TAKEOVERS AND MERGERS PANEL

Panel Decision

In relation to a referral by the Takeovers Executive to the Takeovers and Mergers Panel (the "Panel") for a ruling as to whether certain parties were acting in concert in relation to Merdeka Resources Holdings Limited (the "Company") and, if so, whether a mandatory general offer obligation had been incurred under the Hong Kong Takeovers Code (the "Takeovers Code")

Introduction

1. The Panel met on 9th December, 2010 to consider a referral by the Takeovers Executive under section 10.1 of the Introduction to the Takeovers Code, which relates to referrals by the Takeovers Executive in respect of particularly novel, important or difficult points at issue.

2. The Panel was asked to consider whether:

   (i) Merdeka Commodities Limited ("MCL") and Mr. Lai Wing Hung ("Mr. Lai") (collectively referred to as the "MCL Parties") on the one hand and CCT Telecom Holdings Limited ("CCT Telecom") and its wholly-owned subsidiary, Manistar Enterprises Limited ("Manistar"), (collectively referred to as the "CCT Telecom Parties") on the other are, or were, parties acting in concert in relation to the Company; and

   (ii) if so, whether a mandatory general offer obligation had been incurred as a result of an acquisition on 23rd November, 2010 by MCL of 13.14% of the voting rights (the "Acquisition") in the Company from Manistar.

3. The hearing was called at short notice as it was considered by the Takeovers Executive that it was important that the matter be determined as quickly as practicable because, were it to be decided that a mandatory general offer obligation had arisen, as few shareholders as possible would be disadvantaged by the delay in such an announcement. While this obviously placed a limit on the investigation by the Takeovers Executive of the underlying facts in advance of the hearing before the Panel, it agrees with the approach adopted by the Takeovers Executive.

4. With effect from 5th November, 2010, the Company changed its name from CCT Resources Holdings Limited to Merdeka Resources Holdings Limited. It had previously changed its name in 2008 from Tradeeasy Holdings Limited.

Background and facts

5. The Company was listed on the Growth Enterprise Market in 2002 and from its listing CCT Telecom through Manistar has been a substantial shareholder. Mr. Clement Mak Shiu Tong ("Mr. Mak") and the other directors who resigned from the board of the Company on 22nd November, 2010 were appointed to the board of the Company in April, 2006. They comprised all the executive directors of the Company.

6. In 2008 the Company entered into an agreement with MCL, a company wholly-owned by Mr. Lai, under which the Company agreed to acquire Merdeka Timber Group Limited, a company which held a natural forest concession in Papua, Indonesia, and which was wholly-owned by MCL, in consideration for a payment in cash of HK$7.8 million and an issue of zero coupon convertible bonds (the "Convertible Bonds") with a principal amount of HK$776.88 million. The Convertible Bonds are convertible into shares in the Company at a conversion price of HK$0.10 per share. To the extent that the Convertible Bonds have not been converted, the Convertible Bonds are repayable at their principal amount on 12th August, 2011. It is a term of the Convertible Bonds that MCL and its nominees do not have the right to convert any Convertible Bonds if such conversion resulted in MCL and parties acting in concert with it becoming interested in 30% or more of the enlarged issued share capital of the Company. The terms of the Convertible Bonds were designed so that their initial holder could not trigger a mandatory general offer obligation through their conversion. Notwithstanding this, conversion, whether by MCL and its nominees or others, could be expected to have a substantially dilutive impact on the percentage shareholdings of existing shareholders and to have a substantial impact on the balance of ownership of the Company's shares. To the extent that the Convertible Bonds are not converted, they represent a very substantial liability for the Company.

7. Following the acquisition of Merdeka Timber Group Limited by the Company, Mr. Lai was appointed to the boards of certain of the Company's subsidiaries. He was not appointed to the Company's board. Instead two other directors were appointed by the Company who had direct responsibility for managing the Company's forestry project.

8. The Panel was told that prior to the acquisition of Merdeka Timber Group Limited, there had been no business dealings between companies controlled by Mr. Mak and companies controlled by Mr. Lai. In addition, apart from the Company itself, there were no other business dealings between them subsequent to that time.

9. During 2009 the relationship between CCT Telecom Parties and Mr. Lai appears to have soured. There was little development of the forestry project. The two directors appointed to manage the forestry project either resigned or, according to Mr Lai, were dismissed.

10. On 12th July, 2010, the Company announced that it had entered into conditional acquisition and share subscription agreements under which it would acquire a 28% indirect shareholding in a gold mine situated in Gansu Province, the PRC, in consideration for an issue of 1,200 million shares at HK$0.10 per share and a subscription for cash by the vendor of 500 million new shares at HK$0.10 per share. There was also an option to acquire the balance of the interest in the gold mine. These arrangements were conditional upon the passing of a special resolution to change the name of the Company so that it would not be associated with CCT Telecom.

11. Had these arrangements been implemented there would have been a substantial change in the balance of the shareholdings in the Company with the emergence of the vendor as a substantial shareholder with a holding nearly as large as Manistar's. MCL's shareholding would be considerably diluted. It would also move the Company into a completely new area of activity. Mr. Lai found nothing to recommend in these arrangements and, when asked, CCT Telecom did not expect him to have done so. Despite the fact that it was expected that the MCL Parties would object to the proposal, no effort was apparently made by CCT Telecom to canvass the support of other shareholders for this proposal.

12. At the meeting of shareholders held on 11th August, 2010 to approve the name change the special resolution was not passed. 2,062,908,070 shares voted in favour of the resolution, being almost entirely represented by Manistar's shareholding of 2,031,764,070 shares, representing 38.13% of the Company's issued share capital, and 1,957,096,000 shares voted against, including the shares held by the MCL Parties.

13. In late September, 2010 Mr. Lai approached CCT Telecom seeking that it takes action to recruit professional managers to try to turn the forestry business around. CCT Telecom responded by saying that a change of management would be conditional upon MCL's purchase of 1,000 million shares at no less than HK$0.10 per share. If such a purchase were to be made, the CCT Telecom nominees on the board of the Company would agree to resign and, subject to the approval of the board, would be replaced by nominees of Mr. Lai. Negotiations continued into October, when discussions appear to have centred around the acquisition of 1,000 million shares at HK$0.094 per share, and then negotiations ceased.

14. On 30th September, 2010 the Company announced that a special resolution would be proposed to change the Company's name to its present name. The proposal did not seem to the Panel to have been prompted by the negotiations taking place between Mr. Lai and CCT Telecom. Merdeka is a common word in Bahasa Indonesia, and other than MCL, did not appear to relate to any of Mr. Lai's other business activities. The change of name resolution was passed on 5th November, 2010 without opposition with both the Manistar and the MCL Parties voting in favour of it.

15. Following the publication of the Company's interim results on 12th November, 2010, which showed continuing losses, Mr. Lai contacted CCT Telecom again and negotiations recommenced. At the time of these negotiations, the MCL Parties held 652,680,000 shares in the Company, representing 12.25% of its issued share capital. In addition, it held HK$504,880,000 of the Convertible Bonds which are convertible into 5,048,800,000 shares, representing approximately 95% of the current issued share capital of the Company. Manistar held 2,031,764,070 shares, representing 38.13% of the Company's issued share capital. It also had four of its nominees on the board of the Company, which comprised seven directors. On 19th November, it was agreed that:

    - Manistar would sell to MCL 700 million shares in the Company at HK$0.097 per share thereby increasing the MCL Parties' shareholding to 25.39% and reducing Manistar's shareholding to 24.99%;

    - all four nominees of CCT Telecom would resign from the board of the Company but would remain as unpaid consultants for a period which arrangement could be terminated by giving one month's notice; and

    - the nominees of MCL would be appointed to the board of the Company.

16. The formal agreement was entered into on 22nd November and at separate meetings of the board of the Company where, in the case of the appointment of new directors attended only by the independent non-executive directors, the resignations were accepted and Mr. Lai's nominees were appointed to the board.

The relevant provisions of the Takeovers Code

17. "Acting in concert" is defined in the Takeovers Code as follows:

"Persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), actively cooperate to obtain or consolidate "control" (as defined below) of a company through the acquisition by any of them of voting rights of the company."

As a number of decisions of the Panel confirm, "acting in concert" requires three conditions to be met: it requires more than one person actively cooperating pursuant to an agreement or understanding; the purpose of the cooperation is to obtain or consolidate control of the company to which the provisions of the Takeovers Code apply; and at least one of the persons actively cooperating to acquire voting rights attaching to shares in that company.

18. The Takeovers Code also lists a number of classes of persons who will be presumed to be acting in concert with each other unless the contrary can be established. The relevant part of the definition in the Takeovers Code reads as follows:

"Without prejudice to the general application of this definition, persons falling within each of the following classes will be presumed to be acting in concert with others in the same class unless the contrary is established:-

(i) a company, its parent, its subsidiaries, its fellow subsidiaries, associated companies of any of the foregoing, and companies of which such companies are associated companies…"

19. In this matter following the Acquisition both the MCL Parties and the CCT Telecom Parties were associated companies of each other, as both held more than 20% of the voting rights of the Company. An associated company is defined in the Takeovers Code as follows:

"A company shall be deemed to be an associated company of another company if one of them owns or controls 20% or more of the voting rights of the other or if both are associated companies of the same company."

20. Under Rule 26.1

"Subject to the granting of a waiver by the Executive, when

(a) any person acquires, whether by a series of transaction over a period of time or not, 30% or more of the voting rights of a company;

(b) two or more persons are acting in concert, and they collectively hold less than 30% of the voting rights of a company, and any one or more of them acquires voting rights and such acquisition has the effect of increasing their collective holding of voting rights to 30% or more of the voting rights of the company…

…that person shall extend offers, on the basis set out in this Rule 26, to the holders of each class of equity capital of the company…"

Notwithstanding this the Takeovers Code in Note 1 to Rule 26.1 recognises that there are circumstances when the acquisition by a party acting in concert which does not result in a single member of the concert party holding 30% or more of the voting rights

of a company but may cause a mandatory offer obligation to arise. The relevant part of Note 1 states the following:

"There may also be circumstances where there are changes in the make-up of a group acting in concert that effectively result in a new group being formed or the balance of the group being changed significantly. This may occur, for example, as a result of the sale of all or a substantial part of his shareholding by one member of a concert party group to other existing members or to another person. The Executive will apply the criteria set out below, and in particular in Note 6(a) and Note 7 to this Rule 26.1 and may require a general offer to be made even when no single member holds 30% or more."

The criteria which would persuade the Takeovers Executive that a new concert party had not been formed are set out in Note 6(a) to Note 26.1, the relevant part of which reads as follows:

"In addition to the factors set out in Note 7 to this Rule 26.1, the factors which the Executive will take into account in considering whether to waive the obligation to make an offer include:-

(i) whether the leader of the group or the largest individual shareholding has changed and whether the balance between the shareholdings in the group has changed significantly;

(ii) the price paid for the shares acquired; and

(iii) the relationship between the persons acting in concert and how long they have been acting in concert."

When a controlling shareholder, such as the CCT Telecom Parties, sells a part only of its shareholding, the Takeovers Executive under Note 7 to Rule 26.1 "*will be concerned to see whether in such circumstances the arrangements between the purchaser and vendor effectively allow the purchaser to exercise a significant degree of control over the retained voting rights, in which case a general offer would normally be required."* The Note then describes the criteria which would be applied to establish the degree of control over the retained voting rights in the following terms:

"A judgement on whether such a significant degree of control exists will obviously depend on the circumstances of each individual case, but, by way of guidance, the Executive would regard the following points as having some significance:-

(a) there would be less likelihood of a significant degree of control over the retained voting rights if the vendor was not an "insider";

(b) the payment of a very high price for the voting rights would tend to suggest that control over the entire holding was being secured;

(c) if the parties negotiate options over the retained voting rights it may be more difficult for them to satisfy the Executive that a significant degree of control is absent. On the other hand, where the retained voting rights are in themselves a significant part of the company's capital (or even in certain circumstances represent a significant sum of money in absolute terms) a correspondingly greater element of independence may be presumed; and

(d) it would be natural for a vendor of part of a controlling holding to select a purchaser whose ideas as regards the way the company is to be directed are

reasonably compatible with his own. It is also natural that a purchaser of a substantial holding in a company should press for board representation and perhaps make the vendor's support for this a condition of purchase. Accordingly, these factors, divorced from any other evidence of a significant degree of control over the retained voting rights, would not lead the Executive to conclude that a general offer should be made."

21. Concert parties exercise control through the exercise or potential exercise of voting rights. It is the only way they can exercise control. So voting together would be an action that would be expected of concert parties. However, while voting of itself with other shareholders would not confirm the existence of a concert party, it could be indicative of one depending on the circumstances. Note 4 to Rule 26.1, which deals with shareholders voting together, reads as follows:

"The Executive will not normally regard the action of shareholders voting together on particular resolution as action which of itself should lead to an offer obligation, but that circumstance may be taken into account as one indication that the shareholders are acting in concert."

The case of the Takeovers Executive in summary

22. Although it was not possible to say with precision when the concert party between the MCL Parties and the CCT Telecom Parties had formed, it had certainly formed by the time an agreement in principle had been reached on 19th November, 2010. This was a concert party which held in excess of 50% of the voting rights attaching to the shares in the Company.

23. The evidence of acting in concert is often not direct, because concert party arrangements which are not admitted are often concealed. In these circumstances it is usually the inferences drawn from the facts that establish the existence of a concert party. The negotiations which led to the Acquisition and the arrangements which replaced all the Company's executive directors demonstrated an active cooperation between the parties, the purpose of that cooperation was to acquire or consolidate control and indisputably there was a purchase of shares in the Company by MCL. Acting in concert does not require that a particular purchase results in a takeover threshold being breached; it relates to all purchases by any member of the concert party.

24. The Acquisition resulted effectively in the formation of a new group acting in concert. In this the criteria set out in Note 6(a) to Rule 26.1 are relevant. There is no doubt that the leadership of the concert party group had changed as from the completion of the Acquisition it would be under the direction of Mr. Lai and MCL and that there had been a significant change in the balance between the shareholdings of the parties. A high price had been paid, representing a premium of some 24% over the prevailing market price when the terms had been agreed and a much higher price and premium to market indicated in the negotiations which were aborted in October, 2010. The concert party grouping was also very recently established.

25. There was no requirement under the Takeovers Code for a concert party to be an enduring arrangement. It could be formed for a specific purpose of short duration. In this case, it was impossible to say whether it had continued past 23rd November, 2010 when the Acquisition was completed and this was irrelevant to the assessment of whether the concert party was in existence on 23rd November.

26. Turning to the criteria set out in Note 7 to Rule 26.1, it should be appreciated that the criteria were not exclusive, so that other relevant factors could be taken into account, and that not all the criteria would need to apply for it to be established that there was a significant degree of control by the MCL Parties over the voting rights retained by the CCT Telecom Parties. It was acknowledged that the purchase by MCL was from an insider and the Takeovers Executive considered that a high price had been paid by MCL for 13.14% shareholding in the Company, which was indicative of a premium for control.

27. Further, the MCL Parties and the CCT Telecom Parties were by definition associates with each other in relation to the Company and accordingly were parties presumed to be acting in concert with each other. It was up to the parties to rebut the presumption of acting in concert and this they had failed to do. In this regard, the practice of the Takeovers Executive was to consider a person to be an associate immediately before the transaction which gave rise to it acquiring more than 20% of the voting rights in a company. Accordingly, MCL was an associate immediately before the Acquisition was effected.

The case of the MCL Parties and the CCT Telecom Parties in summary

28. Since the response of the parties was broadly similar, it is summarised here collectively.

29. The evidence pointed strongly to the fact that there was no cooperation between the parties and indeed that there was considerable distrust between them. The manner in which resignations and appointments of directors was effected on 22nd November, 2010 at separate board meetings attended, in the case of the appointment of new directors, only by the independent non-executive directors was illustrative of this. The negotiations which led to the Acquisition were motivated by Mr. Lai's desire to protect his investment in circumstances where the Company's forestry project was not being professionally managed and was continuing to lose money. The negotiations centred around the CCT Telecom Parties' insistence that they would not support any change of management without the sale of a portion of their investment at or near its original cost of HK$0.10 per share. They wanted to recoup part of the cost of their investment; that was the price for their cooperation in effecting a change of management. The arrangements were designed to change management but they did so in a manner which did not change control in Takeovers Code terms. The Takeovers Code defines control in terms of a precise percentage of the voting rights held and not in terms of management or board representation.

30. The price paid by MCL for shares in the Company was not high if it is compared with the prices that the shares had traded in the months before the Acquisition. In any event, the premium to the traded price prevailing at the time an agreement had been reached related to an insistence of recovering as much as the CCT Telecom Parties' original cost as possible and was not a premium for control.

31. There was no indication of any kind that the MCL Parties had any control over the balance of the shares held by the CCT Telecom Parties. This holding represented 24.99% of the voting rights attaching to shares in the Company. This was in the words of Note 7 to Rules 26.1 *"a significant part of the company's capital"* and not significantly less than MCL's shareholding. In this circumstance, the Takeovers Code presumes *"a correspondingly greater element of independence".*

32. The motivation for all the nominees of the CCT Telecom Parties to resign from the board was driven by CCT Telecom's desire that the investment in the Company not be equity accounted as an associate, but rather to be shown as an "available for sale" investment. In this way the losses currently being incurred by the Company would not impact on the

consolidated results of CCT Telecom.

33. In the circumstances with no concert party arrangements in place either before or after the negotiation and completion of the Acquisition, an increase in shareholding to a level below 30% should not cause a mandatory general offer obligation to arise.

The decision and the reasons for it

34. The Panel found no evidence that before negotiations started in November between the MCL Parties and the CCT Telecom Parties there was a concert party between them. It was apparent during the hearing that the relationship had been one of some hostility and distrust. Voting at the first extraordinary general meeting to approve the change of name on 11th August, 2010 demonstrates the respective parties taking contrary positions. As the "Merdeka" name is associated with the Company's forestry project and not, as far as the Panel could tell, with Mr. Lai's other business interests, other than MCL, the voting together of the parties on an uncontroversial resolution to change the Company's name on 5th November, 2010 is not of itself evidence of a concert party in action.

35. The fact of the negotiation of the sale of a part of a shareholding should also not of itself be a concert party action. This is implicitly recognised in Note 7 to Rule 26.1 as it seeks other factors, apart from the purchase of a part of a controlling shareholding interest, which are indicative of a significant degree of control over retained shares and suggestive that control had effectively changed through a concert party arrangement. This is so, even when the purchaser's ideas as regards the way the company is to be directed are reasonably compatible with that of the vendor, which is not the case in this matter. If the fact of negotiating and concluding a sale of a part only of a controlling interest were to be sufficient evidence of parties acting in concert, then all such transactions would fall under the ambit of Note 1 to Rule 26.1. This was not its purpose when the second paragraph of Note 1 to Rule 26.1 was introduced into the Takeovers Code in 2002 and its wording would suggest it operates only in certain circumstances, rather than having a general application. In this regard, the Panel notes that in its previous decisions where the provisions of Note 1 to Rule 26.1 may have been or were relevant, the concert party was in existence before the negotiation of changes in shareholdings and, or, there were agreements between them which were expected to endure after the changes in shareholdings had been effected [see the published decisions of the Panel in relation to China Oriental (6th December, 2007); Wing Hang Bank (29th August, 2008); and Hong Kong Aircraft Engineering Company (10th December, 2008)]. Accordingly, for Note 1 to Rule 26.1 to operate as intended, the concert party is likely to have been in existence before negotiations commenced, to be expected to continue after the Acquisition had been completed or for some other factor or factors to be present to indicate a concert party relationship beyond merely negotiating and implementing the sale of a part only of a controlling shareholding. While the Panel agrees that a concert party arrangement can be of short duration, there would need to be other factors present to indicate a concert party relationship between the MCL Parties and the CCT Telecom Parties in the present case. Accordingly, in this matter, and in the absence of a concert party relationship or other factors of the kind described above, the Panel does not consider that the criteria set out in Note 6(a) to Rule 26.1 are applicable.

36. In the absence of a pre-existing concert party before negotiations commenced or factors which went beyond the negotiation of the sale of a part only of a shareholding, indications of the existence of a concert party arrangement would need to be evident beyond the date of completion of the Acquisition or there should be some evidence of a significant degree of control over retained shares. During the hearing there was no

direct evidence produced of an arrangement of this kind. It was apparent that Mr. Lai had a different view of how the Company should be directed from CCT Telecom; it was this that had caused him to approach CCT Telecom in the first place. Of the factors that might point to the existence of such an arrangement set out in Note 7 to Rule 26.1 the most relevant was the higher than market price paid for the shares of the Company by MCL. The reason for the price has already been described. Even in the absence of this explanation, it is doubtful that the price paid could be described as a "*very high price*" compared to the net assets of the Company and the prices at which the shares were trading and had traded in the recent past. The Panel also noted in this regard that the alternative for Mr. Lai to secure an increased shareholding in the Company would be through the conversion of Convertible Bonds held by him at a conversion price of HK$0.10 per share, which is higher than the purchase price negotiated. The vendor was also an "insider" but this is a less telling factor in the context of a controlled company. Set against these considerations is the fact that the retained shares are a significant part of the share capital of the Company, being nearly the same percentage of its share capital as the holding of the MCL Parties, and of significant value, substantially more than the shares sold to MCL. Given this, and on the basis of the facts of the matter made known to the Panel and the representations made to it, the Panel did not regard the higher-than-market price paid by MCL as being determinative of a significant degree of control over the retained shares.

37. In reaching its decision the Panel did not have to decide at what point does a person become a concert party by presumption in a transaction involving the increase to 20% or more of the voting rights attaching to the shares in a company. Regardless of whether it is immediately before or immediately afterwards, in this case the Panel considered that the presumption, if applicable, had been rebutted.

38. On the basis of the facts made known to it and the representations made the Panel found that there was insufficient evidence to infer that, during the period from when negotiations started in November until the completion of the Acquisition, the MCL Parties and the CCT Telecom Parties were acting in concert with each other. It follows that while a change of management was effected, there was no acquisition of control by the MCL Parties as their combined shareholding never reached 30% or more of the voting rights attaching to shares in the Company. Accordingly, the Panel did not consider that a mandatory general offer obligation had arisen on either Mr. Lai or MCL as a consequence of the Acquisition.

20th December, 2010

Parties to the hearing:

The Takeovers Executive

Mr. Lai Wing Hung and Merdeka Commodities Limited, advised by Herbert Smith

CCT Telecom Holdings Limited and Manistar Enterprises Limited, advised by Sidley Austin