

Introduction

1. This issue of the Takeovers Bulletin contains a summary of the Panel's recent decision in relation to Nam Tai Electronic and Electrical Products Limited and the Executive's subsequent disciplinary action against Mr Koo Ming Kown.
2. The Executive has sought the views of the Panel on the application of the Share Repurchase Code to the amendment of terms and conditions and subsequent redemption of convertible securities. The Executive has issued a new Practice Note 16 to clarify the position.
3. The Executive has also sought the Panel's views on various issues concerning special deals. In this regard, the Executive has issued a new Practice Note 17.
4. The Executive would like to remind market practitioners of Practice Note 5 and the fact that a "no further comment" confirmation given by the Executive after commenting on a Takeovers Code related announcement or document does not equate to a confirmation by the Executive that the draft announcement or document or the conduct of the transaction fully complies with the Takeovers Code.
5. This issue also informs readers that Practice Note 3 (Implementation of Electronic Disclosure Project and the application of Rule 19.1. of the Takeovers Code) has been revised.
6. Lastly, the Executive would like to take this opportunity to update the market on the activities of the Takeovers Team in the six months ended 31 March 2009.

Highlights

- Panel's decision on NTEEP and disciplinary action against Mr Koo
- New Practice Notes 16 and 17
- The Executive's clearance of documents does not give immunity
- Revised Practice Note 3
- Update on the activities of the Takeovers Team

Nam Tai Electronic & Electrical Products Limited – Panel’s Decision dated 21 April 2009 and Cold Shoulder Order against Mr Koo Ming Kown dated 19 May 2009

Panel’s decision

On 14 April 2009 the Takeovers Panel endorsed the Executive’s view that an offer by Nam Tai Electronics, Inc. (NTEI) for all the outstanding shares in Nam Tai Electronic and Electrical Products Ltd (NTEEP) should not be re-opened after the announcement of its lapse.

On 24 February 2009 it was announced that Yu Ming Investment Management Ltd (Yu Ming) would make a voluntary conditional general cash offer on behalf of NTEI for all the outstanding shares in NTEEP. The offer was conditional upon NTEI having received acceptances and/or purchases totalling at least 90% of the shares subject to the offer.

On 6 April 2009, the first closing date, NTEI and NTEEP jointly announced that as at 4:00pm that day NTEI received valid acceptances of 195,899,531 shares under the offer representing about 88.46% of the total number of shares subject to the offer. As the condition of the offer had not been fulfilled it was also stated in the announcement that NTEI did not intend to extend the offer and therefore the offer lapsed on 6 April 2009.

On the following day Yu Ming approached the Executive seeking its view on whether the offer could be re-opened given the high level of acceptances. The Executive referred the matter to the Panel as there were particularly novel, important or difficult points at issue. On 14 April 2009 the Panel met to consider the issues and endorsed the Executive’s view that the offer had lapsed and should not be re-opened.

The full written decision of the Panel can be found in the Takeovers and Mergers Panel Decision section of the SFC website.

Disciplinary Action by the Executive

On 19 May 2009 the Executive announced that it had taken disciplinary action against Mr Koo Ming Kown in relation to breaches of the Takeovers Code.

A copy of the Executive’s Statement dated 19 May 2009 and the order denying Mr Koo direct or indirect access to the Hong Kong securities markets for 24 months from 25 May 2009 to 24 May 2011 can be found in the Takeovers and Mergers Executive Statement section of the SFC website.

Mr Koo is the only non-executive director of NTEEP and the only executive director of NTEI.

Following the Panel’s decision on 14 April 2009, NTEI was prohibited under the Takeovers Code from making a further offer for the shares in NTEEP for 12 months commencing 6 April 2009, unless it obtained the consent of the Executive. Since the Panel’s decision the Executive reminded Mr Koo both directly and through his advisers on a number of occasions of the importance of observing the disciplines of the Takeovers Code. In particular the Executive advised Mr Koo that any proposal to wind-up NTEEP would fall within the meaning of Note 7 to Rule 2 and would be regarded as a further privatisation attempt and as such, would be subject to the 12-month prohibition in Rule 31.1 unless the Executive consented otherwise.

On 11 May 2009 NTEEP announced its latest quarterly results which disclosed a substantial deterioration in the financial performance of NTEEP and its subsidiaries for the three months ended 31 March 2009.

On 12 May 2009 NTEEP issued an announcement regarding a proposed voluntary winding-up of NTEEP. The announcement was published by Mr Koo in full knowledge that it constituted a number of serious breaches of the Takeovers Code.

The Executive raised its grave concerns with Mr Koo. Following further discussions, an application was submitted to the Executive for consent under Rule 31.1 of the Takeovers Code for NTEI to make a further general offer for all the shares in NTEEP. On 19 May 2009 the Executive granted the consent and the reasons for reaching the decision are set out in paragraph 16 of the Executive Statement.

The primary purpose of the Takeovers Code is to afford fair treatment of shareholders. The Executive believes that the conduct of Mr Koo constituted intentional and serious breaches of the Takeovers Code which merit strong disciplinary action. The Executive has therefore imposed an order denying Mr Koo direct or indirect access to the Hong Kong securities market (the Cold Shoulder Order) for a period of 24 months commencing on 25 May 2009 to 24 May 2011. The Executive has also publicly censured Mr Koo in relation to his conduct in the matter.

Mr Koo accepts that he has breached the Takeovers Code and has consented to the disciplinary action taken against him under section 12.3 of the Takeovers Code. Mr Koo has apologised unreservedly for his conduct in this matter and has undertaken to fully co-operate with the SFC and comply with the regulatory requirements on all matters relating to the Takeovers Code.

Practice Note 16 (PN16) – Application of the Share Repurchase Code to the amendment of terms and conditions and the subsequent redemption of convertible securities

The Executive has recently been consulted on a number of occasions about the application of the Share Repurchase Code (SRC) to proposals by listed companies to change the terms and conditions of their issued convertible securities, typically to allow for earlier redemption than stipulated in the original terms. The Executive therefore sought the Takeovers Panel's views on the application of the SRC to (i) the amendment of terms and conditions of convertible securities; and (ii) the subsequent redemption of convertible securities pursuant to amended terms and conditions.

"Share repurchase" is defined in the Codes on Takeovers and Mergers and Share Repurchase as *"a purchase of shares, or an offer to purchase, redeem or otherwise acquire shares of an offeror made by an offeror, including a privatisation, scheme of arrangement or other form of reorganisation that consists in whole or in part of such an offer"*.

For the purposes of the SRC, *"shares"* are defined as *"shares of all classes and securities which carry a right to subscribe or purchase shares issued directly or indirectly by a company or any of its subsidiaries"*.

It follows that the SRC covers redemption of convertible securities by an issuer.

Rule 1 of the SRC provides that a repurchase may only be effected in one of the following ways:

1. on-market share repurchase;
2. off-market share repurchase approved in accordance with Rule 2 of the SRC;
3. exempt share repurchase;
4. share repurchase by general offer in accordance with the General Principles and Rules of the Codes.

An *"exempt share repurchase"* is defined as one of the following:

- "1. an employee share repurchase;*
- 2. a share repurchase made in accordance with the terms and conditions attached to the shares being repurchased, which either permit or require such share repurchase without the prior agreement of the owners of the shares (emphasis added);"*

3. *a share repurchase made by a company at the request of the owners of the shares repurchased **in accordance with the terms and conditions attached to the shares**, which provide the owners of the shares a right to require the company to effect such share repurchase (emphasis added); and*
4. *a share repurchase that is required by the laws of the jurisdiction in which the offeror is incorporated or otherwise established."*

The Panel endorsed the Executive's current approach as follows:

1. *Amended terms* - An amendment of terms and conditions of convertible securities of the entire class of the relevant convertible securities (regardless of the number of holders) is not considered to be a redemption and therefore the SRC does not apply. If the amendment only applies to certain portion of the relevant securities in the class but not all of them, then the position is different.
2. *Redemption pursuant to amended terms* - Any actual redemption of convertible securities pursuant to the terms and conditions (original or amended as the case may be) will be considered an "*exempt share repurchase*" provided that the terms and conditions of the convertible securities do not specifically require separate prior approval of the holders of the convertible securities for such redemption. The reason for this is, if a redemption is made in accordance with the terms and conditions, it clearly falls within the meaning of paragraph (2) of the definition of exempt share repurchase.

In other words, the reference to "*terms and conditions attached to the shares*" in the definition of "*exempt share repurchase*" will not be restricted to the initial terms and conditions at the time of issue, but will also apply to terms and conditions that prevail from time to time (i.e. following amendments). So long as (i) the repurchase/redemption is being made in accordance with the terms and conditions (original or amended) of the shares/securities being repurchased; and (ii) the terms and conditions of the shares/securities (original or amended) do not require the separate prior agreement of the owners of the shares/securities being repurchased, the repurchase/redemption will be treated as an "*exempt share repurchase*".

Practice Note 17 (PN17) – Issues relating to special deals and Rule 25 of the Takeovers Code

Rule 25 of the Takeovers Code, which reflects the provision in General Principle 1 that all shareholders should be treated equally, provides that "*except with the consent of the Executive, neither the offeror nor any person acting in concert with it may make any arrangements with shareholders or enter into arrangements to purchase or sell securities of the offeree company, or which involve acceptance of an offer, either during an offer or when an offer is reasonably in contemplation or for six months after the close of such offer if such arrangements have favourable conditions which are not to be extended to all shareholders.*"

It follows from Rule 25 that special deals are generally not permitted unless the Executive provides the requisite consent. The Notes to Rule 25 set out a number of specific scenarios under which the Executive may grant such consent. In practice the Executive has encountered some issues in respect of applications for consent to transactions that constitute special deals but are not explicitly covered by the Notes to Rule 25. The Executive has sought the Takeovers Panel's guidance in this regard.

Executive's current approach to special deals

The Panel endorsed the Executive's current approach to special deals which can be summarised as follows:

1. If a special deal arrangement is capable of being extended to all other shareholders, it should be so extended;
2. If a special deal arrangement is not capable of being extended to shareholders but the special benefit received by the counter-party shareholder(s) can be quantified, the value of the benefit should be appropriately reflected in the offer price;
3. If a special deal arrangement is not capable of being extended and the special benefit conferred on the counter-party

shareholder(s) cannot be quantified, in cases where considered appropriate, the Executive may consent to these deals subject to compliance with the requirements of Note 4 to Rule 25, in particular, that (a) an independent financial adviser to the offeree company publicly states that in its opinion the terms of the transaction are fair and reasonable; and (b) the transaction is approved at a general meeting of the offeree company's shareholders who are not involved in or interested in the transaction.

Examples of the third type of arrangement mentioned above include:

- (a) Sale of assets between the offeror and a shareholder – most often by its very nature the sale of an asset is not capable of being extended to all shareholders. In practice difficulties arise regarding such sales if they constitute special deals and cannot be valued (such as the sale of a brand or an asset that includes "goodwill" value) and hence it is not possible to extend the benefit to all shareholders;
- (b) The entering into of business, shareholders' or other co-operation agreements between the offeror and a shareholder – again it is often highly problematic if not impossible to ascribe an objective value to an agreement, in particular, one that relates to co-operation; and
- (c) Service and management agreements between the offeree company and outgoing shareholders or senior management - examples of such incentives might be enhanced contractual terms, share options grants from the offeror, or a position on the board of the offeror. Given that management incentives can be substantial, the Executive believes that the process for applying for the Executive's consent to service or other management contracts should be no less stringent than that for a disposal of offeree assets (i.e. the full Note 4 requirements should apply).

Reminder that Executive's commenting process does not give immunity

The Executive wishes to remind market practitioners that the Executive's commenting process does not provide an assurance that all Code requirements have been met nor does it provide a recommendation or endorsement of the contents of the document.

Practice Note 5 reminds parties and their advisers who are involved in Code transactions that the Executive's role in the commenting process is no more than a consulting role where the Executive provides assistance in resolving any Code issues raised by the Executive or identified by the parties and advisers. It is ultimately the responsibility of the issuer of the document (and its directors and advisers) to ensure that all Code requirements are met and that all relevant information is appropriately disclosed.

In this regard Note 2 to Rule 12 states that:

"It is the sole responsibility of the issuer of the document (and its directors and advisers) to ensure that the Codes are fully complied with. The Executive will not verify the accuracy of the statements made in documents submitted for comment. If it subsequently becomes apparent that any statement was incorrect, or any document was incomplete, the Executive may require an immediate correction to be issued in addition to considering any possible disciplinary action in accordance with the Codes."

In Issue No. 7 (December 2008) the Executive also reminded market practitioners of the importance of bringing all relevant facts and issues to the Executive's attention at the earliest possible opportunity in all cases including applications for the Executive's ruling, preparation of documents in Code-related transactions and consultation with the Executive on Code-related matters.

If any person is in doubt whether any provision of the Code is applicable, the Executive should be consulted at the earliest opportunity.

Revised Practice Note 3 (PN3) – Implementation of the Electronic Disclosure Project and the application of Rule 19.1 of the Takeovers Code

The transitional arrangements for implementing the Stock Exchange's new regime for electronic dissemination of regulatory information (the Electronic Disclosure Project) ended on 25 June 2008 and by now, every issuer should have its own website for the purposes of dissemination of regulatory information. All announcements must now be published on both the company's own website and the Stock Exchange's website.

The Executive wishes to clarify that for the purpose of Rule 19.1 it would regard any publication which is in compliance with the Electronic Disclosure requirements in the Stock Exchange Listing Rules as being satisfactory fulfilment of the Republication Requirement.

Revised Practice Note 3 (PN3) has been amended to take into account the expiry of phase one of the Electronic Disclosure Project and can be found in the Takeovers and Mergers Practice Notes section of the SFC website.

Update on the activities of the Takeovers Team in the day-to-day administration of the Codes

Further to our update on the activities of the Takeovers Team in the December 2008 issue of the Takeovers Bulletin, in the six months ended 31 March 2009, the Executive dealt with 19 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer repurchases) and 13 whitewashes. The Executive also received 76 ruling applications.

The Executive referred one case to the Takeovers Panel for a ruling during this six-month period as particularly novel, important and difficult points were at issue. The Panel met on four occasions during this period on policy-related issues.

The Takeovers Bulletin is available under 'Speeches, Publications & Consultations' – 'Publications' of the SFC website at <http://www.sfc.hk>.

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Securities and Futures Commission, 8/F Chater House,
8 Connaught Road Central, Hong Kong

Phone : (852) 2840 9222

Fax : (852) 2521 7836

SFC website : www.sfc.hk

Media : (852) 2283 6860

InvestEd website : www.InvestEd.hk

E-mail : enquiry@sfc.hk