

**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.**

**MEMORANDUM OF FACT AND LAW
OF NEO MATERIAL TECHNOLOGIES INC. ("NEO")**

**"If in pill decisions the commission acts as surrogate for the shareholders,
this is a case where the shareholders have spoken for themselves."**

James Baillie (para. 24)

A. OVERVIEW

1. These submissions are supplemental to those submitted on behalf of Neo on April 28, 2009 (the "April 28th Submissions"). All capitalized terms not defined herein have the meanings given to them in the April 28th Submissions.
2. Pala chose to make a Permitted Bid under the Rights Plan. It could have chosen and can choose in the future to make a bid that is not a Permitted Bid under the Rights Plan. It is, to understate the case, audacious for Pala to ask the Commission to rewrite and amend Pala's offer or consider an offer that Pala did not make but still could make.
3. Pala's application on the Rights Plan is moot unless the New Rights Plan is cease traded (which Neo has addressed in the April 28th Submissions). In that

scenario, the Rights Plan should continue in full force and effect. Shareholders have effectively approved the Rights Plan on three occasions and, most recently, shareholders made it clear that they do not approve Pala. For this reason, Pala cannot overcome the irrevocable 50% minimum tender condition of its own Permitted Bid and acquire effective control of Neo. Pala (and indeed all shareholders) acquired the shares knowing of the Rights Plan and the definition of Permitted Bid and the protections provided. There is no basis for Pala to do indirectly that which it is unable do directly under its current offer due to lack of shareholder support.

B. ISSUES

4. Is it appropriate for the Commission to cease trade the Rights Plan given that Pala has chosen to make a Permitted Bid?
5. Neo's shareholders have recently agreed that no control transaction involving Neo should occur. In so doing, they effectively ratified the Rights Plan. On what basis should Pala be permitted to seek relief or, assuming jurisdiction, should the Commission provide Pala the ability to acquire effective control without disinterested shareholder approval?

C. THE LAW

(a) No jurisdiction, nor public interest to amend a permitted bid

6. The Pala Offer and the Amended Pala Offer constitute a Permitted Bid under the Rights Plan. Indeed, on the face page of the Pala Circular, Pala states that "The Offeror believes the Offer constitutes a Permitted Bid for the purposes of the First Shareholder Rights Plan." This can be distinguished from Pala's

reference to the New Rights Plan, in respect of which “the Offer is not, and will not be, a Permitted Bid.”¹

7. Both Pala and Neo are of the view that the Pala Partial Offer constitutes a Permitted Bid under the Rights Plan. The Pala Partial Offer irrevocably complies with the Permitted Bid requirements of the Rights Plan and the rights issued thereunder cannot separate or become exercisable. Pala is now effectively saying that the Commission ought to amend the terms of its offer so that it ceases to be a Permitted Bid. Pala’s clear purpose in seeking to do so is to avoid the minimum tender condition which is required by the Rights Plan and to circumvent the express determination of an overwhelming majority of Neo’s other shareholders. There is no jurisdiction for Pala to ask the Commission to make an offer it chose not to make, but could.

(b) The Rights Plan has recent and informed shareholder support

8. The protection of the *bona fide* interests of shareholders is the primary objective of the Canadian take-over bid regime (NP 62-202). In deciding whether a rights plan should be allowed to stand in the way of a take-over bid, the relevant securities commission accordingly has to determine “what is in the best interest of shareholders?”. The Commission stated in *MDC Corporation and Regal Greetings & Gifts Inc.* that it would not be prepared to cease trade a rights plan if it is clear that shareholders felt otherwise. In *Pulse Data*, the Alberta Commission held that it was reluctant to interfere with a decision that had very recently been approved by informed shareholders.
9. Any decision to cease trade a rights plan ought to be consistent with the will of shareholders. However, more often than not in pill cases, the Commission does not have a clear manifestation of the will of shareholders. The decision

¹ Pala Circular, Exhibit “M” to the Castro Affidavit, Application Record, Tab 1M

as to “what is in the best interest of shareholders?” is made on the basis that the shareholders should have a choice. Here, the Commission has the best evidence - the benefit of a current, informed and unequivocal manifestation of the will of Neo’s shareholders.

10. The vote in favour of the New Rights Plan is effectively a vote in favour of the Rights Plan. This is inexorably so because the New Rights Plan is substantially similar to the Rights Plan except that it requires that an offeror make a bid to all shareholders for all of their shares. In that sense, the Rights Plan is subsumed by the New Rights Plan (because it is less restrictive). As set out at paragraph 64 of the April 28th Submissions, the shareholder vote was current, informed and deliberate. The argument that the Rights Plan technically was not put to the shareholders is just that - technical. Pala’s position is the quintessential paradigm of “form over substance” that this Commission has never accepted and ought not accept in this case.
11. In terms of the level of support for the Rights Plan, it is clear that the Rights Plan is supported by over 80% of disinterested shareholders, at a minimum. This is because the vote in favour of the New Rights Plan was attenuated by *RiskMetrics*’ recommendation, which several institutional shareholders follow as a matter of course. Had the shareholder vote been directly in relation to the Rights Plan, which *RiskMetrics*’ recommended in 2007, it is likely that those same institutional shareholders would not have voted against it.
12. Furthermore, the Rights Plan was first approved by Neo shareholders at the annual and special meeting in 2004 and later ratified by approximately 90% of shareholders at Neo’s annual and special meeting in April 2007. Pala argues that this shareholder support is “stale”. This notion of staleness is preposterous in light of the approval of the New Rights Plan.

13. Pala is asking the Commission to tell Neo's Board of Directors and shareholders, that it knows better than they do what is in the best interests of Neo and its shareholders. This is an invitation to interfere that Commission ought to refuse.

(c) The "Rules of the Game" - shareholder approval of control transactions by any means

14. The minimum tender condition of the Permitted Bid definition of the Rights Plan is 50%, which means that Pala may not proceed with the offer as a Permitted Bid if less than 50% of Neo's shareholders (other than Pala) tender to the partial offer. The minimum tender condition must also be irrevocable and unqualified. This serves an important purpose: it ensures that no control transaction involving Neo can occur without disinterested shareholder approval, whether obtained through a meeting of shareholders or through an opportunity to accept a formal take-over bid. The minimum tender requirement does not preclude consideration or acceptance of a take-over bid by Neo's shareholders because, by its very terms, it provides disinterested shareholders with the right to accept or reject an offer.

15. The Pala application implies that that the Commission has the ability to permit the waiver of a minimum tender requirement and effectively re-write the Permitted Bid definition of the Rights Plan that was not only approved by Neo's shareholders (three times), but is a widely accepted component of the Permitted Bid definition that is also approved by *RiskMetrics*. If this position is correct, then no permitted bid rights plan could survive an application to a securities commission. The implication of removing the minimum tender condition is that no rights plan can impose requirements on permitted bids beyond what is express in take-over bid legislation.

16. The minimum tender requirement, by its very terms, provides all of Neo's shareholders with the right to accept or reject the Pala Partial Offer. If a majority of shareholders determine that they do not want the Pala Partial Offer to be accepted by any shareholder, the Rights Plan provides them with that protective right. This is particularly important in the case of a partial bid, which is inherently coercive as the acquisition of any additional shares by Pala affects all shareholders and particularly those shareholders who do not tender to its bid. The numerous adverse consequences of Pala's increased control position are set out at paragraphs 29 and 30 of the April 28th Submissions. If, however, a majority of shareholders determine that it would be appropriate for Pala to increase its control position and determine to tender to the Pala Partial Offer, the Rights Plan (in the absence of the new Rights Plan) would afford them that opportunity to partially dispose of their shares on a rateable basis. The terms of the original Rights Plan effectively form part of the securities that were purchased and removing the minimum tender condition would be akin to amending the articles or share terms of Neo against the will of the shareholders. All shareholders knew or were deemed to know of this protection when they bought their shares and it would be manifestly unfair to remove it at the behest of Pala.
17. Pala acquired its entire interest in Neo with full knowledge of the Rights Plan and the minimum tender condition, and even structured its partial offer as a Permitted Bid. In doing so, Pala implicitly acknowledges that no control transaction involving Neo can occur without disinterested shareholder approval. These were the "rules of the game" for all Neo shareholders. The recent and informed shareholder vote on the New Rights Plan - effectively a shareholder vote on a control transaction by Pala - was conclusive: Pala lost.
18. In conclusion, there is no public interest basis for the Commission to override the clear expression of shareholder democracy evidenced by shareholder

approval of the Rights Plan and the mechanism of the minimum tender requirement forming part of the permitted bid definition.

D. ORDER REQUESTED

19. Neo respectfully requests that the Pala Application be dismissed.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

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