

TAKEOVERS AND MERGERS PANEL

The Kwong Sang Hong International Limited

Panel decision in relation to the application of Rule 31.1(a)(i) of the Takeovers Code (the "Code")

Introduction

1. The Panel met on 1 March 1997 to consider a referral by the Executive in connection with the application of Rule 31.1(a)(i) of the Code in relation to The Kwong Sang Hong International Limited ("KSH"), a company incorporated in Bermuda and the shares of which are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The referral was made by the Executive to the Panel for a ruling pursuant to paragraph 10 of the Introduction to the Code as it considered that a novel point was at issue. The novel point is whether consent should be granted under Rule 31.1(a)(i) of the Code for making an unconditional voluntary general offer, immediately after a privatisation offer has lapsed.

Background

2. Peregrine Investment Holdings Limited ("PIV"), the shares of which are also listed on the Stock Exchange, announced in December 1996 a privatisation proposal for KSH to become its wholly owned subsidiary. At the time of the announcement, PIV held approximately 51.8% interest in KSH and such interest increased to approximately 53.11% at the time of the Panel hearing. The proposal was to be implemented by way of a scheme of arrangement pursuant to Rule 2.10 of the Code. Implementation of the scheme was, therefore, subject to approval by a majority in number representing 90% in value of those shares that were voted either in person or by proxy at a duly convened general meeting by shareholders other than PIV and persons acting in concert with it (the "independent shareholders").
3. The scheme proposed that KSH shares held by persons other than PIV and its subsidiaries be cancelled and in consideration for which, such shareholders be entitled to receive a fixed number of shares in PIV plus a fixed amount of cash for every KSH share held. The scheme document contained advice from the independent director and the independent financial adviser of KSH advising that the terms of the scheme were fair and reasonable, and recommending independent shareholders to vote in favour of the scheme.
4. PIV was concerned that the scheme would not be approved by the necessary number of independent shareholders at the scheme meeting (the "court meeting") pursuant to Bermuda law at a date after the Panel hearing, and therefore applied to the Executive under Rule 31.1(a)(i) for consent to make a voluntary general offer for all the shares of KSH not already owned

by PIV and its subsidiaries in the event that the privatisation proposal was not approved by the independent shareholders during the court meeting. The consideration offered to shareholders under the proposed voluntary offer would be the same as the consideration offered under the privatisation proposal. The voluntary general offer would be an unconditional offer.

5. The Executive did not believe that it could give the requested consent and referred the matter to the Panel.

The issue

6. The Panel was asked to consider the application by PIV under Rule 31.1(a)(i) as to whether consent should be granted to it for making an unconditional voluntary general offer for all the shares of KSH not already owned by PIV and its subsidiaries if the privatisation proposal were to lapse as a result of the failure to obtain the necessary approval by independent shareholders.

PIV's reasons for the proposed voluntary offer

7. The principal reasons for PIV's proposal to make the voluntary offer were as follows:-

Due to a procedural irregularity the original court meeting which was scheduled in February 1997 was adjourned to March 1997. The proxies submitted in respect of that meeting were invalidated by Order of the Supreme Court of Bermuda. KSH and PIV were concerned because the proxy position prior to the adjournment demonstrated, in their view, an unusually high level of shareholder apathy: (i) with only some 32% of the KSH shares held through the CCASS system (excluding those held on behalf of PIV) having been voted in relation to the privatisation proposal, out of which 81.6% voted in favour of the scheme; and (ii) with only 23.2% of the total scheme shares having been voted, out of which 78.9% of the independent shareholders indicated in the proxies that they would vote in favour of the scheme.

The directors of PIV were concerned that although it appeared that "a majority of KSH shareholders" might wish to accept the privatisation proposal on its existing terms, the voting condition required by Rule 2.10 of the Code, combined with the disinterest of some KSH shareholders, would result in those "majority" shareholders being prevented from receiving consideration under the proposal.

PIV wished to provide KSH shareholders with an exit through an unconditional voluntary offer on the same terms as the consideration offered to shareholders under the privatisation proposal, should PIV fail to get the necessary approval from independent shareholders at the court meeting. In making the unconditional voluntary offer, PIV indicated that it would maintain the listing status of KSH.

PIV stated that no independent shareholder would be disadvantaged by the voluntary offer.

8. PIV also sought a decision from the Panel (in the form of an addendum to its submission) as to whether PIV may alternatively propose that a voluntary offer be introduced during the course of the privatisation proposal so that it would constitute "a variation to the terms of the existing offer". PIV argued

that such proposal should be viewed as a revision of the terms of the original proposal by allowing it to "waive" the voting condition of 90% as required in the scheme. This would mean that, in the event that the independent shareholders failed to pass the resolution with the requisite 90% majority at the court meeting, PIV should be allowed to waive the 90% voting condition and proceed with a voluntary offer so that at no stage had the offer formally lapsed. This would, in PIV's view, avoid triggering the application of Rule 31 as the offer would not have lapsed, but would be extended and revised, and take on the form of an usual unconditional voluntary offer.

The Code issues

9. The principal Code issue relates to Rule 31 of the Code. Rule 31.1(a)(i) provides that:

"31.1 (a) Except with the consent of the Executive, where an offer has been announced or posted but has not become unconditional in all respects, and has been withdrawn or has lapsed, neither the offeror or any person who acted in concert with it in the course of the original offer, nor any person who is subsequently acting in concert with any of them, may within 12 months from the date on which such offer is withdrawn or lapses ...

 - (i) make an offer for the offeree company,.."
10. The notes to Rule 31, so far as are relevant to this matter, provide as follows:

" Notes to Rule 31 :

 1. Recommended and competing offers

The Executive will normally grant consent under this Rule when -

 - (a) the new offer is recommended by the board of the offeree company and the offeror is not, or is not acting in concert with, a director or substantial shareholder of the offeree company; ..."
11. The circumstances of the case do not fall within Note 1(a) to Rule 31 in that there are a number of common directors between KSH and PIV, and PIV is a substantial shareholder holding more than 50% interest in KSH.
12. The issues for the Panel to decide are:-
 - (a) whether the Executive has discretion to grant consent under Rule 31 in circumstances which fall outside Note 1 to Rule 31;
 - (b) if the Executive has discretion to grant consent, whether consent to make the unconditional voluntary offer should be granted to PIV under the present circumstances; and
 - (c) whether PIV's alternative proposal as set out in its addendum should be allowed.

Panel's decision

13. On the first issue, the Panel is of the view that Note 1 to Rule 31 only provides guidance on the circumstances where the Executive would normally grant consent under Rule 31 and that the Executive does have discretion to

grant consent under Rule 31 in circumstances which fall outside Note 1 to Rule 31.

14. On the issue whether consent under Rule 31.1 should be granted to PIV in the circumstances, the Panel ruled that the proposed voluntary offer is contrary to the disciplines the Code generally seeks to impose on offerors and, in particular, to the requirement of Rule 31 which does not permit an offeror to make a new offer for the same company within the twelve month period following the date on which an offer has lapsed, except with the consent of the Executive. The Code sets out a specified time in which an offeror is permitted to revise the terms of an offer (Rule 15). Thereafter, the terms are final and cannot be revised without the consent of the Executive. These requirements are designed to elicit the highest offer an offeror is prepared to make within a reasonable period. The Code also specifies the minimum condition to which certain offers can be subject (Rules 2.10 and 26.2) and requires that the conditions be published when the offer is first announced (Rule 3.4). If the conditions are not fulfilled generally the offeror or parties acting in concert with it are precluded from making another offer for a period of twelve months. These requirements are designed to protect the interests of public holders of securities which are subject to an offer. Without these requirements there could be considerable uncertainty as to the offer period, final offer price and the conditions to which an offer is subject as an offer with different terms and conditions could be made immediately after the lapsing of an earlier offer from the same offeror. In these circumstances, the merits of an offer which could be readily replaced by another without limit could be difficult to assess contrary to the requirements of the Code (General Principle 5) and it may encourage protracted offers for the same company by the same offeror. The Code also seeks to protect the directors of an offeree company from having to respond to a series of unwelcome offers from the same offeror and to limit the restrictions on making material changes to the offeree company's business or share capital (General Principle 9 and Rule 4) to a reasonable period. Under Note 1 to Rule 31, the consent of the Executive is not normally given when the offeror is a substantial shareholder of the offeree company, as is the case with KSH and PIV. After considering the representations made by the Executive, PIV, and its adviser, the Panel supported the Executive's decision not to exercise its discretion to permit PIV to extend a voluntary offer for KSH immediately following the failure of the privatisation proposal in respect of KSH.
15. In relation to the PIV privatisation proposal, the offer terms were final and the conditions to which the offer was subject were known to the shareholders of KSH from the time the privatisation proposal was first announced. They would also have known that, if the conditions were not fulfilled, the offer would lapse and, in accordance with the Code, no further offer could be made for KSH by PIV or parties acting in concert with it for a period of twelve months without the consent of the Executive, which in normal circumstances would not be given.
16. Regarding the alternative proposal as set out in the addendum, the Panel is not convinced by the argument that the proposed voluntary offer is a revision of the terms of the existing offer. The Panel is of the view that, as the alternative proposal was contrary to the specific requirements of 2.10(a) which requires the approval of a privatisation scheme by a majority in

number representing 90% in value of the independent shareholders voting at the relevant meeting, it is not appropriate to consider this alternative proposal further.

17. The Panel also informed PIV and KSH and their advisers that it intended to review the application of Rule 2.10 of the Code and, in particular, the appropriateness of requiring a 90% majority for privatisation proposals implemented by way of a scheme of arrangement.

March 1997