

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

Disciplinary proceedings against chairman of Pearl Oriental Oil Limited and others for alleged breach of Takeovers Code

On 18 September 2013 the Executive commenced disciplinary proceedings before the Takeovers and Mergers Panel (Takeovers Panel) against the chairman of Pearl Oriental Oil Limited (Pearl Oriental), Mr Wong Yuk Kwan (also known as Mr Wong Kwan) and four other people as it believes that there has been a breach of the Takeovers Code.

The Executive alleges that Mr Wong and the four actively co-operated to assist Mr Wong to obtain or consolidate control of Pearl Oriental and avoid the obligations under the Takeovers Code to make a general offer for the shares of the company (known as Pearl Oriental Innovation Limited at the material time).

The other four individuals involved in the disciplinary proceedings are Mr Ma Yueng-Lin, Ms Li Jiong Jenny, Ms Yip Sui Kuen Kitty and Ms Yik Siu Hung. Mr Ma, Ms Li and Ms Yip were closely connected to Mr Wong and Ms Yik was one of Mr Wong's business partners.

In late 2009, Mr Wong and Ms Yik invested in a gas and oil field in Utah, USA. In January 2010, they agreed to sell their interests in the gas and oilfield to Pearl Oriental in a US\$200 million deal to be paid in a combination of cash and new shares to be issued by Pearl Oriental.

At that time, Mr Wong held a 43.38% stake in Pearl Oriental while Ms Yik had a 1.53% interest in the company. The new shares to be issued by Pearl Oriental to Mr Wong and Ms Yik would have increased their shareholdings in the company to 44.50% and 12.37% respectively. The Executive raised concerns that this might trigger an obligation for Mr Wong and Ms Yik to make a general offer under the Takeovers Code to all the company's shareholders to buy their shares.

Highlights

- Disciplinary proceedings against chairman of Pearl Oriental Oil Limited and others for alleged breach of Takeovers Code
- Dealing disclosures under Rule 22 of the Takeovers Code
- Application of Rule 10.9 to unaudited quarterly results published during an offer period
- Quarterly update on the activities of the Takeovers Team

Whilst the acquisition of the gas and oil field was completed in various stages, the issuance of the new shares in Pearl Oriental was deferred so that a general offer obligation under the Takeovers Code would not be triggered.

On 16 May 2011, Mr Wong purported to sell his entire stake in Pearl Oriental for HK\$825 million to Mr Ma, Ms Li and Ms Yip, all of whom were described at the time as independent third parties. Not only were Mr Ma, Ms Li and Ms Yip closely connected to Mr Wong but they never paid Mr Wong for the shares. On the following day, Mr Wong and Ms Yik received the new shares issued by Pearl Oriental. Ms Yik immediately passed her shares on to Mr Wong without money changing hands, boosting Mr Wong's direct stake in the company to 26.35% but below the 30% threshold to trigger a mandatory general offer.

Mr Wong's purported sale of shares to Mr Ma, Ms Li and Ms Yip enabled Mr Wong to take up not only the new shares to be issued by the company but also those to be issued to Ms Yik and to avoid an obligation under the Takeovers Code to make a general offer while still maintaining control of the company. It is alleged that rather than being genuine buyers at all material times the trio held the Pearl Oriental shares on behalf of Mr Wong. This type of arrangement is commonly referred to as "warehousing".

The disciplinary proceedings before the Takeovers Panel will be held in public. Details of the proceedings can be found under "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Disciplinary proceedings before the Takeovers Panel" on the SFC website.

Dealing disclosures under Rule 22 of the Takeovers Code

Dealing disclosures now available on HKExnews

We are pleased to announce that from 1 October 2013 disclosures of dealings in relevant securities under Rule 22 will be posted on the HKExnews' website "Listed Company Information" under the relevant listed company (www.hkex.com.hk) as well as the SFC website under "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Dealing disclosures".

Notifications about offer periods

In addition to receiving email alerts about takeovers related press releases and statements, subscribers to our Subscription Service on "Takeovers & mergers" will now also receive email alerts when any of the Offer Period Tables is updated on the SFC website under "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Offer period tables". There are three Offer Period Tables:

Table 1 - New offer periods that have commenced in the past 14 days

Table 2 - Offer periods that have closed in the past 14 days

Table 3 - All current offer periods under the Codes

The Offer Period Tables aim to assist relevant parties to discharge their obligations under the Codes, including the dealing restrictions under Rule 21 and dealing disclosure obligations under Rule 22 of the Takeovers Code. In this regard, market participants, Exempt Principal Traders, Exempt Fund Managers and all interested investors (in particular those who hold 5% or more of any class of relevant securities (as defined in paragraphs (a) to (d) in Note 4 to Rule 22 of the Takeovers Code) in a company) are encouraged to use our Subscription Service on "Takeovers & mergers" to stay informed about relevant takeovers related news.

Please note that the Offer Period Tables are compiled and updated on a best-effort basis. Whilst every effort is made to ensure the accuracy and reliability of the information provided, market practitioners and investors are encouraged to refer to announcements and documents issued by listed companies which are published on the HKEx website (www.hkex.com.hk) and to announcements and documents issued by unlisted entities which are published on the SFC website under “Regulatory functions – Listings & takeovers – Takeovers & Mergers – Transaction announcements & documents”. This is particularly important during weekends and public holidays in Hong Kong when information updates may be delayed and trading in the relevant securities in respect of an offeree company, which has newly become subject to an offer period, may be continuing on an overseas exchange.

Reminder to “associates” and in particular fund managers about dealing disclosure obligations under Rule 22 of the Takeovers Code

The Executive would like to remind “associates” of their dealing disclosure obligations under Rule 22 of the Takeovers Code.

Rule 22 of the Takeovers Code requires parties to an offer and their respective associates to disclose dealings in relevant securities (as defined in Note 4 to Rule 22) of the offeree company and the offeror (in the case of a securities exchange offer) conducted for themselves or on behalf of discretionary clients during an offer period.

An “associate” is defined under the Takeovers Code as, among others, any person who owns or controls 5% or more of any class of relevant securities. It is vital therefore that any associate, including a 5% shareholder, understands that dealing disclosure is required under Rule 22 of the Takeovers Code when an offer period commences for a relevant company.

To ensure that takeovers are conducted within an orderly framework, the Executive would like to emphasise the importance of timely and accurate disclosure of relevant information by associates and any party who may have the ability to exercise a material influence over the outcome of an offer. This is in line with General Principle 6 of the Takeovers Code.

Fund managers

In light of the above and to help raise awareness of the significance of the Takeovers Code requirements and facilitate better compliance among fund managers, who are “associates” under the Takeovers Code, the Executive wrote to fund managers in Hong Kong and overseas in November 2011. The letter provided some practical guidance on the steps a fund manager might take to ensure timely and appropriate compliance with its dealing disclosure obligations. The Executive wishes to emphasise that ultimately it is an obligation for each fund manager to take all appropriate measures to ensure compliance with the Takeovers Code.

The contents of the letter are set out in “Guidelines to fund managers on dealing disclosure obligations under Rule 22 of the Code on Takeovers and Mergers” (the Guideline) issued on 29 December 2011. Relevant fund managers are advised to refer to the Guideline under “Regulatory functions – Listings & takeovers – Takeovers & Mergers – Guidelines – Guidelines by topic – Takeovers (only)” on the SFC website. Fund managers are advised to remind appropriate persons in their overseas offices, who are likely to deal in the relevant securities of Hong Kong-listed companies, of the relevant provisions of the Takeovers Code, including the obligations under Rule 22.

We hope that fund managers will find helpful the practical guidance below:

(a) Identifying relevant companies in an offer period

- (i) Review regularly the Offer Period Tables under “Regulatory functions – Listings & takeovers – Takeovers & Mergers – Offer period tables” on the SFC website for details of current offer periods under the Takeovers Code. The tables are updated on a best-effort basis and provide a useful reference to identify issuers in an offer period. We do not recommend that the Offer Period Tables are the sole source of monitoring.

- (ii) Subscribe to the SFC's Subscription Service on "Takeovers & mergers" to receive email alerts which will include updates on the Offer Period Tables.
- (iii) Monitor regularly HKExnews on the HKEx website (www.hkex.com.hk) to see whether an announcement has been issued by, or in relation to, a relevant company that has commenced an offer period.
- (iv) Subscribe to the News Alerts service on the HKEx website to receive relevant information.
- (v) Monitor regularly media sources such as newspaper and financial news services to identify takeovers-related articles.

(b) On-going training of staff

- (i) All appropriate individuals should have proper training on the relevant provisions of the Takeovers Code including, in particular:
 - the meaning of the term "associate" and its significance; and
 - the rules relating to the disclosure of dealings in relevant securities of an offeror or an offeree company contained in Rule 22 and Schedules I and II of the Takeovers Code.

Such training should be conducted on a regular and on-going basis. Practice Note 9 and the Takeovers Bulletin provide a good source of information on, among other things, practical guidance concerning dealing disclosure obligations and related recent developments. These can be found under "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Practice notes" and "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Takeovers Bulletin" on the SFC website respectively.

- (ii) Compliance personnel should keep themselves fully up-to-date on changes to the Takeovers Code. They may find it useful to subscribe to the SFC's Subscription Service to receive notifications about Takeovers-related news such as news items relating to the issuance of the Takeovers Bulletin and market consultations on amendments to the Takeovers Code.

(c) Proper compliance systems

A fund manager should ensure that adequate and proper compliance systems are in place to enable it to fully discharge its obligations under the Takeovers Code including dealing disclosure obligations under Rule 22.

Application of Rule 10.9 to unaudited quarterly results published during an offer period

Rule 10 of the Takeovers Code governs the treatment of profit forecasts and other financial information in the context of an offer or a possible offer. Rule 10 provides that if a party to an offer publishes a profit forecast during the course of an offer, or when an offer is in contemplation, the party issuing the forecast must obtain and publish an accountant's report and financial adviser's report on the forecast. An estimate of profit for a period which has already expired should be treated as a profit forecast (see Rule 10.6(b)). The Executive has recently reviewed whether the reporting requirements should apply to unaudited quarterly results that are issued by companies with dual listings of their shares pursuant to a requirement under the relevant laws or regulations of the overseas jurisdiction.

Rule 10.9 requires any unaudited profit figures published during an offer period to be reported on except with the consent of the Executive or in the following instances:

- (i) unaudited statements of annual or interim results which have already been published;
- (ii) unaudited statements of annual results which comply with the requirements for preliminary profits statements as set out in the Rules Governing the Listing of Securities on the Stock Exchange (Listing Rules);
- (iii) unaudited statements of interim results which comply with the requirements for half-yearly reports as set out in the Listing Rules in cases where the board of the offeree company has not publicly advised its shareholders not to accept an offer; or
- (iv) unaudited statements of interim results by offerors which comply with the requirements for half-yearly reports as set out in the Listing Rules, whether or not the offer has been publicly recommended by the board of the offeree company but provided the offer could not result in the issue of securities which would represent 10% or more of the enlarged voting share capital of the offeror.

Currently the Note to Rule 10.9 extends the exemptions from the reporting requirements to unaudited quarterly results of companies listed on the Growth Enterprise Market (GEM) of The Stock Exchange of Hong Kong Ltd (Stock Exchange).

The exemptions for companies listed on the Stock Exchange (either on the Main Board or GEM) from the reporting requirements contained in Rule 10.9 are appropriate as:

- (i) the relevant unaudited interim and quarterly figures and preliminary announcements of results are required to be published and prepared to the standards required by the respective applicable Listing Rules¹; and
- (ii) the unaudited figures must be included in a full-year audit in due course.

The Executive believes that if a company has a dual listing and is required by the relevant laws or regulations of the overseas jurisdiction to publish unaudited quarterly results the exemption from the reporting requirements in Rule 10.9 should also apply.

In relevant cases where a company with a dual listing wishes to take advantage of the exemptions from the reporting requirements in Rule 10.9, the Executive must be consulted at the earliest opportunity. Where appropriate, the Executive may require the relevant party to apply for a formal ruling under section 8 of the Introduction to the Codes.

Rule 10.9 also provides that the Executive should be consulted in advance if a company is not listed on the Stock Exchange but wishes to take advantage of the exemptions under this Rule.

Practice Note 2 has been revised to reflect the above. For ease of reference Practice Note 14 (which explains the meaning of "reporting on") has been moved to form part of the revised Practice Note 2. The revised Practice Note 2 can be found in the "Regulatory functions – Listing & takeovers – Takeovers & Mergers – Practice notes" section of the SFC website.

¹ See Appendix 16 to the Main Board Listing Rules and Chapter 18 of the GEM Listing Rules

Quarterly update on the activities of the Takeovers Team

In the three months ended 30 June 2013, the Executive received 10 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer repurchases), seven whitewashes and 57 ruling applications.

The Takeovers Bulletin is available under 'Published resources – Industry-related publications' of the SFC website at www.sfc.hk.

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

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