



Hong Kong

October 2015

TAKEOVERS PANEL UPHOLDS EXECUTIVE'S DECISION THAT NO MANDATORY GENERAL OFFER OBLIGATION AROSE FOR CHINA ORIENTAL

Introduction

The Takeovers and Mergers Panel (the **Panel**) has upheld the ruling of the Takeovers Executive (the **Executive**) granting ArcelorMittal (**AM**) a waiver from the obligation to make a mandatory general offer for the shares in China Oriental Group Company Limited (**CO**) under the Code on Takeovers and Mergers (the **Takeovers Code**). AM, a substantial shareholder of CO, sought the waiver in circumstances where put option arrangements were to be terminated, resulting in AM's shareholding increasing from just below 30% to approximately 47%.

Background

Following a mandatory general offer for shares in CO in 2007, AM's shareholding increased to approximately 47%. Consequently, AM together with Mr. Han Jingyuan (the chairman of CO and an approximately 45% shareholder) held around 92% of the shares in CO. This meant that CO did not comply with the minimum public float requirement of 25% under the Hong Kong Stock Exchange's Listing Rules.

Under an agreement between AM and Mr. Han, AM was required to ensure CO's compliance with the public float requirement. AM therefore entered into the following arrangements:

- it sold 9.9% and 7.5% of the shares in CO to ING Bank (**ING**) and Deutsche Bank (**DB**), respectively;

- it granted each of the banks a put option to sell back the shares at the original purchase price (with adjustments). The put option was fully cash collateralised, so that apart from bank fees, no cash was exchanged; and
- AM could compel the banks to exercise their put options following its exercise of call options granted by Mr. Han.

At the time they were entered into, these arrangements satisfied the Listing Rules' public float requirements. Subsequently, near the end of 2013, the Hong Kong Stock Exchange notified CO that the arrangements no longer complied with the public float requirements.

After DB informed AM that it would not be rolling over their arrangements, AM negotiated with Macquarie Bank Limited (**Macquarie**) to purchase DB's 7.5% shareholding. AM granted Macquarie a put option to sell back the shares at Macquarie's original purchase price (with adjustments). The put option was fully cash collateralised so that apart from some fees and reimbursements, no cash was exchanged. Macquarie was also indemnified by AM against all risks under the arrangements. ING's arrangements with AM were rolled over on the same terms as agreed with Macquarie.

In 2014, the independent non-executive directors (**NEDs**) of CO requested the Executive to rule that these arrangements required AM to make a mandatory general offer for CO's shares at HK\$6.50 per share. The Executive ruled that no such obligation had been triggered. The NEDs sought a review by the Panel of that ruling, who agreed with the Executive that no mandatory general offer had been triggered by AM.

In its 2014 decision, the Panel reasoned that AM did not acquire additional voting rights on DB being replaced by Macquarie. On the contrary, the voting rights passed directly from DB to Macquarie. It also held that AM and Macquarie were presumed to be acting in concert by reason of their financial arrangements, and the presumption had not been rebutted. Similarly, both ING and DB were also presumed to be acting in concert with AM. Given that the concert parties held a combined 47% interest in CO for the duration of the arrangements, the Panel found that the concert parties' aggregate holding had not increased; and that the arrangements had not caused any concert party to cross a mandatory offer trigger point, or any significant change to the concert party arrangements. Consequently, there was no mandatory offer obligation.

In late 2014, AM consulted the Executive on a number of issues in relation to the arrangements with the banks, and this resulted in a January 2015 application by AM for a waiver of the mandatory general offer obligation, which would arise when the arrangements with the banks were terminated. In May 2015, the Executive granted the waiver. Two minority shareholders of CO, Mr. Chan Pak To and Mr. Churk Shue Sing, requested a review of the Executive's waiver ruling. In October 2015, the Panel reviewed the Executive's ruling and upheld it.

The Takeovers Code

Under Rule 26.1 of the Takeovers Code, a mandatory general offer is required when, inter alia, any person acquires at least 30% of the voting rights of the company. This requirement can be waived by the Executive.

Under Note 1 to Rule 26.1, the Executive may require a person who is acting in concert to make a general offer even though no single member of the concert party holds more than 30%. Further, a mandatory general offer obligation may arise where there are changes within a concert party group even if the concert party does not acquire any additional voting rights or there is no crossing of a Takeovers Code threshold.

According to Note 6(a), the Executive, in determining whether to grant the waiver, takes into account certain criteria, which the Panel has described as not exhaustive. The criteria are: (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.

Acting in concert is defined in the Takeovers Code as persons who, by virtue of an agreement or understanding (whether formal or informal), actively cooperate to obtain or consolidate control of a company through the acquisition by any of them of voting rights of the company.

Further, under the Definitions section, there is a rebuttable presumption that certain categories of persons act in concert. Thus, where a person (not being an authorised institution) provides finance or financial assistance (directly or indirectly) to any person (or a person acting in concert with that person) in connection with an acquisition of voting rights, those persons are presumed to be acting in concert.

Note 3 to the definition of acting in concert states that once it has been determined that persons are acting in concert, they will continue to be regarded as such until there is clear evidence to the contrary.

The Decision and Reasons

The Panel noted that AM had provided the Executive with sufficient information so that it could make an informed decision on the grant of the waiver, and that no material, new or significant factors had arisen since the Executive's decision. Where a party to a possible takeover or merger transaction receives a ruling from the Executive, in normal circumstances it should be confident that it can rely on that decision, otherwise this would "undermine the consultation process and the efficacy of obtaining rulings from the Takeovers Executive in advance of any action".

The Panel is required under the Takeovers Code to look at previous decisions. The Panel described their 2014 decision as an important precedent, and noted that the case concerned the same company and similar issues. The Panel emphasized the finality of their 2014 decision and noted that they had already ruled in their 2014 decision that AM, ING and Macquarie were persons acting in concert, which the Executive correctly followed in its 2015 decision.

The termination of AM's put option arrangements with ING and Macquarie resulted in an increase in AM's shareholding in CO from just below 30% to around 47%, and thus triggered the mandatory general offer obligation in the absence of a waiver by the Executive.

In exercising its discretion to waive a mandatory general offer, the Executive must take into account not only certain criteria under Note 6(a), but also all relevant factors. In this case,

the Executive took into account the criteria under Note 6(a), and particularly that there was no change in leadership as AM continued to be the leader of the concert group, and that there was no significant change in the balance between the shareholdings in the concert group. Other material factors that the Executive took into account were:

- the risk exposure of AM in relation to the arrangements and the underlying economic interest that AM held in the shares in CO registered in the names of the banks. The Executive did not consider that there had been a significant change in what it referred to as the “beneficial ownership” which it interpreted in terms of where the economic benefits lay rather than the strict legal definition;
- that the shares were being warehoused by the banks on a temporary basis for the benefit of AM;
- the unusual circumstances that resulted in the implementation of the arrangements between AM and the banks; and
- AM’s accounting treatment of its investment in CO which suggested that it had a significant risk exposure in relation to the shares held by the banks.

The Panel considered that these factors provided reasonable grounds for the Executive’s waiver decision and that there was therefore no reason to amend or reverse it.

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Hong Kong Office

Dominion Centre

12th Floor

43-59 Queen's Road East

Hong Kong

Tel: + (852) 2905 7888

Fax: + (852) 2854 9596

www.charltonslaw.com