ownership of its shares* of any class or series except by way of a constraint permitted under section 174. [emphasis added]

[81] Pala also relies on the Supreme Court of Canada decision in *Edmonton Country Club v. Case* where the Court stated that "[t]he right of a shareholder to transfer his shares is undoubtedly one of the incidents of share ownership…" (*Edmonton Country Club Ltd. v. Case*, [1975] 1 S.C.R. 534 at 549). It also cites the Ontario Court of Appeal decision in *Royal Bank of Canada v. Central Capital Corp*. where the Court describes one of the basic rights of a shareholder to be "the right to transfer ownership of the share" (R.M. Bryden in his chapter,

"The Law of Dividends", contained in Ziegel ed., Studies in Canadian Company Law (1967), at p. 270, cited in *Royal Bank of Canada v. Central Capital Corp.* (1996), 132 D.L.R. (4th) 223 at para. 40).

[82] Pala argues that directors may make recommendations, but they cannot take steps to usurp the fundamental rights of ownership. Citing *Re Cara*, Pala states:

> [w]hile it may be important for shareholders to receive advice and recommendations from the directors of the target company as to the wisdom of accepting or rejecting a bid, and for directors to be satisfied that a particular bid is the best likely bid under the circumstances, in the last analysis the decision to accept or reject should be made by the shareholders, and not by the directors or others.
>
> (*Re Cara* at para. 53)

[83] Accordingly, Pala takes the position that it was improper for the Neo Board to implement a defensive mechanism which has the effect of denying Neo's shareholders the opportunity to tender to the Pala Offer.

[84] Similarly, given that the primary objective of NP 62-202 is the protection of the *bona fide* interests of the shareholders of the target company, Pala urges the Commission to be mindful not to thwart the ability of shareholders to exercise their fundamental right of ownership to sell their shares as they see fit.

[85] In oral submissions, counsel for Pala expanded on Pala's position by submitting that if the Commission is of the opinion that shareholder rights plans can be used for a purpose other than attempting to obtain a better bid, then public interest dictates that the Commission should allow such rights plans to stand only in the most egregious of circumstances where a serious risk of harm to shareholders arises. In Pala's view, that is not the case here.

[86] Pala takes issue with Neo's postion that in this case, Neo has taken appropriate steps to consider alternatives to maximize shareholder value. Pala submits that Neo was only paying lip service to this fundamental purpose by establishing an independent committee and retaining independent legal and financial advice. Pala points out that the Neo Board has yet to find a better deal even though the offer has been on the table for a significant period of time.

[87] Pala relies on the Alberta Securities Commission decision in *Re Samson Canada, Ltd.* (1999), 8 ASCS 1791 ("*Re Samson*") (QL) at 3 and *Re 1153298 Alberta Ltd.*, 2005 ABASC 725 at para. 52, where the Alberta Securities Commission has held that the board of the target company bears the onus of establishing that the rights plan is in the best interest of the shareholders. Pala also relies on the Commission's decision in *Re Cara* at para. 66, where it was held that if, in the face of a take-over bid, directors act in a manner that raises serious questions as to whether they are acting solely in the best interest of the shareholders, then the onus of establishing that the rights plan is in the best interest of the shareholders may be "significantly increased".

[88] Pala also argues that the additional defensive tactics adopted by the Neo Board serve to entrench management. In particular, Pala refers to certain change of control provisions in key executive employment agreements which could trigger payments of approximately $5 million in the event that any person acquires beneficial ownership of 30% of Neo's common shares. Pala submits that these change of control provisions necessarily deter parties from seeking control of Neo. In Pala's view, the decision of the Neo Board to implement these change of control provisions was taken with a view to dissuading Pala from continuing with its bid regardless of whether the rights plans are ceased traded. Therefore, Pala argues, this conduct strongly suggests that the Neo Board is motivated by considerations other than the best interests of shareholders. As such, relying on *Re Cara*, the Neo Board is under a significantly higher onus to justify the continuation of the rights plans, which it is unable to do.

**(ii) Neo**

[89] Neo submits that two core principles underlie the take-over bid rules, namely procedural fairness for all, and the fulfillment of the fiduciary duty of directors. These principles, Neo submits, must be reflected in conduct and recommendations that are based upon the best interests of the shareholders generally (*Re Cara* at paras. 58 and 61).

[90] Neo takes the position that, in adopting the Second Shareholder Rights Plan, the Neo Board did not breach its fiduciary duties to Neo's shareholders since: (i) the motivation behind their actions and decisions was a valid business purpose; and (ii) it exercised reasonable business judgment. As such, in Neo's view, there is no basis for the Commission to assert and exercise its public interest jurisdiction.

[91] According to Neo, Canadian courts have recognized the business judgment rule and have shown deference to a decision made by directors provided that the directors have acted reasonably and fairly. Neo further submits that Canadian courts have not recognized a "*Revlon* duty" *per se* which established that, when effecting a change of control transaction involving a Delaware corporation, directors have a fiduciary obligation to maximize value for the shareholders (*Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986)). As such, in Neo's view, directors are not necessarily under an obligation, in all cases, to enter into a change of control transaction or put the company "in play" simply because it would immediately result in proceeds to shareholders above current market prices (*Schneider* at para. 61); boards of directors can "just say no" after due consideration of an offer.

[92] Neo also takes the position that its response was appropriate and reasonable in light of the Pala Offer, and was in the best interest of Neo's shareholders. In support of this contention, Neo lists the following dangers associated with a successful Pala Offer:

(a) The Pala Offer is, or could lead to a creeping take-over bid.

(b) Given Neo's wide shareholder base and the historically low voting levels at meetings of shareholders (ranging from 53% to 76%), the Pala Offer would provide Pala with effective control of Neo, without offering an appropriate control premium for the shares purchased.

(c) The Pala Offer does not reflect Neo's strong financial position, the value of Neo's recent strategic initiatives and Neo's future growth and acquisition opportunities. Neo argues that: (i) the Pala Offer is opportunistically timed to take advantage of a recent period during which prices generally have declined as a result of the current economic crisis (65.7% drop in the price of Neo's shares since February 8, 2008); and (ii) the Pala Offer significantly undervalues Neo's assets and businesses.

(d) If Pala acquires effective control of Neo subsequent to a successful Pala Offering, there is a substantial risk associated with the potential loss of key management personnel.

(e) The Pala Offer seeks to provide Pala with effective control of Neo, without offering an appropriate control premium for the shares purchased and no premium for the shares not purchased.

(f) If successful, the Pala Offer will have an adverse effect on the liquidity of Neo's shares.

(g) Pala's intentions with respect to Neo are unclear.

[93] Neo submits that its board complied with its fiduciary obligations to consider the interests of all shareholders by taking the following actions:

(a) the Neo Board carefully reviewed and evaluated the Pala Offer by establishing a special committee of independent directors;

(b) the Neo Board obtained legal advice before implementing the Second Shareholder Rights Plan;

(c) the Neo Board retained financial advisors who gave an opinion that the consideration offered by Pala for Neo shares is inadequate;

(d) the Neo Board considered alternatives to maximizing shareholder value, including maintaining the *status quo* and pursuing the company's current business plan; and

(e) the Neo Board put the Second Shareholder Rights Plan to a shareholder vote at the next annual shareholder meeting.

[94] In addition, Neo disagrees with Pala's allegation that the Neo Board and management have taken steps that have the effect of entrenching management. In support of its position, Neo points out that the change of control provisions had existed in all the agreements and were disclosed years before the Pala Offer. Moreover, Neo submits that Pala has consistently praised the work of Neo's management and cited the strong management of Neo as a reason for its investment.

[95] Neo further submits that even if the Neo Board had made an improper decision in implementing the Second Shareholder Rights Plan (which is strongly denied), under Canadian corporate law, the impropriety could be waived by a majority of shareholders voting at a meeting (see *Bamford v. Bamford*, [1969] 2 W.L.R. 1107 (Eng. C.A.)). It argues that should the

Commission decide in favour of Pala and set aside the Second Shareholder Rights Plan, the Commission would effectively be substituting its business judgment for that of Neo's shareholders and the Neo Board. Neo's position is that Canadian courts and securities commissions have consistently said that they cannot and will not do that.

**(iii) Staff**

[96] Staff takes the position that the Neo Board has acted in the best interests of the shareholders as a whole and, as such, the Commission's intervention to "cease trade" the Second Shareholder Rights Plan is not required.

[97] Staff agrees with Neo's submissions that at least two underlying principles emerge from the rules and policies for take-over bids and the various rights plan hearings. The first is the principle of procedural fairness. The second is the principle of the fiduciary duty of the directors, members of the special committee of directors and advisors. In support of this position, Staff refers us to the Commission's decision in *Re Cara* where the Commission took the stance that the exercise of fiduciary duties "…should be reflected in conduct and recommendations that are based upon the best interest of shareholders generally and not those of any group of shareholders, bidders, potential bidders or others" (*Re Cara* at paras. 57-61).

[98] Staff also referred to *Pulse Data* in which the Alberta Securities Commission stated that it was reluctant to interfere with a decision of the target's board, which has a fiduciary duty to act in the best interests of shareholders, particularly where that decision has very recently been approved by informed shareholders.

[99] Staff is of the view that there is no evidence that the process undertaken by the Neo Board to evaluate and respond to the Pala Offer, including the decision to implement the Second Shareholder Rights Plan, was not carried out in what the Neo Board determined to be the best interests of the corporation and of Neo's shareholders, as a whole.

[100] Staff agrees with Neo's submissions that the Neo Board discharged its fiduciary obligations by: (i) establishing an independent special committee; and (ii) retaining independent legal and financial advisors to assist the independent special committee in reviewing the Pala Offer.

[101] Staff refers us to subsection 1.1(3) of NP 62-202 which states that "…it is inappropriate to specify a code of conduct for directors of a target company, in addition to the fiduciary standard required by corporate law". Notwithstanding, according to Staff, the Commission should and does scrutinize the board process. Where there is evidence that the process has been compromised or is questionable, it will be more difficult for the Commission to conclude that the board or special committee actions are taken with the view to the best interests of the target shareholders. However, Staff submits that no such evidence exists in the present case.

### b. Analysis

[102] We agree with Neo and Staff that in *Re Cara*, the Commission recognized that at least two underlying and animating principles emerge from the rules, policies and cases in the context of take-over bids: (1) the principle of procedural fairness for all; and (2) the principle of the fiduciary duty of directors, members of a special committee of directors, and their advisors (*Re Cara* at paras. 58 and 61). It flows from these principles that the process of implementing a shareholder rights plan in the face of a hostile take-over bid must be carried out in accordance with the fiduciary obligations of the directors, which, under Canadian corporate law, are owed *to the corporation*.

[103] A review of the case law supports the position that in ascertaining whether a board of directors has discharged its fiduciary obligations, the Commission must give effect to the business judgment rule. As the Ontario Court of Appeal stated in *Schneider*:

> [t]he law as it has evolved in Ontario and Delaware has the common requirements that the court must be satisfied that the directors have acted reasonably and fairly. The court looks to see that the directors made a reasonable decision not a perfect decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board's decision…This formulation of deference to the decision of the board is known as the "business judgment rule"…
>
> (*Schneider* at para. 36)

[104] We are therefore left to consider whether the Neo Board exercised reasonable business judgment in furtherance of its fiduciary obligations: (i) in adopting the Second Shareholder Rights Plan in the face of the Pala Offer; and (ii) in subsequently deciding not to trigger an auction in order to maximize shareholder value at that time. In other words, were these decisions within the range of reasonable alternatives?

[105] In our view, the Neo Board was entitled to adopt the Second Shareholder Rights Plan in the face of the Pala Offer. Such defensive tactics "…are neither novel nor exotic" (*Falconbrige* at para. 36) and their adoption has been explicitly recognized for legitimate business purposes in NP 62-202. Based on the evidence before us, we find that the Neo Board undertook a rigorous process to evaluate its response to the Pala Offer and identified a number of concerns, as identified above. The principal concern was that the Pala Offer would have constituted or facilitated a creeping take-over.

[106] Furthermore, although we accept Pala's position that a fundamental right of share ownership includes the right to freely alienate shares of a publicly traded corporation, the Canadian take-over bid regime, and in particular NP 62-202, recognizes that this fundamental right is subject to reasonable restrictions. Indeed, the Canadian take-over bid regime itself restricts alienability, on policy grounds, by imposing limits on the manner in which certain

prospective buyers can acquire shares. By their very nature shareholder rights plans impose restrictions on a shareholder's right to freely dispose of shares. Nevertheless, as discussed above, such defensive tactics are expressly permitted by NP 62-202. Moreover, we are of the view that the overwhelming shareholder ratification of the Second Shareholder Rights Plan, in the circumstances of this case, and in the face of the outstanding Pala Offer, can be seen as a clear rejection of the Pala Offer. Therefore, we do not agree with Pala that Neo's shareholders were deprived of an opportunity to respond to the take-over bid, as contemplated by subsection 1.1(6) of NP 62-202.

[107] We acknowledge that in many instances a primary purpose for adopting a shareholder rights plan is to allow the board to pursue alternative value-enhancing transactions, which includes seeking an alternate bid. In fact, we recognize that in the circumstances of many of the cases referred to, and considered by us, that obligation may have crystallized. However, we do not see this as the only legitimate purpose for a shareholder rights plan. As stated above, Canadian law imposes and recognizes a fiduciary duty owed by a board to the corporation as a whole. The so-called "business judgment" rule properly permits directors to make appropriate decisions sufficient to fulfill their fiduciary obligations. To the extent that the scope and content of these duties were not clear in the context of a hostile take-over bid, they have been better amplified by the recent statements of the Supreme Court of Canada in *BCE Inc., Re*, [2008] 3 S.C.R. 560 ("*BCE*"). In that case, the Supreme Court discussed the fiduciary duty of directors as follows:

> The fiduciary duty of the directors to the corporation originated in the common law. It is a duty to act in the best interests of the corporation. Often the interests of shareholders and stakeholders are co-extensive with the interests of the corporation. But if they conflict, the directors' duty is clear – it is to the corporation: *Peoples Department Stores*.
>
> The fiduciary duty of the directors to the corporation is a broad, contextual concept. *It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation*… [emphasis added]
>
> In *Peoples Department Stores*, this Court found that although directors *must* consider the best interests of the corporation, it may also be appropriate, although *not mandatory*, to consider the impact of corporate decisions on shareholders or particular groups of stakeholder. As stated by Major and Deschamps JJ., at para. 42:
>
> > We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment. [emphasis in original]
>
> (*BCE* at paras. 37-39)

[108] The Court went on to state:

> …[d]irectors, acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on corporate stakeholders, such as the debentureholders in these appeals … However, the directors owe a fiduciary duty to the corporation, and only to the corporation. People sometimes speak in terms of directors owing a duty to both the corporation and to stakeholders. Usually this is harmless, since the reasonable expectations of the stakeholder in a particular outcome often coincides with what is in the best interests of the corporation. However, cases (such as these appeals) may arise where these interests do not coincide. In such cases, it is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation.
>
> (*BCE* at para. 66)

[109] In our view, these statements make it clear that there is no specific formula to apply on directors in every case, including an obligation to permit and facilitate an auction of company shares each and every time an offeror makes a bid. In fact, Canadian courts have historically not imposed such duty on directors to the corporation. As the Ontario Court of Appeal stated in *Schneider*:

> [t]he decision in *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), stands for the proposition that if a company is up for sale, the directors have an obligation to conduct an auction of the company's shares. *Revlon* is not the law in Ontario. In Ontario, an auction need not be held every time there is a change of control of a company.
>
> (*Schneider* at para. 61)

[110] We also defer to the comments of the Supreme Court of Canada in *BCE* where the Court noted:

> What is clear is that the *Revlon* line of cases has not displaced the fundamental rule that the duty of directors cannot be confined to particular priority rules, but is rather a function of business judgment of what is in the best interest of the corporation, in the particular situation it faces….
>
> (*BCE* at para. 87)

[111] We are bound by this principle as a matter of law, and have a duty to apply it in cases such as these. However, we add that in our view this articulation is not a deviation from past Commission determinations but is consistent with them.

[112] As discussed above, in this case, Pala submits that the *only* proper use of a shareholder rights plan in the face of a take-over bid is to allow a board of directors sufficient time to seek

out alternative bidders. Consistent with the Supreme Court's statements in *BCE* and the established body of corporate case law it is our view that, shareholder rights plans *may* be adopted for the broader purpose of protecting the long-term interests of the shareholders, where, in the directors' reasonable business judgment, the implementation of a rights plan would be in the best interests of the corporation.

[113] Based on the evidence before us, we find that after assessing the offer the Neo Board concluded that: (i) the current economic circumstances are, if not unique, a once in a lifetime event and have depressed the market prices of shares in a broad range of public companies, including Neo; (ii) Neo has little debt, strong cash reserves and solid business relationships and so, at present, is well positioned not only to survive the current economic situation but also to emerge a stronger and more valuable enterprise upon the eventual return of more normal conditions; (iii) now is an absolutely inappropriate time for the collectivity of Neo's shareholders to run an auction or allow effective control of Neo to be acquired by any one shareholder as that would be an impediment to such a transaction in the future; and (iv) the effect of a bid by a financial investor such as Pala would not be advantageous at this time for either Neo as an enterprise or the collectivity of Neo shareholders.

[114] It is evident that, in the view of the Neo Board, avoiding an auction *at this time* was in the long-term best interest of the corporation and of the shareholders, as a whole. This decision reflects the business judgment of the Neo Board, and there is no evidence to suggest that it was made in any manner other than in furtherance of its fiduciary obligations to the corporation.

[115] The Commission has historically scrutinized the integrity of the board process in responding to a take-over bid. Where there is evidence that the process has been compromised or is questionable, it will be more difficult for the Commission to conclude that board or special committee actions are taken with a view to the best interests of the target shareholders.

[116] Board process will be compromised where: (i) advisors to the special committee are not independent; or (ii) decisions by the target board or special committee suggest entrenchment.

[117] In *Re Cara*, the Commission was concerned that a longstanding legal advisor to the target could not truly act as an independent advisor to the special committee since the Commission concluded that if the offeror's bid were to succeed, the retainer of the legal advisor would very likely cease (*Re Cara* at para. 74). Moreover, the Commission became suspicious when the special committee recommended, and the board approved, reimbursement payments to the target's chairman for expenses by the chairman in respect of a potential "white knight" bid. The Commission commented on the behaviour of the board and special committee noting:

> [t]he decision … showed conduct that caused us to believe that the special committee and the directors who approved the reimbursements were not motivated solely by the best interests of the shareholders.
>
> (*Re Cara* at para. 75)

[118] Similarly, in *Re CW Shareholdings Inc.* (1998), 21 O.S.C.B. 2899 at para. 71, the Commission placed less reliance on the special committee's review of the bid where the committee was "… set up for purposes of convenience only, and not as an independent committee".

[119] We note that the Neo Board undertook a well-structured evaluation process in response to the Pala Offer which involved: (i) establishing a special committee of independent directors; (ii) obtaining legal advice before implementing the Second Shareholder Rights Plan; (iii) retaining financial advisors who gave an opinion that the consideration offered by Pala for Neo's shares is inadequate; (iv) considering alternatives to maximizing shareholder value, including maintaining the *status quo* and pursuing the company's current business plan; and (v) putting the Second Shareholder Rights Plan to a shareholder vote at the next annual shareholder meeting.

[120] There is no evidence that this evaluation process has been compromised. While Pala submits that the Neo Board and management have taken steps to entrench themselves, on the evidence, we are not convinced that this is the case.

[121] In summary, based on the foregoing, we conclude that there is no evidence that the board process in evaluating and responding to the bid, including the decision to implement the Second Shareholder Rights Plan, was not carried out in the best interest of the corporation and the shareholders, as a whole.

### 3. Is there evidence to suggest that management or the board of directors coerced or unduly pressured the target's shareholders to approve the shareholder rights plan?

#### a. Position of the Parties

[122] Pala argues that the actions of the Neo Board prior to the shareholder vote at the 2009 Annual and Special Meeting held on April 24, 2009 are suspicious and indicative of entrenchment. Specifically, Pala refers to the fact that the Neo Board waived the 48-hour proxy cut-off prior to the meeting.

[123] Pala submits that Neo waived the 48-hour proxy cut-off, "so as to enable itself to continue to solicit proxies in its favour and with knowledge of the identity of shareholders who had already voted against the Second Shareholder Rights Plan".

[124] In its oral submissions, Neo takes the position that the waiver of the proxy cut-off was done strictly in response to Pala's announcement on April 21, 2009 that the Pala Offer would be amended so as to: (i) increase the offer price to $1.70 per share; (ii) extend the offer to May 15, 2009; and (iii) decrease the maximum number of shares to be taken up to 10.6 million.

[125] Neo submits that the waiver of the proxy cut-off was in the best interest of the shareholders because it allowed them to make an informed choice based on up-to date facts.

[126] Staff submits that it is not aware of any evidence suggesting coercive tactics on behalf of the Neo Board.

#### b. Analysis

[127] In examining shareholder support, the Commission has scrutinized how that support was obtained. However, the fact that a target's board may approach and consult institutional shareholders regarding the implementation of a rights plan does not necessarily mean that shareholders have been coerced or unduly pressured to approve a plan.

[128] In *Regal*, the Commission was told that Regal management had consulted with its institutional shareholders about the rights plan and modified it to reflect their concerns. Despite that consultation, the Commission found "no suggestion of coercion or undue managerial pressure imposed on shareholders to ratify the Plan" (*Regal*, para. 11).

[129] The Alberta Securities Commission drew a similar conclusion in *Pulse Data* where it stated:

> [t]here was no suggestion of managerial coercion or inappropriate managerial pressure being brought to bear on Pulse Shareholders to approve the Rights Plan. Indeed, we noted that ISS, an independent advisory service, recommended to its institutional shareholder clients that they vote in favour of the Rights Plan at the special meeting of Pulse Shareholders….
>
> (*Pulse Data* at para. 101(d))

[130] While we were told that Neo management had consulted with institutional shareholders in the process of implementing the Second Shareholder Rights Plan, there is no evidence of coercion or undue managerial pressure imposed on shareholders to ratify the Second Shareholder Rights Plan. Moreover, we are not aware of any evidence that suggests the 48-hour proxy cut-off resulted in any solicitation by the Neo Board or that such solicitation, if it occurred, was coercive.

### C. If the Second Shareholder Rights Plan is allowed to stand, has the time come for it to be terminated by the Commission?

#### 1. Position of the Parties

[131] Pala takes the position that the fundamental question underlying a decision to dissolve or maintain a rights plan is whether it is likely to enhance, limit or deny shareholders' ability to respond to a take-over bid (*Re Tarxien Corporation and Ventra Group Inc.* (1996), 19 O.S.C.B. 6913 at 6919). According to Pala, this requires the regulators, with a view to the *bona fide* interests of the shareholders of the target company, to balance management's ability to generate competing bids if given more time against the danger that an existing bid will disappear if the rights plan is not dissolved. Therefore, Pala argues, the question becomes not if, but when the rights plan will be set aside.

[132] The jurisdiction of the Commission to intervene lies in its obligation to protect the public interest (*Re Canadian Jorex Ltd. and Mannville Oil & Gas Ltd.* (1992), 15 O.S.C.B. 257 ("*Re Jorex*") at 266 and 267).

[133] Pala submits that the key issue in determining whether it is time for the rights plan to go is whether the plan will facilitate an unrestricted auction of the corporation or will deprive the shareholders of their fundamental right to tender their shares to the offer (*Royal Host* at 7828 and *Falconbridge* at paras. 34 and 35). Ordinarily, the target company bears the burden of proof (*Re Samson* at 3).

[134] Pala argues that typically, when a target company is "put into play", its directors begin the process of attempting to maximize shareholder value. In this case, however, despite a considerable amount of time having elapsed since the launch of the Pala Offer, the Neo Board has not identified any alternative bids or transactions, or the possibility thereof, or even made any attempts to entice a competing bid. As such, Pala submits the Second Shareholder Rights Plan serves no central purpose and should be terminated.

[135] Pala further contradicts Neo's position that the Second Shareholder Rights Plan has not outlived its usefulness because this defensive pill has already resulted in an increased offer price by Pala. Pala contends that the increased offer price by Pala merely reflects the fact that stock prices have generally gone up across all markets and Pala's increased bid reflects that widespread increase.

[136] Neo submits that Canadian securities regulatory authorities expressly recognize in NP 62-202 that a board may adopt defensive tactics in a genuine attempt to obtain a better bid.

[137] According to Neo, the general thrust of Canadian decisions on whether the "pill must go" has been to treat the pills as devices whereby the target company board may require that the take up of shares under the offer be delayed beyond the period required by the statutory take-over bid legislation, in order to allow the board a longer opportunity to "conduct an auction". When the securities commission determines that this quest has gone on long enough, then it makes an order rendering the poison pill ineffective.

[138] Neo's position is that the Second Shareholder Rights Plan has not outlived its usefulness. Neo points out that since Pala announced its intention to launch its partial offer, Pala has since raised its offer price by over 20% in the absence of a competing bid. As such, Neo submits that the Commission should not adopt a premature or arbitrary timeline for when the tactical pill must be set aside.

[139] Staff agrees with Pala's position that past cases support the conclusion that there comes a time when a rights plan must go. According to Staff, the benchmark for determining when that time has come has generally been when the rights plan no longer serves its purpose – i.e. to provide time for the board to create an auction or consider other alternatives to maximize shareholder value.

[140] However, in Staff's view, the Second Shareholder Rights Plan stands in the way of the Pala Offer and therefore continues to serve its purpose, which reflects the will of the substantial majority of Neo shareholders.

**2. Analysis**

[141] We acknowledge that case law supports both Pala's and Staff's submissions that "there comes a time when a rights plan must go". In *Re Jorex*, the Commission had to consider whether it should exercise its public interest jurisdiction to cease trade a rights plan which was adopted, without shareholder approval, nine days after an offer by Mannville, the offeror, to acquire all of shares of Jorex, the target. Jorex had waived the plan in the face of a rival bid launched by Trans-Arctic, but not in Mannville's case. The Commission identified the sole issue before it as follows:

> [a]ll seemed to agree, as Commissioner Blain put it early on in the hearing, that "there comes a time when the pill has got to go." The only real issue before us, then (again, as succinctly framed by Commissioner Blain), was "when does the pill go".
>
> (*Re Jorex* at 263)

[142] Similarly, in *Lac Minerals* the Commission adopted the *Re Jorex* approach and observed that "[a]ll parties agreed that the critical issue that the Commission had to decide was 'is it time for the pill to go?'" (*Lac Minerals* at 4963).

[143] The principle that "it's not if but when a pill must go" was also reiterated in *Regal.* However, although the Commission recognized that the only real issue before it was "when does the pill go", the Commission noted:

> [i]t is true that Jorex teaches that "there comes a time when a pill has to go". However, this is not to say that, once a take-over bid has been made, a shareholder rights plan can have no effect, and it must automatically be struck down by the Commission so as to allow the bid to proceed at the stated expiry date of the acceptance period of the bid. If there appears to be a real and substantial possibility that, given a reasonable period of further time, the board of the target corporation can increase shareholder choice and maximize shareholder value, then, absent some other compelling reason requiring the termination of the plan in the interests of shareholders, it seems to us that the Commission should allow the *plan to function for such further period, so as to allow management and the board to continue to fulfil their fiduciary duties.* [emphasis added]
>
> (*Regal* at 4979)

[144] We echo the statements of the Commission in *Regal*, in finding that so long as the rights plan continues to allow the target's management and board the opportunity to fulfill their fiduciary duties, the plan continues to serve a purpose.

[145] In light of our findings above, we are not convinced that the time has come to "cease trade" the Second Shareholder Rights Plan. The Second Shareholder Rights Plan stands in the way of the Pala Offer and has continued to provide the Neo Board the opportunity to act in a manner which, based on the reasonable business judgment of the Neo Board and management, protects the long-term interests of Neo and the shareholders, as a whole.

[146] At the time the Application came before us, little time had passed since the shareholders' ratification of the Neo Board's decision to maintain the Second Shareholder Rights Plan. To paraphrase the words of this Commission in *Jorex*, the time for the pill to go is not yet upon us.

## VI. CONCLUSION

[147] For the Reasons set out in our brief decision dated May 11, 2009, and the full Reasons set out above, we declined to exercise our public interest jurisdiction to "cease trade" the Second Shareholder Rights Plan at that time, and dismissed the Application.

Dated at Toronto this 1st day of September, 2009.

"Lawrence E. Ritchie" "David L. Knight"

_____ _____

Lawrence E. Ritchie David L. Knight, FCA

**SCHEDULE A: DECISION, MAY 11, 2009**

Ontario Securities Commission | Commission des valeurs mobilières de l'Ontario | P.O. Box 55, 19th Floor 20 Queen Street West Toronto ON M5H 3S8 | CP 55, 19e étage 20, rue queen ouest Toronto ON M5H 3S8

---

**IN THE MATTER OF THE *SECURITIES ACT***
**R.S.O. 1990, c.S.5, AS AMENDED**

**- AND -**

**IN THE MATTER OF**
**NEO MATERIAL TECHNOLOGIES INC. AND PALA INVESTMENTS HOLDINGS LIMITED AND ITS WHOLLY-OWNED SUBSIDIARY 0833824 B.C. LTD.**

**DECISION (REASONS TO FOLLOW)**
**Section 127 of the *Securities Act,* R.S.O. 1990 c. S.5**

| | | |
|---|---|---|
| **Hearing:** | May 7, 2009 | |
| **Decision:** | May 11, 2009 | |
| **Panel:** | Lawrence E. Ritchie | - Vice-Chair (Chair of the Panel) |
| | David L. Knight, FCA | - Commissioner |
| **Counsel:** | Tom Friedland<br>Grant McGlaughlin<br>Rebecca Burrows<br>Melanie Ouanounou | - Pala Investments Holdings Limited and its wholly-owned subsidiary 0833824 B.C. Ltd. |
| | Peter F.C. Howard<br>Edward J. Waitzer<br>David Weinberger<br>Samaneh Hosseini | -Neo Material Technologies Inc. |
| | James Sasha Angus<br>Shannon O'Hearn<br>Paul Hayward<br>Konata Lake | -Staff of the Ontario Securities Commission |

## DECISION

[1] This is the decision of the Ontario Securities Commission (the "Commission") in connection with the application brought by Pala Investments Holdings Limited ("Pala") and 0833824 B.C. Ltd. ("083") related to the transaction under which Pala proposes to purchase for cash up to a maximum of 10.6 million (as amended on April 27, 2009) of the outstanding common shares of Neo Material Technologies Inc. ("Neo").

[2] This document does not constitute the Commission's reasons for our decision in this matter. Given the nature of the application and the facts that gave rise to it, we have been asked to render a decision as quickly as possible. Accordingly, we are issuing this decision now on an expedited basis. Full reasons will follow in due course for purposes of subsection 9(1) of the Securities Act, R.S.O. 1990, c. S.5, as amended (the "Act").

## I. THE APPLICATION

[3] This matter arises out of an application brought by Pala and 083 seeking an order from this Commission made pursuant to section 127 of the Act in connection with an offer by 083 to purchase for cash up to a maximum of 23 million (or approximately 20%) of the outstanding shares of Neo not already held by 083 and its affiliates at a price of $1.40 for each common share (the "Pala Offer"). The Pala Offer was subsequently amended on April 27, 2009 (i) to increase the offer price to $1.70 per share (ii) to decrease the maximum number of shares to be taken up to a maximum of 10.6 million (or approximately 9.5%) and (iii) to extend the expiry time of the Pala Offer to May 15, 2009.

## III. THE RELIEF SOUGHT BY PALA

[4] In connection with the Pala Offer, 083 and Pala seek a permanent order pursuant to subsection 127(1) of the Act that:

(a) trading cease in respect of any securities issued, or to be issued, under or in connection with the Second Shareholder Rights Plan (as defined below); and

(b) trading cease in respect of any securities issued, or to be issued, under or in connection with the First Shareholder Rights Plan (as defined below).

[5] In argument, the Respondent to this Application, Neo, and Staff of the Commission take the position that our focus need be only on the Second Shareholder Rights Plan. All parties agree that if we do no grant the relief sought in respect of the Second Shareholder Rights Plan, the relief sought in respect of the First Shareholder Rights Plan is unnecessary.

## III. THE TRANSACTION

[6] The parties to this Application provided us with an agreed statement of facts, as well as affidavit materials relied on respectively by each party.

[7] Neo is a public corporation continued under the laws of Canada. It is a producer, processor and developer of neodymium-iron-boron magnetic powders, rare earths and zirconium based engineered materials and applications.

[8] Pala is a multi-strategy investment company launched in 2006 and registered in Jersey, Channel Islands. It has a particular focus on mining and resource companies in both developed and emerging markets. Pala has been an investor in Neo since July 2007. At the date of the Pala Offer, Pala had beneficial ownership of, or exercised control or direction over, 23,640,000 common shares of Neo, representing 20.46% of the 115, 521,000 outstanding common shares of Neo.

[9] 083 was incorporated on August 29, 2008 under the laws of the province of British Columbia. It was incorporated for the purpose of acquiring or investing in Canadian businesses.

[10] Neo has a shareholder rights plan dated as of February 5, 2004 (the "First Shareholder Rights Plan"). The First Shareholder Rights Plan was approved by the Neo shareholders at the annual and special meeting of shareholders held June 28, 2004 and reconfirmed on April 28, 2007. It contains a minimum tender condition requiring that at least 50% of the independently held common shares of Neo must be tendered in order for a bidder to take up and pay for any of the shares deposited under the offer (the "Minimum Tender Condition").

[11] On February 9, 2009, Pala announced that, through a wholly-owned subsidiary, it intended to acquire up to a maximum of 23 million of the outstanding common shares of Neo, representing approximately 20% of Neo's shares at a price of $1.40 per share. The Pala Offer was structured to comply with the Permitted Bid definition contained in the First Shareholder Rights Plan by remaining open for at least 60 days, and, in the event that the Minimum Tender Condition is met, by remaining open for another 10 days from the date of the announcement that 50% had been tendered.

[12] On February 12, 2009, Neo's Board of Directors (the "Neo Board") adopted a second shareholder rights plan (the "Second Shareholder Rights Plan"). The Second Shareholder Rights Plan is substantially similar to the First Shareholder Rights Plan except that it prohibits partial bids.

[13] Pala issued a Take-over Bid Circular on February 25, 2009.

[14] On April 21, 2009, Pala filed a press release announcing its intention to vary and extend the Pala Offer (i) to increase the offer price to $1.70 per share (ii) to decrease the maximum number of shares to be taken up to a maximum of 10.6 million and (iii) to extend the expiry time of the Pala Offer to May 15, 2009.

[15] At Neo's Annual and Special Meeting on April 24, 2009, Neo's shareholders passed a resolution to approve, ratify and confirm the adoption of the Second Shareholder Rights Plan. Although not in the agreed statement of facts, it was not contested that (i) excluding Pala's holdings, 81.24% of the shares voted were in favour of the Second Shareholder Rights Plan and (ii) 82.74% of Neo's shares were represented in person and by proxy at the meeting.

[16] On April 27, 2009, Pala formally amended the Pala Offer by filing its Notice of Variation and Extension.

## IV. DECISION

[17] In this case, the Applicant asserts that Neo's "pill" must go, and urges us to exercise our public interest jurisdiction to "cease trade" the Second Shareholder Rights Plan. In all of the circumstances, we are not satisfied that it is in the public interest to grant the relief sought at this time.

[18] While we intend to expand on these points in the reasons to follow, at this time (and without limiting ourselves), we point out that we are influenced by the following considerations:

(a) the Second Shareholder Rights Plan was adopted by the Neo Board in the context of, and in response to the Pala Offer;

(b) there is no evidence that the process undertaken by the Neo Board to evaluate and respond to the Pala Offer, including the decision to implement the Second Shareholder Rights Plan, was not carried out in what the Neo Board determined to be the best interests of the corporation and of the Neo shareholders, as a whole;

(c) an overwhelming majority of the Neo shareholders (excluding Pala) approved the Second Shareholder Rights Plan while the Pala Offer remained outstanding;

(d) the evidence supports a finding that the Neo shareholders were sufficiently informed about the Second Shareholder Rights Plan prior to casting their votes; and

(e) there is no evidence to suggest that management or the Neo Board coerced or unduly pressured the Neo shareholders to approve the Second Shareholder Rights Plan.

[19] As a result of our decision, the Application is dismissed.

Dated at Toronto this 11th day of May, 2009.

| | |
|---|---|
| *"Lawrence E. Ritchie"* | *"David L. Knight"* |
| Lawrence E. Ritchie | David L. Knight, FCA |