

China Corporate Bulletin

Welcome to White & Case's monthly China Corporate Bulletin. This bulletin covers recent corporate regulatory developments and news in the PRC and Hong Kong, ensuring you stay up to date on the latest market issues.



PRC

MOFCOM delegates foreign investment approval authority to its local counterparts

The Ministry of Commerce ("MOFCOM") issued four new circulars (*Shang Zi Han No. 6 – 9 (2009)*)¹ within the last several months that further delegate its foreign investment approval authority to MOFCOM's counterparts at provincial levels. Specifically, the circulars address the devolution for the following types of foreign investments: (a) foreign-invested service companies; (b) foreign-invested enterprises that do not require the state's assistance in balancing foreign exchange; (c) foreign-invested enterprises in the automobile sector; (d) merger and acquisition of domestic companies; (e) foreign-invested holding companies, and (f) foreign-invested venture capital enterprises and venture capital management enterprises.

Generally, instead of applying to the central MOFCOM, foreign investors can now go directly to the local MOFCOM branch for approval of these investments if their investment does not exceed US\$100 million for encouraged projects or US\$50 million for restricted projects. The rule applies to both the establishment of new companies as well as amendments (e.g., capital increases, amendments to joint venture contracts or articles of association) to companies that were established with central MOFCOM approval, unless the amendment is for a single injection of capital over US\$100 million or for a change in the company's shareholder(s). MOFCOM still retains discretion to approve certain things, such as strategic investments in listed companies.

The delegation of approval authority to the local levels seems likely to create several benefits in efficiency, as the local approvals should be more streamlined. However, a potential drawback of local approval may be that variation will develop among local authorities as to what is required for certain approvals, leading to inconsistencies in the application of the law.

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¹ For more information on MOFCOM's public consultation, please refer to White & Case China Newsletter, January 2009.

Hong Kong

SFC secures first ever jail sentence for insider dealing offence in Hong Kong

In March and April, 2009, in two separate prosecutions for the criminal offence of insider dealing, the Securities and Futures Commission (“SFC”) secured convictions that resulted in the first ever jail sentences in Hong Kong for this offence. The offence of insider dealing which is contained in the Securities and Futures Ordinance (“SFO”), has been in force in its current form for a little over six years. The SFC has recently stepped up its pursuit of insider dealing cases, and it must be considered likely that for any convictions secured for this offence in the future, the SFC will be pushing for more jail terms to be imposed. The three defendants in total were sentenced to jail terms of 8, 12, and 26 months, respectively, as well as being ordered to pay fines. Other defendants involved in these prosecutions were also found guilty and fined with other orders made against them.

The first conviction was of a former investment banker and four other defendants who were found guilty of insider dealing by the Hong Kong District Court after the first indictable trial for such offence under the SFO. The former investment banker tipped off the other three defendants with information relating to a proposed privatization of a Hong Kong listed company that he was working on and that he knew was confidential, price sensitive information. The other defendants all purchased shares in the listed issuer before the announcement of the privatization.

The second conviction was of a former accounting manager, who was employed by a listed company, who in the course of his employment learned of price sensitive information about a second listed company with which the first company was proposing to enter into an asset swap transaction. He placed orders in the accounts of himself and his wife to buy shares in the second company before the asset swap proposal was publicly announced.

The convictions were secured under section 291 (*Offence of insider dealing*) of the SFO. Section 291 is drafted understandably in very broad terms. The main components of the offence include prohibitions against any person “connected with a listed corporation” in possession of information which he knows is price sensitive information (referred to as “relevant information”) in relation to that corporation (i) dealing in the listed securities of that corporation, or (ii) counseling or procuring another person to deal in those securities, knowing or having reasonable cause to believe that the other person will deal in them, or (iii) disclosing that information to another person, knowing or having reasonable cause to believe that the other person will make use of the information to deal in those securities.

In the first case mentioned above, the defendant would have been treated as a person “connected” with a listed corporation” (i.e. the company proposed to be privatized) in that he was an investment banker at the time working on the deal, and he occupied a position which would reasonably have been expected to give him access to price sensitive information in relation to that corporation by reason of the business relationship existing between his employer and the corporation.

In the second case mentioned, the defendant would also have been treated as a person “connected with a listed corporation” in that he had access to information about the proposed deal (i) by reason of his being in such a position that he would thereby have been regarded as connected with the second corporation, and (ii) the information related to a transaction that involved both corporations i.e. his employer and the second listed company.

Additionally, the other defendants who were in receipt of the confidential information would have committed the offence of dealing in the securities of the particular listed corporation, having received information which the defendant knew to be price sensitive information for the listed corporation, from a person whom he also knew to be “connected” with that corporation and whom he knew or had reasonable cause to believe held the information as a result of being connected with that corporation (i.e. in the first case the former investment banker, and in the second, the former accounting manager).

For more information, please refer to <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR37> and <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR50>.

Decision of the Takeovers and Mergers Panel

– Once an offer has lapsed, it can be re-opened only in wholly exceptional circumstances

The Securities and Futures Commission (“SFC”) has published a decision of the Takeovers and Mergers Panel (“Panel”) made on April 21, 2009, in response to a referral to it by The Takeovers Executive of the SFC (“Executive”) of a request for a ruling under the Code on Takeovers and Mergers (“Code”). The Code applies to takeovers, mergers and share repurchases affecting public companies in Hong Kong and companies with a primary listing of their equity securities in Hong Kong. The public company in this case was Nam Tai Electronics & Electrical Products Ltd (“Nam Tai”), whose shares are listed on the Stock Exchange of Hong Kong.

Issue

The question presented to the Panel was whether it agreed with the Executive that an offer should not be extended for a further 14 days where (i) the offeror (Nam Tai's controlling shareholder) had made an offer for all the outstanding shares in Nam Tai not already owned by it or persons acting in concert with it, and for which the required level of acceptances had failed to be met, and (ii) the offeror had already made an announcement after the first closing date that the condition to which the offer was subject was not fulfilled, and that the offeror did not intend to extend the offer and that the offer had lapsed.

Summary facts

The summary facts were that in February 2009 a voluntary conditional general cash offer was made on behalf of Nam Tai's controlling shareholder for all the outstanding shares in Nam Tai not already owned by the offeror or persons acting in concert with it. The offer was conditional on the receipt of acceptances equal to at least 90% of the shares subject to the offer (i.e. the disinterested shares), being the threshold percentage level of acceptances required by the Code in the case of a privatization, which coincides with the separate applicable statutory threshold at which the remainder of the disinterested shares for which acceptances have not been received, can be compulsorily acquired.

As at 4:00 p.m. on the first closing date, the offeror had received acceptances for 88.46% of the shares under offer. The offeror then published on the same day, an announcement stating that the condition was not fulfilled, that the offeror did not intend to extend the offer and that the offer had lapsed.

The next day, the offeror approached the Executive seeking to have the offer extended. It was subsequently discovered that in several instances, shareholders who would have accepted the offer failed to do so either because their broker failed to submit the acceptance on time, or it was wrongly advised that it need take no action to accept the offer. Had these additional acceptances been lodged before 4:00 p.m. on the first closing date, the 90% threshold for acceptances would have been reached, and the offer would have become unconditional.

Summary of Panel's decision

The Panel endorsed the decision of the Executive that the offeror should not be permitted to extend the offer for a further 14 days.

In summary, the Panel made the following points in support of its decision:

- The "no extension statement" contained in the offeror's announcement should be subject to Rule 18.2 of the Code, which says:

"If statements in relation to the duration of an offer such as "the offer will not be extended beyond a specified date unless it is unconditional as to acceptances"....are made by or on behalf of the offeror....., and not withdrawn immediately if incorrect, only in wholly exceptional circumstances [our emphasis] will the offeror be allowed subsequently to extend its offer beyond the stated date except where the right to do so has been specifically reserved."

- Note 1 to Rule 18.2 includes:

"In general, an offeror will be bound by any firm statements as to the duration or finality of its offer."

- An offeror is not permitted except in wholly exceptional circumstances, to reverse a statement made in connection with the duration of the offer. This is set out in Rule 18.2 (see above).
- Rule 31.1 sets out the consequences of an offer which has lapsed because it has not become or been declared unconditional. Rule 31.1 states:

"Except with the consent of the Executive, where an offer has been announced or posted but has not become or been declared unconditional, and has been withdrawn or has lapsed, neither the offeror nor any person who acted in concert with it in the course of the original offer, nor any person who is subsequently acting in concert with any of them, may within 12 months from the date on which such offer is withdrawn or lapses either:

- (i) *announce an offer or possible offer for the offeree company (including a partial offer which could result in the offeror holding shares carrying 30% or more of the voting rights of the offeree company),".*

- Takeovers in Hong Kong are expected to be an orderly activity and the Code is designed to place disciplines on those who engaged in a takeover. Decisions and statement made concerning a takeover are expected to be made with a high degree of care, and other than wholly exceptional circumstances, statements made cannot be retracted.
- It was noted that the offeror was accustomed to takeover and other corporate activity in Hong Kong as it had previously attempted an earlier privatization of Nam Tai. When the offeror decided not to extend the offer, it knew or ought to have known the implications of what it was doing.

- Whilst much had been made of the attractions of the offer and the unfortunate consequences of its lapsing on minority shareholders, the Code, and consequently the Panel, is not interested in the commercial merits of a transaction. Thus the merits of an offer or the consequences of its lapsing are not an adequate ground for relaxing or waiving the application of the rules of the Code.

The Panel concluded that there did not exist a wholly exceptional circumstance of the kind which would warrant the retraction of the decision not to extend the offer, which would thereby have allowed the offer to be re-opened.

For more information, please refer to <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR53>.

Sequel to the Panel's decision

The sequel to the Panel's decision is instructive in that it reinforces how important it is that persons who wish to take advantage of the Code, conduct themselves in accordance with its terms (it should be noted that the Code does not have the force of law). It also reinforces the importance of obtaining appropriate advice as to how to proceed under the Code. As the sequel to the Panel's decision shows, rather ironically, a director incurred a "cold shoulder" order from the SFC for pursuing a second route to privatization not in compliance with the Code, when there was the prospect of the Executive giving its consent under the Code to a repeat procedure of the first route employed for the proposed privatization.

SFC issues "cold shoulder" order

The first part of the sequel to the Panel's decision (see above), was that following Nam Tai's publication of its latest quarterly results which disclosed a substantial deterioration in its financial performance, it issued an announcement that it would be convening a shareholders meeting to approve a resolution to place the company in voluntary winding-up. At that time Mr Koo Ming Kown (the "Director") was the only non-executive director of Nam Tai and the only executive director of its controlling shareholder, the offeror. The Director had previously been made aware by the SFC that the winding-up proposal would be treated by the Executive as a further privatization attempt under the Code. Consequently, this would be subject to the 12-month prohibition in Rule 31.1 of the Code (see above) requiring that a further offer for Nam Tai's shares within that period be subject to the Executive's consent. The Director had also been made aware that it was open to the offeror to apply for consent for a relaxation of the 12-month prohibition. The Executive had raised its grave concerns with the Director as the announcement of the winding-up proposal had been published by the Director in full knowledge that it constituted a number of serious breaches of the

Code. He also failed to co-operate with the Executive, in breach of General Principle 10 of the Code which says:

"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 Appeals Committee, and to provide all relevant information."

On the basis that "the conduct of [the Director] constituted intentional and serious breaches of the Takeovers Code which merit strong disciplinary action", a "cold shoulder" order was made against him. The effect of the order is to deny to the Director direct or indirect access to the Hong Kong securities markets for a period of 24 months. The Executive also publicly censured the Director in relation to his conduct. The Director also publicly apologized unreservedly for his conduct in the matter and undertook to fully co-operate with the SFC and comply with the regulatory requirements on all matters relating to the Code.

The "cold shoulder" is the harshest form of disciplinary action available to the SFC and is rarely utilized. It is implemented through an order issued by the Executive to all persons in the Hong Kong securities industry that the SFC regulates, not to act for or assist the person against whom the order is made. An exception to the order was made for Nam Tai and its controlling shareholder.

Executive's consent under Rule 31.1

The second part of the sequel was that following discussions between the SFC and the Director, an application was submitted to the Executive for a relaxation of the Rule 31.1 prohibition to enable a further general offer to be made for Nam Tai's privatization. The consent was granted on very specific terms including a requirement that as far as possible, the new offer would mirror the terms of the previous offer.

As mentioned above, as the possibility of this route may have been available to the offeror from the time that the Panel issued its decision, it is somewhat ironic that the Director engaged in conduct that resulted in the "cold shoulder" order being made against him.

For more information, please refer to <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR65>.

First case of use of statutory derivative action involving a Hong Kong listed company

In what is believed to be the first case of its kind involving a company listed on the Hong Kong Stock Exchange (“SEHK”), the Hong Kong High Court has granted leave to a shareholder to bring a statutory derivative action on behalf of the company against certain of its directors for alleged breaches of fiduciary duties.

It is a general principle of company law that where a wrong has been committed against a company, the company is the proper person to bring the action for the loss or damage incurred. This presents an issue for minorities when the misfeasance has been committed by the person or persons who control the company, or by a related third party, and the person in control refuses to allow the company to bring the action. Part IVAA (Statutory Derivative Action) (sections 168BA to 168BK) of the Companies Ordinance, which came into effect in 2005, was introduced to overcome this difficulty, by giving to member of a company a statutory right to bring this type of action in the company’s name. The action is only available where there has been misfeasance committed against the company i.e. fraud, negligence, default in compliance with any enactment or rule of law, or breach of duty.

Significantly, these statutory provisions apply also to non-Hong Kong incorporated companies that have established a place of business in Hong Kong, and thus they also apply to every such company listed on the SEHK as it will be treated as having a place of business in Hong Kong. In this case, the listed company in question was incorporated in Bermuda

To bring the action, the applicant is required to show why it should be allowed to do so. In making its determination, factors that the Court will consider include whether it appears to be prima facie in the interest of the company that leave be granted to the applicant and in such case whether there is a serious question to be tried and the company has not itself brought the proceedings against the defendants. In both cases, the requirements have what the Court has described as a “relatively low threshold”.

This is an important remedy for minority shareholders of publicly listed companies in Hong Kong. Whilst a form of derivative action is available to minority shareholder at common law, advantages of the statutory action over the common law action include: first, the ability of the shareholder to bring the action against a non-Hong Kong incorporated company; and, secondly, the much broader scope as well as clarity of scope of the statutory action, when set against the common law action, which often gave rise to difficulties of interpretation as to whether an action could be brought within the available exceptions for that action.

For more information, please refer to <http://www.scmp.com> (Subscription required.)

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