

## PANEL ON TAKEOVERS AND MERGERS

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### Proposed Voluntary Offer for Seapower International Holdings Limited ("SIH")

#### Application of the Chain Principle under Note 8 to Rule 26.1

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#### Introduction

1. On 22 July 1994 the Panel considered a referral by the Takeovers and Mergers Executive in relation to an application for confirmation that the chain principle would not apply to a proposed voluntary offer by Mr. Choi Sai Leung ("Mr Choi") for the shares and warrants of SIH.

#### Background

2. SIH currently owns approximately 37.4% and 63.1% respectively of the issued share capital of two listed public companies in Hong Kong, Seapower Resources International Limited ("SRI") and Paramount Publishing Group Limited ("Paramount"). Based on these shareholdings and the pro forma gross asset values of SIH, SRI and Paramount as at 30 September 1993, approximately 58.7% of the gross assets of SIH is attributable to SRI and approximately 21.6% of the gross asset of SIH is attributable to Paramount. SIH's other assets include a holding of securities of China Food Holdings Limited, some investment properties and joint venture property development projects in China.

3. Following a scheme of arrangement which became effective on 18 July 1990, Mr. Choi and his associates held 46% of the shares of SIH. As a result of placements of securities in February 1992 and November 1993, at the time of the application the holding of Mr. Choi and his associates had been reduced to approximately 23.2% of the issue share capital (34.7% on a fully diluted basis), with approximately 49.9% in aggregate held by four other parties, of which 19.2% was held by Kee Shing (Holdings) Limited, 8.6% was held by Tien Fung Investment Holding Limited ("Tien Fung"), 8.9% was held by private companies wholly owned by Mr. Li Ka Shing, and 3.2% was held by private company wholly owned by Mr. Larry Yung Chi Kin. Tien Fung is owned as to 51% by Mr. Francis Yuen Tin Fan ("Mr. Yuen") and the remainder by Peregrine Investment Holdings

Limited.

4. The business of SRI is primarily in cold storage, financial services (through Seapower Financial Services Group Limited) and projects in China, while Paramount and its subsidiaries are principally engaged in printing, publishing and the provision of reprographic and other associated services. The interest in Paramount and its business activities were not acquired by SIH until 1992.

5. It was submitted that Mr. Choi's purpose in making a voluntary general offer for the securities of SIH would be to bring about an immediate resolution to the ongoing management differences in SIH between himself and Mr. Yuen, the chairman of SIH, which were considered harmful to the interests of SIH and its shareholders and warrant holders.

### **Code Issues**

6. Under the chain principle set out in Note 8 to Rule 26.1 of the Code, if Mr. Choi acquires statutory control (i.e. more than 50%) of SIH thereby acquiring control of a second company because SIH holds a controlling interest (i.e. 35% or more) in the second company, the Executive will not normally require Mr. Choi to make any offer for the second company under Rule 26.1 unless either-

(a) the holding of SIH in the second company constitutes a substantial part of the assets of SIH (the "substantiality test"); or

(b) Mr. Choi has as one of his main purposes in acquiring control of SIH the securing of control of the second company (the "purpose test").

7. The Executive, in attempting to apply the substantiality test to SRI and Paramount in turn or in aggregate as the second company, recognised that there was no direct precedent in Hong Kong and that no specific percentage guideline had been established by the Panel or its predecessor, the Committee on Takeovers and Mergers. The Executive of The Panel on Takeovers and Mergers in London indicated informally that it was not aware of any precedent in London either but that the London Panel would probably not apply the chain principle to require a general offer for SRI or Paramount on the basis of the substantiality test.

8. In its decision in connection with the proposed offers by Mr. C S Hwang and parties acting in concert with him for the Evergo group of companies in August 1990, the Takeovers Committee took cognizance of a 70% guideline for the substantiality test used

by the London Panel in finding that the chain principle did not apply to a company representing only 24% of the gross assets of its parent. The Committee further stated that the London Panel's interpretation was not regarded as necessarily appropriate in a Hong Kong context.

## **Decision**

9. On 22 July 1994 the Panel decided that if Mr. Choi were to make a voluntary general offer for SIH, under the purpose test he would be required to make a general offer for SRI, but he would not be required to make a general offer for Paramount. On the basis of the particular facts of this case and after carefully considering Mr. Choi's oral representations to the Panel and his answers to questions at the hearing, the Panel found that Mr. Choi's dominant purpose in making a general offer for SIH was to regain control of the SRI side of the business. The Panel took into account the historical background of the SIH group, including the founding and development of SRI by Mr. Choi and Paramount's more recent addition to the SIH group. The Panel also noted that SRI represented the single largest company or asset controlled by SIH by a significant margin, that Mr. Choi's statements to the Panel indicated that his interest rested with the SRI side of the business, and that SRI was largely run as part of SIH rather than as a separate entity.

10. The Panel did not decide whether the gross assets of SRI amounted to a substantial part of the gross assets of SIH for purposes of the substantiality test. However, the Panel noted that it would be provided with up-to-date financial information on the relevant companies for the purpose of dealing with the substantiality test in future cases.

11. The Panel stressed that its decision was made on the particular facts of this case.

11 August 1994