

## Highlights

- Takeovers Panel ruled that mandatory general offer be made for China Oriental Group Company Limited
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## Introduction

In this issue of the Takeovers Bulletin, you will find three Practice Notes that clarify the application of certain provisions of the Codes relating to appropriate offers for convertible notes or warrants, asset valuations and reiterate the importance of consulting the Executive at the earliest opportunity.

This issue also contains the Takeovers Panel's recent decision that a mandatory general offer should be made for China Oriental Group Company Limited and details of the subsequent announcement that was released in relation to the offer.

We would like to take this opportunity to draw your attention to our Consultation Paper on proposals to introduce procedural rules for hearings under the Codes and to hold disciplinary proceedings before the Panel in public.

Finally, we wish all our readers a Merry Christmas and a Happy New Year.

## Takeovers Panel ruled that mandatory general offer be made for China Oriental Group Company Limited

### The Panel's decision

On 6 December 2007, the SFC published the Panel's decision that ArcelorMittal S.A. and Mr Han Jingyuan, Wellbeing Holdings Limited and Chingford Holdings Limited (both are under Mr Han's control) are parties acting in concert with regard to China Oriental Group Company Limited. As a result, ArcelorMittal's acquisition of 28.02% of China Oriental gave rise to a mandatory offer obligation under the Takeovers Code. The Panel also ruled that a put option arrangement between ArcelorMittal and Mr Han constituted a special deal within the meaning of Rule 25 of the Takeovers Code.

By way of background, in June 2007, Ms Chen Ningning (the then 28.11% shareholder of China Oriental) announced a hostile offer for the shares of China Oriental. Shortly after the hostile offer was announced, ArcelorMittal approached Mr Han to discuss possible future co-operation between them with a view to defeating the hostile offer and acquiring control of China Oriental. On 8 November 2007 (about a month after the hostile offer lapsed), ArcelorMittal acquired Ms Chen's 28.02% interest in China Oriental. The Executive considered that a

mandatory general offer had been triggered and should be made in accordance with the Takeovers Code.

The Executive referred the matter to the Panel for a ruling under section 10.1 of the Introduction to Codes as there were particularly novel, important or difficult points at issue. The Panel met on 5 December 2007 to consider this matter.

If you would like to know more about the Panel's decisions, please follow this [link](#).

### **Announcement of the mandatory general offer**

Following the Panel's decisions, ArcelorMittal and China Oriental jointly issued an announcement on 13 December 2007 setting out the terms of the unconditional mandatory general offer that ArcelorMittal will make for the shares of China Oriental. In order to address the Panel's decision that the put option granted by ArcelorMittal to Mr Han under the shareholders' agreement constituted a special deal under the Takeovers Code, the put option was valued and the offer price was increased to reflect that value thereby enabling all shareholders to be treated equally in accordance with General Principle 1 of the Codes.

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## **Practice Note 6 (PN6) – Appropriate offers should be made for convertibles or warrants under Rule 13 even if they are not exercisable within the offer period**

Rule 13.1 of the Takeovers Code provides that *“[w]here an offer is made for equity share capital and the offeree company has convertible securities outstanding, the offeror must make an appropriate offer or proposal to the holders of the convertible securities to ensure that their interests are safeguarded. Equality of treatment is required”*.

In a recent consultation the Executive was asked whether it would waive the requirement to make an appropriate offer to the holder of a convertible note of the offeree company under Rule 13.1 in the event a possible offer is made. This request was made on the basis that, among other things, the conversion rights under the note are not exercisable within the offer period (the note would only be exercisable sometime after the end of the offer period).

The main rationale of Rule 13.1 is to ensure equal treatment of holders of convertible securities or warrants of the offeree company during an offer (see General Principle 1 of the Codes). Rule 13.1 also reflects General Principle 2 of the Codes which provides that *“[i]f control of a company changes or is acquired or is consolidated, a general offer to all other shareholders is normally required”*. The Executive wishes to clarify that regardless of whether the conversion rights under convertible securities or warrants are exercisable within the offer period, where there is an offer for shares of a company under the Codes, the Executive would normally require an appropriate offer to be made under Rule 13.

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## **Practice Note 7 (PN7) – Treatment of certain assets for the purpose of Rule 11.1(f)**

Rule 11 of the Takeovers Code deals with asset valuations. Rule 11 provides that when valuations of assets are given in connection with an offer, details of the valuations must be included in the relevant document and should be properly supported by the opinion of a suitably qualified independent valuer. This helps to ensure that shareholders are provided with sufficient information to reach an informed decision on an offer as required by General Principle 5 of the Codes.

Some aspects of Rule 11 are unique to Hong Kong insofar as it imposes an obligation on a company to obtain an asset valuation in certain circumstances. There is no such requirement in the UK Takeover Code. The obligation to require an asset valuation under Rule 11 arises under Rule 11.1(f) which provides that “... a valuation of properties will be required in the case of an offer for a company with significant property interests and, in the case of a securities exchange offer, where the offeror company has **significant property interests**” (emphasis added). This requirement was introduced into the Codes to reflect the relatively high concentration and volatility of property companies listed in Hong Kong at the time.

Rule 11.1(f) provides further guidance on the meaning of “*significant property interests*”:

*“As a general guide, this should be taken to refer to a company or group of companies, the book value of whose property assets or consolidated property assets, respectively, **exceeds 15% of the book value** of total assets or total group assets, as the case may be”* (emphasis added).

Recently some market practitioners have voiced concerns that strict compliance with Rule 11.1(f) may in some circumstances be unduly burdensome. These practitioners have suggested that certain assets should not be regarded as property assets for the purpose of calculating the 15% threshold even though they may be listed on a company’s balance sheet as “buildings” or “plant and buildings”. For example, it has been suggested that account should not be taken of properties of a mining company which are used for smelting or storage purposes or infrastructure such as roads at the mining sites.

The Executive agrees that in some circumstances the strict application of Rule 11.1(f) may be unduly burdensome and should be decided on a case-by-case basis. If parties or their advisers are in doubt as to whether certain assets should be taken into account for the purpose of calculating the 15% threshold, they should consult the Executive at the outset of the transaction.

The Executive may request to see a list of the assets including a detailed description of their nature, location, size, book value and any other characteristics or relevant information which would assist in its consideration of the matter.

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## Practice Note 8 (PN8) – Reminder about early consultation with the Executive

The Executive has noted that many market practitioners consult the Executive about the application of the Codes on a “no-name” basis. Section 6.1 of the Introduction to the Codes provides that when there is any doubt as to whether a proposed course of conduct is in accordance with the General Principles or the Rules, parties or their advisers are encouraged to consult the Executive in advance in order to clarify the basis on which they can properly proceed and thus minimise the risk of taking action which might be a breach of the Codes. Section 6.3 of the Introduction to the Codes goes on to say that while the Executive will respond to questions on interpretation of the Codes, it should not be expected to answer purely hypothetical questions, or to give provisional rulings (e.g. when the parties with an interest in such rulings cannot be identified). This is particularly important in respect of consultations concerning concert party relationships where the provision of the full facts, including the names of the parties and details of their relationship, are often crucial to the Executive’s assessment of the matter. Whenever there is any doubt as to the application of the Codes parties and their advisers are urged to consult the Executive at the earliest opportunity.

## Consultation Paper on new procedures for hearings under the Codes

On 2 November 2007 the SFC issued a Consultation Paper introducing procedural rules for hearings under the Codes. These proposals, which were formulated in close consultation with the Panel, are intended to facilitate fair, efficient and timely decision-making. The proposals are not only important for investor protection and the credibility of the Codes and the Panel but also help promote flexibility, speed and certainty which enable parties to know where they stand under the Codes in a timely fashion. Furthermore, to ensure fairness and transparency in the hearings process, it is proposed that disciplinary proceedings before the Panel should be held in public and chaired by an experienced litigation counsel/solicitor or a retired judge. This should facilitate the smooth management of the hearings process and promote public understanding of the operation of the Codes and hearings before the Panel.

The consultation period ended on 14 December 2007. A Consultation Conclusions Paper will be issued in due course.

You can also follow this [link](#) to the Consultation Paper.

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Feedback and comments are welcome and can be sent to [takeoversbulletin@sfc.hk](mailto:takeoversbulletin@sfc.hk)

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