

TAKEOVERS AND MERGERS PANEL

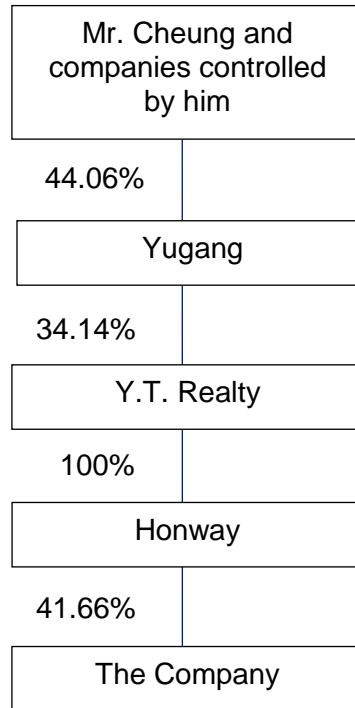
**Panel decision
in relation to a referral by the Takeovers Executive
to the Takeovers and Mergers Panel for a
ruling on whether a general offer obligation will
result from the proposed transfer of the controlling shareholding
interest in The Cross-Harbour (Holdings) Limited (Stock Code 32)
by Y.T. Realty Group Limited (Stock Code 75) to
Mr. Cheung Chung Kiu and, if so, whether it should be waived**

Purpose of the hearing

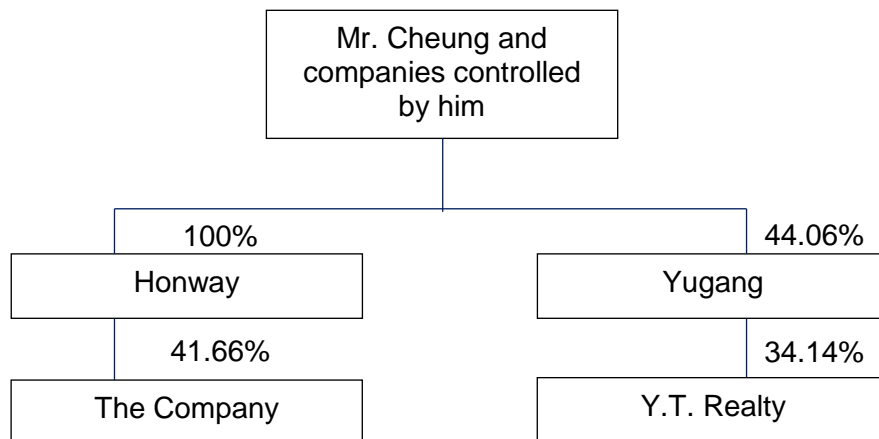
1. The Takeovers and Mergers Panel (the "Panel") met on 7th December, 2015 to consider a referral by the Takeovers Executive under Section 10.1 of the Introduction to the Codes on Takeovers and Mergers and Share Buy-backs (the "Takeovers Code"), which relates to a particularly novel, important or difficult point at issue. Mr. Cheung Chung Kiu ("Mr. Cheung"), through a company controlled by him, proposes to purchase the entire issued share capital of Honway Holdings Limited ("Honway") from Y.T. Realty Group Limited ("Y.T. Realty"). Honway holds a controlling shareholding in The Cross-Harbour (Holdings) Limited (the "Company"). The Panel was asked to rule whether a general offer obligation would be triggered as a result of the completion of the proposed acquisition by Mr. Cheung and, if so, whether a waiver of that obligation should be granted, under Note 6 of the Notes to the Rule 26.1 of the Takeovers Code.
2. The Panel was also asked by Mr. Cheung to consider whether it would agree to delay publishing its decision for thirty days following its decision as the reorganisation contemplated by Mr. Cheung was price sensitive and the decision itself might result in changes being made to the terms of this proposed reorganisation.

Background and facts

3. Since 2001 Mr. Cheung has been the controlling shareholder of Yugang International Limited ("Yugang", Stock Code 613), which in turn through its controlling interest in Y.T. Realty (also listed on The Stock Exchange of Hong Kong Limited) holds a controlling interest in the Company. At the time of the hearing the shareholding structure was as follows:



4. Each of Yugang, Y.T. Realty and the Company is listed on The Stock Exchange of Hong Kong Limited. From the public disclosures made by each of the listed companies in the chain, there were no other substantial shareholders; that is shareholders holding 5% or more of the shares in any of these publicly listed companies.
5. As part of a larger group reorganisation, Mr. Cheung was considering an arrangement under which a company controlled by him will purchase the entire issued share capital of Honway at a price equal to the five day average closing price of the shares in the Company held by Honway immediately before the announcement of such a proposed purchase. On completion of this arrangement the shareholding structure would then be as follows:



6. The sale of Y.T. Realty's shareholding in the Company to Mr. Cheung would constitute a connected transaction under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and would therefore be subject to the approval of independent shareholders of Y.T. Realty. As Y.T. Realty is not a subsidiary of Yugang, there would be no Listing Rule implications for Yugang and consequently no requirement for approval by its independent shareholders.

7. From the representations made to the Panel it was apparent that no consideration had been given to the sale of the controlling interest in the Company to anyone other than Mr. Cheung or a company controlled directly by him and no effort had been made under these arrangements to maximise the value of the shares in the Company through their sale by Y.T. Realty. To the extent that an average market price did not reflect the full value of a controlling interest in the Company, this would impact unfavourably on Y.T. Realty and to a lesser extent Yugang.

The relevant provisions of the Takeovers Code

8. Rule 26.1 of the Takeovers Code requires a general offer to be made in the event that a person acquires 30% or more of the voting rights attaching to the shares of a company to which the Takeovers Code applies, unless such obligation is waived. The relevant part of the Rule states:

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

- (a) any person acquires, whether by a series of transactions over a period of time or not, 30% or more of the voting rights of a company...*

... that person shall extend offers, on the basis set out in this Rule 26, to the holders of each class of equity share capital of the company, whether the class carries voting rights or not, and also to the holders of any class of voting non-equity share capital in which such person, or persons acting in concert with him, hold shares (see also Rule 36)....”

9. While Rule 26.1 gives a wide discretion to the Takeovers Executive to waive a general offer obligation, for the majority of cases the criteria used to support the grant of a waiver are set out in Notes 6 and 7 to the Notes to Rule 26.1. In this matter the criteria set out in Note 7 are not relevant. However, since the decision required a detailed consideration of Note 6(a), it is quoted here in full. Note 6(a) and the preamble to the Note read as follows:

“Acquisition of voting rights by members of a group acting in concert

While the Executive accepts that the concept of persons acting in concert recognises a group as being the equivalent of a single person, the holdings of members and the membership of such groups may change at any time. This being the case, there will be circumstances when the acquisition of voting rights by one member of a group acting in concert from another member of the concert group or from a non-member, will result in the acquirer of the voting rights having an obligation to make an offer.

- (a) Acquisitions from another member*

Whenever the holdings of a group acting in concert total 30% or more of the voting rights of a company and as a result of an acquisition of voting rights from another member of the group a single member comes to hold 30% or more or, if already holding between 30% and 50%, has acquired more than 2% of the voting rights in any 12 month period, an obligation to make an offer will normally arise.

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.*

The Executive would normally grant the acquirer of such voting rights a waiver from such general offer obligation if:–

- (i) *the acquirer is a member of a group of companies comprising a company and its subsidiaries and the acquirer has acquired the voting rights from another member of such group of companies; or*
- (ii) *the acquirer is a member of a group of persons comprising an individual, his close relatives and related trusts, and companies controlled by him, his close relatives or related trusts, and the acquirer has acquired the voting rights from another member of such group of persons.”*

10. In the event that a person acquires statutory control of a first company thereby acquiring or consolidating control of a second company as defined in the Takeovers Code, a general offer may be required, if the holding in the second company is significant in relation to the first. This is referred to in the Takeovers Code as the “chain principle”. In this instance if the arrangement were to be implemented, Mr. Cheung or a company controlled by him will acquire statutory control of Honway, the sole material asset of which is the controlling shareholding in the Company. The chain principle is set out in Note 8 to the Notes to Rule 26.1 and reads as follows:

“Occasionally, a person or group of persons acting in concert acquiring statutory control of a company (which need not be a company to which the Takeovers Code applies) will thereby acquire or consolidate control, as defined in the Codes, of a second company because the first company itself holds, either directly or indirectly through intermediate companies, a controlling interest in the second company, or holds voting rights which, when aggregated with those already held by the person or group, secure or consolidate control of the second company. The Executive will not normally require an offer to be made under this Rule 26 in these circumstances unless either:–

- (a) *the holding in the second company is significant in relation to the first company. In assessing this, the Executive will take into account a number of factors including, as appropriate, the assets and profits of the respective companies. Relative values of 60% or more will normally be regarded as significant; or*
- (b) *one of the main purposes of acquiring control of the first company was to secure control of the second company.*

The Executive should be consulted in all cases which may come within the scope of this Note to establish whether, in the circumstances, any obligation arises under this Rule 26.

“Statutory control” in this Note means the degree of control which a company has over a subsidiary.”

11. General Principle 10 of the Takeovers Code requires cooperation with the Panel to the fullest extent. The General Principle states this in the following terms:

“All parties concerned with transactions subject to the Codes 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.”

The case of Mr. Cheung in summary

12. The first argument was that the arrangements contemplated by Mr. Cheung were those to which a waiver should be granted under Note 6(a)(ii) as it was an arrangement between a group of persons comprising in this case an individual and companies controlled by him. If the Note applied, it would follow that a waiver would normally be granted.
13. Even if Note 6(a)(ii) did not apply, it was clear that Mr. Cheung was the controlling shareholder of each listed company in the chain, by definition, and also on a practical basis in fact. The arrangements would not change this. He was the chairman and directing mind of each company in the chain. While the controlling shareholdings in each of the publicly listed companies in the chain was less than statutory control, given the fact that there were no other substantial shareholders, the voting strength of the controlling interest was in practice rather greater than its percentage of the votes attaching to shares would indicate, as many public shareholders do not attend or vote at meetings of the companies in which they have invested.
14. Using the criteria set out in the Note, the leadership of the concert group was unaltered and no change of control resulted from the acquisition of Honway as the Company has always been effectively controlled by Mr. Cheung. The price being paid for the indirect shareholding in the Company did not reflect any premium for control and the concert party through which Mr. Cheung controlled the Company had been in place for many years. The advisers to Mr. Cheung considered that the decision in connection with Hong Kong Aircraft Engineering Company Limited made on 10th December, 2008 (the “Haeco decision”) was not particularly relevant, since in this case statutory control would not be obtained by Mr. Cheung and no premium is being paid for control.
15. The imposition of Honway should have no bearing in this case. Honway is a company incorporated in the British Virgin Islands so it would be tax efficient to acquire it, rather than the shares in the Company held by it, because no stamp or transfer duty would be paid.
16. The Panel’s attention was also drawn to the Takeovers Executive’s decision to grant a waiver to the Lai Sun Group in 2010 in similar circumstances when controlling shareholdings were transferred within the Lai Sun Group but which did not result in any additional voting rights being acquired.
17. Lastly, whatever the decision of the Panel, Mr. Cheung will need time either to respond to the decision or to document fully the arrangements that he had in mind. For this reason, Mr. Cheung was requesting a delay of thirty days before the Panel’s decision was made public.

The case of the Takeovers Executive in summary

18. The Takeovers Executive recognised that its response to the request for a waiver was influenced by the Haeco decision which interpreted Note 6 more narrowly and placed greater emphasis on its provision that changes in concert party groups which resulted in a concert party member crossing a Takeovers Code threshold, being 30% or if holding more than 30% but less than 50%, more than 2%, would normally result in a general offer obligation arising, unless the specific exemptions in Notes 6(a)(i) or (ii) applied.

Accordingly, the Haeco decision is on the point and relevant to this application for a waiver.

19. The application of Note 6(a)(ii) by its wording and as it has been applied for many years by the Takeovers Executive, relates specifically to transfers between persons who are closely related, that is family members, and not to an individual and companies he controls. In this instance, therefore, the Note did not apply since this was not a transfer between family members but between Mr. Cheung and a chain of companies, all of which are parties acting in concert with him.
20. The Takeovers Executive also distinguished between a direct holding of a controlling interest and a chain of listed companies each of which was controlled with a shareholding which was a controlling interest, as defined by the Takeovers Code, but not conferring statutory control on any of the companies in the chain. There was a qualitative difference between holding a controlling interest in the Company directly and the shareholding structure as it is presently configured, where a majority of the shareholders were not aligned with Mr. Cheung. This is particularly so of Y.T. Realty where Yugang's shareholding falls well short of statutory control.
21. If the Takeovers Executive determined that an application for the waiver fell outside the ambit of Note 6(a)(ii), the Takeovers Executive was required to consider the factors set out in the Note when Note 6(a)(i) and (ii) did not apply. In this both the Haeco decision and the recent decision on China Oriental Group Company Limited on 19th October, 2015 would indicate that waivers under this Note were to be granted in a comparatively narrow set of circumstances and that, given the importance of Rule 26.1 to the Takeovers Code, it was very strictly regulated.
22. In this instance there is no doubt that Mr. Cheung has been and will remain the leader of the concert group. However, the balance of the shareholdings of the concert group will have changed substantially. Mr. Cheung will hold the controlling shareholding in the Company through Honway and Y.T. Realty will have no interest in the Company whatsoever. As far as price was concerned, there does not appear to be any premium for control but this did not appear to be determinative in all the circumstances of this case. The Takeovers Executive accepted that the relationship between Mr. Cheung and the chain of publicly listed companies had been a relatively long one but that this might be less relevant to a concert group comprising a chain of listed companies to which stringent regulations apply. This fact distinguishes this case from those that normally fall within Note 6(a), which comprise a concert group made up of individuals and private companies usually controlled by a person and his family members.
23. The Takeovers Executive considered that the waiver granted by it to the Lai Sun Group was of limited precedential value, as the decision to grant the waiver was based on the exceptional facts and circumstances of that case.
24. The Takeovers Executive submitted that a general offer obligation will arise on the completion of the purchase of Honway by Mr. Cheung and that on balance it does not consider it appropriate for the Panel to grant the required waiver.
25. Lastly, it was the Takeovers Executive's preference that a decision be published as soon as possible in the interests of transparency and to inform the market on a timely basis.

The decision and reasons for it

26. It is clear from Rule 26.1 and its Note 8 (the chain principle) that on the sale of Honway to Mr. Cheung or a company controlled by him a general offer obligation arises. The Takeovers Code is unambiguous on this point because Mr. Cheung or a company

controlled by him will acquire statutory control of Honway, which holds more than 30% of the voting rights of the Company and Honway has no material assets other than its shareholding in the Company.

27. The second question referred to the Panel is whether a waiver of the general offer obligation should be granted under Note 6(a) to the Notes to Rule 26.1.
28. In the circumstances of the case, the Panel considers that the Haeco decision provides useful guidance in assessing whatever a waiver should be granted when the Takeovers Code normally expects an offer to be made. The Lai Sun Group matter is not one on which the Panel has been required to make a determination and the full facts and circumstances of that matter and the reasons for the grant of a waiver have never been put before the Panel. For this reason its value as a precedent is at best limited.
29. In Note 6(a) the transfer between members of a concert party group is to be treated differently depending on the relationship between the parties. Where the relationship is close, being a holding company and its subsidiaries or a group of persons who are closely related as set out in Notes 6(a)(i) and (ii), a waiver is normally granted. In this case, the Panel does not consider that Note 6(a)(ii) is applicable. Note 6(a)(ii) applies to concert party groups that comprise family members, family controlled companies and family trusts. It is intended to facilitate family succession and estate planning. The arrangements contemplated by Mr. Cheung are not arrangements for the transfer of voting rights, between him and members of his family, whether held directly or through related family trusts or family-controlled companies. The arrangements are between him and Y.T. Realty, a publicly listed company, which is an associate of Yugang, itself another publicly listed company in circumstances where Mr. Cheung has control of Yugang for the purpose of the Takeovers Code. The Panel is in no doubt that Note 6(a)(ii) was never intended to, and does not, apply to the kind of arrangement now contemplated by Mr. Cheung.
30. Note 6(a)(i) covers intra-group reorganisations. Even if the company acquiring Honway is the same company through which Mr Cheung controls Yugang, the proposed transaction would not be a group reorganisation because Yugang is not a subsidiary of that company and Y.T. Realty is not a subsidiary of Yugang, so that Note does not apply.
31. If Notes 6(a)(i) and (ii) do not apply, it is clear from the introductory words to Note 6(a) that *“whenever the holdings of a group acting in concert total 30% or more of the voting rights of a company and as a result of an acquisition of voting rights from another member or single member comes to hold 30% or more... an obligation to make an offer will normally arise”* [Our emphasis]. Waivers from the obligation are the exception. The issue is then whether the circumstances of the case warrant a waiver being granted. While it is apparent that the Note does not restrict the factors to be taken into account in considering whether to grant a waiver, given the use of the word “include”, the Note does require that the three factors listed to form part of the factors to be considered, being in summary (i) the leadership of the concert group and the balance of the shareholdings, (ii) the price paid for the shares acquired, and (iii) the duration of the concert party and the relationship between its members, in addition to the factors set out in Note 7.
32. As previously stated, the factors set out in Note 7 do not apply in this case. While the Panel is in no doubt of the leadership of the group which is obviously held by Mr. Cheung, the largest shareholding and the balance of the shareholdings will change fundamentally as a result of the implementation of the proposed transfer to Mr. Cheung. On completion, the previous controlling shareholder, Y.T. Realty, will hold no shares in the Company and Mr. Cheung will hold indirectly through Honway a controlling interest in it. Indeed, none of the chain of listed companies will have any direct or indirect interest in the Company.

33. The payment of a high price can be indicative of a premium being paid for control or for the advantage a sizeable shareholding can confer. This was a factor in the Haeco decision. When a publicly listed company sells a controlling interest in another public company, it would be expected that an effort to obtain a premium for control over and above the market price would be made. In this instance the arrangements do not envisage any premium for control, as Y.T. Realty level is selling a controlling interest in the Company to its own controlling shareholder.
34. The chain of listed companies has been in existence for a number of years and to the extent they are or are deemed to be acting in concert, it is a concert group that has lasted for a relatively long period. There is also no doubt as to who ultimately directs them now. However, the relationship between Mr. Cheung and Y.T. Realty is less direct and less firmly under his control than, for example, Swire Pacific Limited's relationship with Haeco as the chain of control has endured only by the acquiescence of the holders of a majority of the shares in Y.T. Realty and Yugang, the continuation of which is beyond the control of Mr. Cheung.
35. Taking all these factors into account, the Panel agrees with the Takeovers Executive and has decided not to grant the waiver to Mr. Cheung.
36. The Panel was also asked whether it would agree to postpone the publication of its decision for a period of thirty days. As set out in Section 16.1 of the Introduction to the Takeovers Code, irrespective of the outcome of the matter it is the policy of the Panel to publish its rulings and the reasons for them as soon as practicable, so that their activities may be understood by the public. In normal circumstances publication follows within two weeks of a hearing. In the present case, in order to give Mr. Cheung and his advisers time to respond to this decision to the extent that he is still interested in effecting a reorganisation of the listed companies he controls directly or through other controlled companies, it was agreed that this decision will be published no earlier than Monday, 21st December, 2015.

Full cooperation with the Panel

37. In a hearing of this kind the Panel expects that, in compliance with General Principle 10, the party initiating the transaction which is the subject of the hearing would attend the hearing itself, and not through its legal advisers only. Mr. Cheung informed the Panel that he was unable to attend the hearing and there was apparently nobody within his group available to attend the hearing who had any direct knowledge of the arrangements he was contemplating. As an alternative, the managing director of the Company attended, although it soon became apparent that he had no direct knowledge of the arrangements beyond what had been contained in submissions made to the Panel. This was not an entirely satisfactory state of affairs and the Panel would like to place its disappointment in this regard on record.

Parties present at the hearing:

The Takeovers Executive

Woo Kwan Lee & Lo, legal advisers to Mr. Cheung

Mr. John Yeung Hin Chung, Managing Director – The Cross-Harbour (Holdings) Limited

21st December, 2015