

A periodic newsletter to help participants in Hong Kong's financial markets better understand the Codes on Takeovers and Mergers and Share Repurchases

Introduction

1. Post-vetting regime was implemented on 25 June 2010. Revised Practice Note 5 provides practical and prescriptive guidance to parties and their advisers.
2. Amendments to extend the application of the Codes to SFC-authorized real estate investment trusts (REITs) became effective on 25 June 2010.
3. This issue of the Takeovers Bulletin contains a summary of the Takeover Panel's decision to uphold the Executive's ruling that China Gas Holdings Ltd must proceed with general offers for Zhongyu Gas Holdings Ltd.
4. Finally, we would like to take this opportunity to update the market on the activities of the Takeovers Team in the six months ended 31 March 2010.

Consultation conclusions on post-vetting of certain documents under Rule 12.1

On 21 April 2010, the SFC issued a consultation paper on (1) the proposal to stop commenting on routine announcements under the Codes on Takeovers and Mergers and Share Repurchases and (2) proposed miscellaneous amendments to the Codes.

The consultation period ended on 19 May 2010. The SFC received eight responses during the consultation period. Respondents generally agreed with the proposals (as outlined below) and the related proposed amendments to the Codes.

In part 1 of the Consultation Paper, the Executive proposed to relax the pre-vetting requirement under Rule 12.1 of the Takeovers Code so that certain routine announcements will no longer be required to be submitted to the Executive for comment prior to publication. As part of the proposal, the Executive also recommended the following:

Highlights

- Post-vetting of certain routine announcements implemented
- Revised Practice Note 5 on post-vetting issued
- Codes now apply to REITs
- Takeovers Panel upheld the Executive's ruling that offers for Zhongyu Gas must proceed
- Update on the activities of the Takeovers Team
- Printing tips for Practice Notes and Post-Vet List

- (a) the introduction of a new Note to Rule 12.1 of the Takeovers Code, which provides that the Executive will maintain a **Post-Vet List** (being the list of documents that will not be subject to the Executive's prior comment under Rule 12.1), to be made available on the SFC website (www.sfc.hk). The Post-Vet List that currently consists of the following types of announcement will be reviewed by the Executive from time to time (see also paragraph 12 of revised Practice Note 5 below):
- Announcements of the appointment of independent financial advisers under Rule 2.1
 - Announcements of the despatch of circulars under Rule 8 or Rule 25
 - Announcements of delay in the despatch of circulars under Rule 8.2 or Rule 8.4
 - Announcements of the appointment and resignation of directors of the offeree company under Rule 26.4 and Rule 7
 - Announcements of placing and top-up transactions under Note 6 on dispensations from Rule 26
- (b) the expansion of Note 2 to Rule 12 to reinforce the message in the then current Practice Note 5 entitled "Responsibility for documents: Executive's commenting does not give immunity;" and to make it clear that parties and their advisers should consult the Executive in advance if there is any doubt as to whether an announcement qualifies for post-vetting.
- (c) the issuance of a Practice Note (i.e. Revised Practice Note 5) to provide practical and prescriptive guidance to parties and their advisers in respect of announcements that appear in the Post-Vet List, including clarification of instances when the Executive should be consulted in advance of publication.

The Executive believes that the proposal will not only serve to reduce the cost and burden of compliance for the industry, but will also help promote self-discipline among parties and market practitioners to ensure compliance with the Codes.

In part 2 of the Consultation Paper, the Executive proposed to amend section 16.1 of the Introduction to the Codes to provide the Panel and the Takeovers Appeal Committee with *absolute discretion* in deciding whether or not to agree to delay the publication of their rulings. The Executive believes this increased flexibility will help reduce unnecessary delay in the publication of such rulings and ensure that they are made available equally and in a timely manner to all market participants who can take account of them when dealing with Code matters. A number of miscellaneous "housekeeping" amendments were also proposed to clarify and reflect current practice.

A conclusions paper containing the SFC's response to public comments received was issued on 25 June 2010. All the amendments outlined in the Consultation Paper subject to the minor modifications as set out in the Conclusions Paper became effective on the same day.

The Consultation Paper and the Conclusions Paper containing the revised Practice Note 5 can be found in the "Prospectuses, Takeovers & Mergers" – "Takeovers and Mergers" – "Consultation Papers & Conclusions" section of the SFC website.

Revised Practice Note 5 (PN 5) – Post-vetting of certain documents under Rule 12.1

1. Rule 12.1 of the Takeovers Code was amended on 25 June 2010 to provide that "[a]ll documents (**other than those referred to in the Note to Rule 12.1 below**) must be filed with the Executive for comment prior to release or publication and must not be released or published until the Executive has confirmed that it has no further comments thereon..." (emphasis added to highlight the relevant changes)

2. "Document" is defined in the Codes to include *"any **announcement**, advertisement or document issued or published by any party to an offer or possible offer in connection with such offer or possible offer other than documents required to be put on display under Notes 1 and 2 to Rule 8 of the Takeovers Code..."* (emphasis added)
3. A new Note to Rule 12.1 has been added to provide, among other things, that the Executive will from time to time publish a list of documents that will not normally be regarded as subject to Rule 12.1 and therefore will not be required to be submitted to the Executive for comment prior to release or publication (**Post-Vet List**). This List can be found in the "Prospectuses, Takeovers & Mergers" – "Takeovers and Mergers" section of the SFC website.
4. The purpose of this Practice Note is to provide guidance to parties and their advisers in respect of announcements appearing in the Post-Vet List.

Commenting process under the Codes

5. As stated in Rule 12.1, the Executive will not normally comment on drafts of announcements set out in the Post-Vet List. This change recognises the routine nature of such announcements and serves to reduce the cost and burden of compliance for relevant parties and their advisers.
6. For the avoidance of doubt, any "document" that is not specified in the Post-Vet List (for example, a circular or an announcement issued under Rule 3 of the Takeovers Code) is still required to be submitted to the Executive for comment before publication in accordance with Rule 12.1.
7. In addition, if an announcement in the Post-Vet List contains additional information relating to other material matters or Code provisions (such as issues relating to profit forecasts or valuations), the announcement would not be considered as falling within the Post-Vet List for the purposes of the Note to Rule 12.1. The relevant announcement would, therefore, be required to be submitted to the Executive for comment under Rule 12.1 of the Takeovers Code before its publication. Parties and their advisers must consult the Executive at the earliest opportunity if there is any doubt as to whether an announcement qualifies for post-vetting (see Note 2 to Rule 12 of the Takeovers Code).

Post-publication review and follow-up action

8. The new Note to Rule 12.1 requires that a published version of the document (i.e. the document which qualifies for post-vetting) must be filed with the Executive immediately after the document is published.
9. The Executive will review the relevant announcement after publication and make appropriate enquiries where necessary. Parties and their advisers are expected to respond promptly to any follow-up enquiries made by the Executive and provide all necessary information (see General Principle 10). A party and/or its advisers should make every effort to resolve an issue once it has been raised which may include the need to publish a supplementary disclosure or clarification announcement.
10. Notwithstanding the exemptions mentioned in paragraph 1 above, the Executive may, where it considers it necessary or appropriate, require a party and/or its advisers to submit drafts of documents which appear in the Post-Vet List for review prior to publication.

Guidance on contents of announcements in the Post-Vet List

11. All documents issued under the Codes must include a responsibility statement as required by Rule 9.3 of the Takeovers Code. This includes announcements that appear in the Post-Vet List. Any proposed modification or change to the responsibility statement, including the exclusion of directors under Rule 9.4, is subject to the Executive's prior consent.
12. Guidance is set out below on specific information that will normally be required in respect of each announcement set out in the Post-Vet List. Where the Codes prescribe specific disclosure to be made, parties and/or their advisers are reminded that

they are expected to exercise due diligence to ensure that the required information is fully disclosed in the announcement. In case of doubt the Executive should be consulted at the earliest opportunity.

(a) **Announcements of the appointment of independent financial advisers under Rule 2.1**

Rule 2.1 requires that “[t]he board must announce the appointment of the independent financial adviser in the initial announcement of the offer or possible offer, or as soon thereafter as the appointment is made.” Rule 2.6 further sets out persons not regarded to be suitable to give independence advice. If there is any doubt regarding compliance with Rule 2.1 and Rule 2.6, parties are encouraged to consult the Executive before the appointment is made and announced. In the event that, following an announcement of its appointment as independent financial adviser, an adviser is considered not suitable to give independent advice, a further announcement of a change of independent financial adviser would be required.

(b) **Announcements of the despatch of circulars under Rule 8 or Rule 25**

Typically an announcement informing shareholders of the despatch of a circular under the Codes will be made on or before the date of despatch. In cases where the parties wish to reproduce certain information such as the timetable, recommendation of the independent board committee and/or the independent financial adviser in the despatch announcement, they should take all appropriate care to ensure that such information is properly and accurately extracted from the relevant circular and no additional or new information is included in the announcement. Parties should also submit evidence about the date of despatch in accordance with Note 4 to Rule 8.

(c) **Announcements of delay in the despatch of circulars under Rule 8.2 or Rule 8.4**

Under Rule 8.2 or Rule 8.4, the Executive’s consent is required if the offer document, composite document or the offeree board circular cannot be posted within the prescribed period. Rule 8.4 further provides that the Executive’s consent will be given only if the offeror agrees to an extension of the first closing date by the number of days in respect of which the delay in the posting of the offeree board circular is agreed. In this connection, parties and their advisers should submit the consent application before the relevant announcement is issued. If it is not possible to obtain a formal written ruling in advance, the Executive’s indicative view on the period of extension must be sought in advance of publication of the relevant announcement. The announcement normally should contain a confirmation (i) that the Executive has granted consent to the delay in despatch; or (ii) that an application for consent has been, or will be, made to the Executive and the Executive has indicated that it is minded to grant consent; and (iii) the expected date of despatch and the reasons for the delay. Such announcement should be published on or before the original despatch date required by Rule 8.2 or Rule 8.4.

(d) **Announcements of the appointment and resignation of directors of the offeree company under Rule 26.4 and Rule 7**

Rule 7 restricts the earliest time the directors of an offeree company may resign except with the consent of the Executive. Rule 26.4 restricts the earliest time that a nominee of an offeror or person acting in concert with it may be appointed to the board of the offeree company except with the consent of the Executive. It follows that where relevant, the Executive’s consent must be obtained before publication of the announcement.

(e) **Announcements of placing and top-up transactions under Note 6 on dispensations from Rule 26**

Note 6 on dispensations from Rule 26 provides that “[a] waiver from the obligation to make a general offer under this Rule 26 will normally be granted where a shareholder, who together with persons acting in concert with him holds 50% or less of the voting rights of a company, places part of his holding with one or more independent persons (see Note 7 on dispensations from Rule 26) and then, as soon as is practicable, subscribes for new shares up to the number of shares placed at a price substantially equivalent to the placing price after taking account of expenses incurred in the

transaction. Such a waiver is required even if the placing and top-up are to be effected simultaneously whether by way of placing and subscription agreements that are inter-conditional or otherwise..."

Normally a straightforward placing and top-up involves the relevant parties entering into a placing and subscription agreement relating to:

- (i) the placing of existing shares to independent persons; and
- (ii) a subscription by the placing shareholder(s) for new shares up to the number of shares placed.

Only announcements relating to straightforward placing and top-up transactions will qualify for the Post-Vet List. Where a placing and top-up transaction involves other arrangements or agreements, which may or may not be contained in the placing and subscription agreement(s), the Executive must be consulted in advance of publication of the placing and top-up announcement. For example, a placing and top-up involving a repurchase arrangement between the placing shareholder(s) and the placees would not be considered as falling within the Post-Vet List. In all cases of doubt parties should consult the Executive at the earliest opportunity.

In practice, the Executive would expect a placing and top-up announcement to contain the following information:

- (i) the terms of the placing and top-up transaction;
- (ii) a statement that the placees and their ultimate beneficial owners are, or will be, (if not yet procured) independent of and not acting in concert with the placing shareholder(s) and its/their respective concert parties;
- (iii) a statement confirming that the condition precedent relating to the granting of a waiver by the Executive under Note 6 on dispensations from Rule 26 cannot be waived by the placing shareholder(s). The Executive should be consulted in advance if such a condition is waivable; and
- (iv) a statement that an application will be or has been made by the placing shareholder(s) to the Executive for a waiver under Note 6 on dispensations from Rule 26.

Note 6 on dispensations from Rule 26 provides guidance as to the circumstances in which the Executive would normally waive the obligation under Rule 26 for a placing and top-up transaction. It is clearly the responsibility of the financial adviser or placing agent to verify and confirm the independence of placees as soon as practicable. It should be noted that in the event that the Executive does not grant a waiver under Note 6 on dispensations from Rule 26 and the top-up transaction proceeds as proposed, a mandatory general offer obligation under Rule 26 would be triggered. Please also see the article entitled "Responsibility of financial advisers or placing agents to verify and confirm independence of placees in placing and top-up transactions" in the December 2009 Takeovers Bulletin.

Responsibility for documents

13. The Executive would like to remind parties and their advisers who are involved in Code transactions about the newly amended Note 2 to Rule 12 of the Takeovers Code, which provides 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 their advisers. 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.

Where the Rules prescribe specific disclosure to be made parties and their advisers are expected to exercise due diligence to ensure that the required information is fully disclosed in the first draft document submitted to the Executive for comment under Rule 12.1.

Most importantly, parties and their advisers should not be under the misconception that by expressing that it has no further comment on a draft document the Executive is confirming that the document fully complies with the Codes. The Executive will not verify the accuracy of 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.

Parties and their advisers must consult the Executive at the earliest opportunity if there is any doubt as to whether a document qualifies for post-vetting."

14. Finally, parties who issue Code-related announcements and documents should be aware of possible criminal liability arising under Section 384 of the Securities and Futures Ordinance (Cap. 571) for any false or misleading information contained in such announcements and documents.

Revised Practice Note 5 can be found in the "Prospectuses, Takeovers & Mergers" – "Takeovers and Mergers" – "Practice Notes" section of the SFC website.

The Codes apply to SFC-authorized REITs with immediate effect

On 25 June 2010, the Code on Real Estate Investment Trusts (REIT Code) was amended to align the control structure of real estate investment trusts (REITs) with that of listed companies. The Codes were also amended to extend the application of the Codes to REITs. Both sets of changes are effective from 25 June 2010. The related amendments to the REIT Code and the Codes can be found in the Conclusions Paper issued on 25 June 2010.

On 8 January 2010 the SFC issued a Consultation Paper on the proposal to extend the application of the Codes to REITs and related amendments to the REIT Code and the Codes. The consultation ended on 8 March 2010.

The SFC received a total of 12 written submissions from market participants. Respondents generally welcomed and supported the proposal to extend the application of the Codes to REITs and believed the proposal would protect unitholders' interests as well as align the treatment of REITs more closely with comparable international markets.

A Conclusions Paper containing the SFC's response to public comments received was issued on 25 June 2010. The amendments outlined in the Consultation Paper subject to the modifications as set out in the Conclusions Paper became effective on the same day.

The Consultation Paper and the Conclusions Paper can be found in the "Prospectuses, Takeovers & Mergers" – "Takeovers and Mergers" – "Consultation Papers & Conclusions" section of the SFC website.

Takeovers Panel's decision relating to Zhongyu Gas Holdings Ltd

The Takeovers Panel met on 13 May 2010 to consider an application for a review of the Executive's ruling in relation to the conditional voluntary general offers (Offers) to acquire the outstanding shares, convertible bonds and share options of Zhongyu Gas Holdings Limited (Zhongyu) as announced on 26 January 2010. The Panel upheld the Executive's ruling that Rich Legend International Limited (Offeror) would not be permitted to invoke certain conditions and therefore that the Offeror must proceed with the Offers.

One of the conditions of the Offers was that Zhongyu shares remain listed and traded on The Stock Exchange of Hong Kong Ltd up to the closing date of the Offers, save for any temporary suspension of trading as a result of the Offers. Trading in the shares of Zhongyu had been suspended since 22 March 2010 upon its own request, pending the finalisation and publication of its annual results for year ended 31 December 2009. The review was sought by the Offeror, a wholly-owned subsidiary of China Gas Holdings Limited, after the Executive refused to consent to the Offeror invoking certain conditions to the Offers and ruled that accordingly the Offeror should proceed with the Offers.

The Panel emphasised the importance of creating conditions of the greatest practicable certainty as manifested by the various Rules and Notes to Rules of the Takeovers Code. The Panel further noted the fact that in creating such conditions, the risks of an offer are to be assumed primarily by the offeror and not the offeree company's shareholders. The decision focuses principally on the ambit of Note 2 to Rule 30.1 of the Takeovers Code (which stipulates that "[a]n offeror should not invoke any condition, other than the acceptance condition, so as to cause the offer to lapse unless the circumstances which give rise to the right to invoke the condition are of material significance to the offeror in the context of the offer.") and how this Note operates with respect to Rule 5 of the Takeovers Code, which prohibits the withdrawal of an offer unless certain conditions are met.

The Panel agreed with the Executive that the invoking of general business and performance conditions, such as the ones named by the Offeror in this case, would require the Offeror to demonstrate to the satisfaction of the Executive that the circumstances were of material significance to the Offeror in the context of the offer. This question would, the Panel noted, clearly depend on the facts of each particular case. The Panel went on to note that the circumstances which would justify the invoking of a condition would appear to need to:

- go to the heart of the commercial rationale for the transaction;
- be specific to the offeree company or the particular industrial or commercial sector in which it operates and not the market as a whole;
- be matters which could not be adequately addressed or mitigated substantially before a firm intention to make the offer was announced;
- be normally of a permanent or enduring nature; and,
- if they had yet to occur, be likely to occur.

The full written decision of the Panel can be found in the "Prospectuses, Takeovers & Mergers" – "Takeovers and Mergers" – "Panel and Executive Decisions / Statements" 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 2009 issue of the Takeovers Bulletin, in the six months ended 31 March 2010, the Executive dealt with 26 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer repurchases) and 16 whitewashes. The Executive also received 126 ruling applications.

The Takeovers Panel met once during this six-month period on policy-related issues.

Printing tips

Takeovers-related documents (including Practice Notes and the Post-Vet List) can be downloaded from the SFC website. If parties wish to change the size of a downloaded print-out for insertion into the Code binder, please select the “two pages per sheet” print option. The page may then be cut in half to the appropriate size for insertion.

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

Feedback and comments are welcome and can be sent to takeoversbulletin@sfc.hk.

If you want to receive the Takeovers Bulletin by email, simply register for the Update Email Alert service at <http://www.sfc.hk> and select Takeovers and Mergers. Intermediaries licensed by the SFC receive the Takeovers Bulletin via their FinNet email accounts.

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