

TAKEOVERS AND MERGERS PANEL

Decision on preliminary issue

In relation to an application by Charterbase Management Limited for a review of a ruling by the Executive

UDL Holdings Limited ("UDL")

1. The Panel met on Friday, 17 August 2001, to consider whether the application before it constituted an abuse of process or was frivolous.

Salient Facts

2. This is an application by a minority shareholder of UDL, namely, Charterbase Management Limited ("Charterbase"), for a review of a ruling of the Executive issued on 16 July 2001. The background of this matter is as follows.
3. UDL is in financial difficulties. In October 1999, UDL announced a restructuring proposal which involved:
 - (1) a rights issue to existing shareholders ("Rights Issue"); and
 - (2) a contemporaneous issue of new shares ("Scheme Shares") to a group of UDL's creditors through an administrator under a scheme of arrangement ("Scheme").
4. The Scheme became effective on 18 April 2000. The Scheme Shares were issued in April 2000 and the Rights Issue was completed in May 2000. As a result of the restructuring :
 - (1) the scheme administrator held 50% of the enlarged issued share capital of UDL; whereas
 - (2) the shareholding of UDL's previous controlling shareholder, Harbour Front Limited ("Harbour Front"), was diluted from 54.53% to 27.26%.

(For the sake of completeness, it is noted that Harbour Front's shareholding was initially diluted from 54.53% of the issued share capital prior to the restructuring to

27.26% of the issued share capital of UDL as enlarged by the Scheme Shares. It then increased to 31.11% of the issued share capital of UDL as enlarged by the Rights Issue, in which Harbour Front participated.)

5. Before the Scheme became effective, UDL's advisers consulted the Executive (verbally) as to whether the restructuring proposal (described above) would have any implications under the Hong Kong Codes on Takeovers and Mergers and Share Repurchases ("Codes"). One of the key issues raised was whether or not the Scheme Shares carried voting rights as defined in the Takeovers Code ("Voting Rights"). (Voting Rights are defined in the Takeovers Code as "*all the voting rights currently exercisable at a general meeting of a company whether or not attributable to the share capital of the company*".)
6. This issue was important because :
 - (1) If the Scheme Shares did carry Voting Rights, then the restructuring would have had the effect of reducing the percentage of Harbour Front's Voting Rights from 54.53% to 31.11%. This in turn would mean that any further acquisitions of UDL shares by Harbour Front might trigger a general offer obligation under Rule 26 of the Takeovers Code, if such acquisitions increased Harbour Front's holding of Voting Rights in UDL to 35% or more.
 - (2) On the other hand, if the Scheme Shares did not carry Voting Rights, then the issue of the Scheme Shares would not have affected the percentage of Voting Rights held by Harbour Front, which would have remained at 54.53% and increased to 62.21% as a result of the Rights Issue. Consequently, further acquisitions would not have triggered a general offer obligation. This is because once a person holds more than 50% of the Voting Rights in a company, further acquisitions of Voting Rights do not trigger an offer obligation under the Takeovers Code.
7. Based on the representations from UDL's advisers, the Executive verbally indicated its agreement with UDL's advisers that the Scheme Shares did not carry Voting Rights and that therefore any further acquisitions of shares or Voting Rights by Harbour Front would not trigger a general offer obligation under the Takeovers Code.
8. On 30 March 2001, UDL announced a capital reorganisation involving, amongst other things, a proposed subscription by Harbour Front for a further 100,922,478

shares in UDL at \$0.04 each ("Subscription"). As a result of this acquisition, Harbour Front's shareholding in UDL increased from 31.11% to 42.89% of the enlarged issued share capital. However, according to UDL's advisers, its Voting Rights increased from 62.21% to 73.01% and hence no general offer was made.

9. Between May 2001 and July 2001, Charterbase and its legal advisers raised a number of questions regarding the calculation of the Voting Rights held by Harbour Front and whether the Subscription should trigger a general offer obligation by Harbour Front. In a letter to Fong & Ng, solicitors acting for Charterbase, dated 16 July 2001, the Executive, amongst other things, confirmed in writing its earlier verbal decision that the Scheme Shares did not carry Voting Rights and that therefore Harbour Front's subsequent acquisition (through the Subscription) did not trigger a general offer obligation ("Executive's Ruling").
10. Charterbase does not agree with the Executive's Ruling. It argues that :
 - (1) the Scheme Shares did carry Voting Rights;
 - (2) as a result of the restructuring, the percentage of Voting Rights held by Harbour Front dropped from above 50% to 31.11%; and
 - (3) this percentage then increased to 42.89% as a result of the Subscription thereby triggering a general offer obligation under Rule 26 of the Takeovers Code.
11. On 19 July 2001, Charterbase applied for a review of the Executive's Ruling. The next day, that is 20 July 2001, the Executive asked Charterbase to provide certain information regarding its identity and its shareholding in UDL. On 2 August 2001, Charterbase provided some but not all of the information requested. Subsequently, the Executive and Harbour Front raised further questions regarding Charterbase's identity and shareholding in UDL. At the time, Charterbase did not answer these questions.
12. In a letter dated 9 August 2001, Harbour Front (through its then financial advisers) made a number of allegations regarding the identity of the person behind Charterbase and his motive for bringing this application before the Panel. In particular, the letter alleged that the application by Charterbase was but another episode in a family feud. It also alleged that the person behind Charterbase jointly owned a property with Harbour Front and that by bringing this application, he was

deliberately putting Harbour Front to unnecessary expense so as to drain its resources and force it to sell this property to him at below market price.

13. Charterbase denied the allegations made by Harbour Front, describing them as "scandalous and unfounded without any clear and unequivocal evidence produced in support."
14. In a letter dated 10 August 2001, the Acting Chairman of the Panel asked Charterbase to provide various information relating to its identity and shareholding which, at that time, remained outstanding despite repeated requests from the Executive and Harbour Front. This same letter of 10 August 2001 also noted that the allegations made by Harbour Front taken together with Charterbase's and their advisers' continued failure to provide the requested information regarding its identity and shareholding, raised concerns as to whether the present application was an abuse of process or frivolous. The Acting Chairman further noted that, as a result, it may be necessary to convene a preliminary hearing to consider this issue.
15. In a letter dated 13 August 2001, the Acting Chairman of the Panel confirmed that a preliminary hearing would be convened to determine whether Charterbase's application for review was an abuse of process or frivolous. Following this, Charterbase provided most of the information sought. However, an amount of information remained outstanding.

Decision

16. The Panel has carefully considered the evidence before it including both written and oral submissions of Charterbase, Harbour Front and the Executive received up to and during the preliminary hearing. The Panel has decided as follows :

(1) *Abuse of process*

- (a) Section 16.1 of the Introduction to the Codes empowers the Panel to "(direct) its own proceedings and (make) any inquiries it deems relevant or appropriate". The Panel notes that, amongst other things, this section empowers it to dismiss proceedings for being an abuse of process. However, to do so, it must be satisfied that the applicant (in this case Charterbase) is misusing the machinery of Panel proceedings, ie that it is not using such machinery properly, honestly

and in good faith.

- (b) The Panel has carefully considered the evidence before it (including both documentary and oral evidence given by Ms Irene Leung of Harbour Front during the hearing). The Panel is however not satisfied that the allegations by Harbour Front have been substantiated. The Panel is therefore not satisfied that the application by Charterbase constitutes an abuse of process.

(2) *Frivolous*

- (a) Section 11.1 of the Introduction to the Codes provides that "The Panel has a discretion to entertain a request for review by an aggrieved shareholder, if it is satisfied that such request is not frivolous." The Panel notes that for the application to be frivolous, there must be no substance to it or no prospect of success at all.
- (b) The Panel is of the view that the main issue raised in Charterbase's application, namely whether the Scheme Shares carried Voting Rights, is an important issue deserving the Panel's consideration. Accordingly, the Panel is satisfied that the application for review raises an issue of substance and hence is not frivolous.

The Panel accordingly directs that this matter proceed to a full substantive hearing.

Conduct of Charterbase and its advisers

17. Finally, the Panel notes its disappointment with Charterbase's conduct of this case up to the date of the preliminary hearing. In particular, it is disappointed in their failure to provide information and respond to the Panel's enquiries expeditiously and in the failure of the beneficial owners of Charterbase to attend the preliminary hearing. The Panel further notes that in future it expects full cooperation from Charterbase and its advisers in this matter as is required by General Principle 10 of the Introduction to the Codes, which provides that "All parties concerned with takeovers and mergers are required to co-operate to the fullest extent with the Executive, the Panel and the Takeovers Appeal Committee, and to provide all relevant information."

Dated 4 September 2001