



Hong Kong Law

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TAKEOVERS PANEL RULES THAT THE CODES APPLY TO SOUTHGOBI RESOURCES LIMITED

The Takeovers and Mergers Panel (the **Panel**) has ruled that SouthGobi Resources Limited (**SouthGobi**) should be considered a ‘public company in Hong Kong’ under the Codes on Takeovers and Mergers and Share Buy-backs (the **Codes**), and is therefore subject to the Codes (the **Decision**).

Timeline

Prior to its 2010 secondary listing on the Stock Exchange of Hong Kong (the **Exchange**), SouthGobi obtained a ruling that it would not be considered as a ‘public company in Hong Kong’ within the meaning of the Codes and therefore the Codes would not apply to it upon completion of its secondary listing. The ruling expressly required the Executive to be informed immediately of any material change to the information provided and/or representations made, so that it could determine whether the ruling should remain valid.

In May 2014, SouthGobi’s application for a ruling that it should continue to be regarded as not being a public company in Hong Kong for the purposes of the Codes, was referred to the Panel for consideration.

The Decision

The Panel endorsed the Executive’s view that the current situation represented a material change from the information provided and/or representations made to the Executive prior to listing and upon which the 2009 ruling was premised. SouthGobi should be regarded as a public company in Hong Kong for the purposes of the Codes.

In reaching the Decision, the Panel noted that section 4.2 of the Introduction to the Codes states that the main factors in determining whether a company is a ‘public company in Hong Kong’ are the number of Hong Kong shareholders and the extent of share trading in Hong Kong.¹ It rejected the argument that where a company has a secondary listing on the Exchange, the continuance of shareholder protections in the market of its primary listing is the primary factor to be considered in determining whether it should continue to be regarded as a non-public company.

Reasons for the Decision

At the time of pre-listing application, in its representations to the Executive as to “the number of Hong Kong shareholders and the extent of share trading in Hong Kong” after its secondary listing on the Exchange, SouthGobi estimated that:

- i) approximately 6.8% of its shares would be held on the Hong Kong register and approximately 93.2% of its shares would be held on the Canadian register;
- ii) excluding shares held by Turquoise Hill, SouthGobi’s controlling shareholder, from the liquidity analysis, approximately 74% of SouthGobi’s remaining shares post secondary listing on the Exchange were expected to be held on the Canadian register and 26% on the Hong Kong register; and

¹ This was confirmed in the Panel decision in the Husky Energy case in 2011.

- iii) trading volumes in Hong Kong would not exceed those in Canada in the short to medium term.

The Number of Hong Kong shareholders

As to the information provided to the Panel in 2014, over 30% of SouthGobi's issued shares are now held on the Hong Kong register compared with the estimate of 6.8% at the time of the 2009 ruling. The Panel did not agree with SouthGobi's suggestion that the number of Hong Kong shareholders should be determined by reference to the number of shareholders with Hong Kong addresses. Since the Codes are intended to afford protection to "shareholders who are affected by takeovers, mergers and share buy-backs"² which include overseas and domestic shareholders, the correct test is to consider the proportion of shares registered in Hong Kong versus the proportion registered in Canada.

The Panel also ruled that the fact that a single shareholder holds a significant proportion of the Hong Kong registered shares (China Investment Corporation (**CIC**) held almost 48% of SouthGobi's Hong Kong registered shares), should not detract from the fact that the Hong Kong registered shares now represent a significant proportion of SouthGobi's issued shares. Excluding CIC's and Turquoise Hill's respective shareholdings, shares registered in Hong Kong represented 65.45% of the remaining shares whereas the shares on the Canadian register represented only 34.55%. There has been a material increase in the shares on the Hong Kong register compared with the estimate provided pre-listing with the result that a significant proportion of SouthGobi's total shares are now held on the Hong Kong register. Almost two-thirds of shares held by the two substantial shareholders are now held on the Hong Kong register.

The Extent of Trading on the Exchange

With regard to the extent of trading in the shares in Hong Kong, during the six months preceding the Panel's decision, the monthly trading volume in Hong Kong ranged between 72% and 96% of total trading in the shares. Compared with the estimate provided in the pre-listing application, there has been a material shift in the relative proportion of trading volume from Canada towards Hong Kong.

In addition to the primary factors, other factors are to be taken into account including (i) the location of the company's head office and place of central management, (ii) the location of the company's businesses and assets, including such factors as

registration under companies legislation and tax status, and (iii) the existence or absence of protection available to Hong Kong shareholder given by any statute or code regulating takeovers, mergers and share buy-backs outside Hong Kong.

Other Factors

According to section 4.2 of the Introduction to the Codes, other factors to be taken into account in determining whether a company is a 'public company in Hong Kong', in addition to the primary factors discussed above, include:

- i) the location of the company's head office and place of central management;
- ii) the location of the company's business and assets, including such factors as registration under companies legislation and tax status; and
- iii) the existence or absence of protection available to Hong Kong shareholders given by any statute or code regulating takeovers, mergers and share buy-backs outside Hong Kong.

The Panel considered it to be immaterial that SouthGobi now has more than one place of management and some of its senior management now divide their time between various locations including Hong Kong. The Decision noted that companies with a primary listing on the Exchange commonly have substantially all of their management, assets and business outside Hong Kong. The other two factors were also considered not to be material.

The Panel's full written decision can be found on the website of the Securities and Futures Commission. (http://www.sfc.hk/web/EN/files/CF/pdf/Takeovers%20and%20Mergers%20Panel%20-%20Panel%20Decision/SouthGobi%20Panel%20Decision_EN_dated%2024%20June%202014.pdf)

² Section 1.2 of the Introduction to the Codes.

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