

## TAKEOVERS AND MERGERS PANEL

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### Panel Decision

**In relation to a referral to the Takeovers and Mergers Panel (the “Panel”) for a ruling on whether a Chain Principle Offer will be triggered for Greenheart Group Limited (“Greenheart”, Stock Code: 94) upon the implementation of the restructuring of Sino-Forest Corporation (“Sino-Forest”)**

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### Purpose of the hearing

1. The Panel met on 17<sup>th</sup> January, 2013 to consider a referral to it at the request of the advisers to an ad hoc committee, comprising holders of a significant amount of notes issued by Sino-Forest which are now in default (the “Ad Hoc Committee”) with the agreement of the Takeovers Executive in accordance with the provisions of Section 10.1 of the Introduction to the Codes on Takeovers and Mergers and Share Repurchases (the “Takeovers Code”) because the matter involves particularly novel, important or difficult points at issue.

### Background and facts

2. Sino-Forest is a company whose shares were previously listed on the Toronto Stock Exchange. Following a report in June, 2011 by Muddy Waters L.L.C., Sino-Forest experienced severe financial difficulties with the result that it defaulted on certain of its obligations under certain notes it had issued.
3. In March, 2012 Sino-Forest filed a motion under the Canadian Companies’ Creditors Arrangement Act (the “CCAA”) seeking the protection of the Ontario Court to rearrange its affairs. Under the terms of the CCAA order that was granted two alternative restructuring alternatives were proposed. The first alternative involved the sale of the assets of Sino-Forest to a third party in accordance with certain court-sanctioned sale procedures. If that failed, then the second alternative would be the transfer of the assets of Sino-Forest to a new company or a wholly-owned subsidiary of it (collectively “New Holdco”) which would be owned by Sino-Forest’s creditors. These arrangements were supported by 100% of Sino-Forest’s creditors.

held in a litigation trust to fund certain legal actions. This arrangement, on implementation, will result in New Holdco directly or indirectly holding substantially all the assets of the Sino-Forest Group; and

- the noteholders and certain contingent creditors with claims which would rank pari passu with the noteholders receiving shares in, and notes of, New Holdco and a pro rata share in 75% of the proceeds from the litigation trust. The effect of this arrangement is that substantially all of the assets of the Sino-Forest Group will be owned by noteholders and possibly certain other creditors with the objective over a period to realise these assets to their best advantage to repay as much of the money as possible presently owed by Sino-Forest to noteholders and other creditors.
7. On completion it is not expected that funds managed by any one fund manager will represent more than 20% of the shares in New Holdco. It was not known whether there are any concert party arrangements between noteholders, beyond that of the presumed concert party between a fund manager and the funds under its management, but it was submitted that this was unlikely to be the case.
  8. One of the assets to be transferred from Sino-Forest to New Holdco will be the entire issued share capital of Sino-Capital Global Inc. ("SCGI") which company holds shares representing some 63.6% of the voting rights of Greenheart, and some other businesses, being primarily a business owned by another subsidiary, Homix Limited, engaged in wood manufacturing. There was no debate that the value of its shareholding in Greenheart was significant in relation to SCGI, representing over 60% of its gross and net assets, and revenues.
  9. While there are considerable uncertainties over the aggregate value of the Sino-Forest Group's assets, as there is uncertainty regarding the financial information available under 16.6(a)5.c, as -.016



second company is one of the main purposes of the transaction. The Note also makes it apparent that in all cases the Takeovers Executive should be consulted when a transaction may come within the scope of this Note.

14. Any transfer of a shareholding between members of a concert party potentially triggers a mandatory offer, even when the relationship is very close. In all cases where a mandatory offer would be required, a specific waiver from the Takeovers Executive is required if such an offer obligation is to be avoided. This is set out in Note 6 to Rule 26.1, the relevant sections of which read as follows:

*"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..."*

*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;..."*

15. Rule 26 also contains other provisions which may permit the mandatory offer obligation which would otherwise arise from the acquisition of control over voting rights being waived. These include the circumstances when a receiver or liquidator is appointed. Under Note 2 to the Notes on dispensations from Rule 26 it states that:

*"Although a receiver or liquidator of a company is not required to make an offer when he takes control of a holding of 30% or more of the voting rights of another company, the provisions of this Rule 26 apply to a purchaser from such a person."*

16. In certain circumstances dispensations can be sought when there is a rescue operation but it is clear that this applies only to financial difficulties being experienced by a company to which the Takeovers Code applies and not a major shareholder of it. The relevant section of Note 3 to the Notes on dispensations from Rule 26 reads:

*"The requirements of this Rule 26 will not normally be waived in a case when a major shareholder in a company rather than that company itself is in need of rescue. The*

### **The case of the Takeovers Executive in summary**

18. Rule 26 is at the heart of the Takeovers Code and reflects General Principles 1 and 2 which underpin the Rule by requiring an offer to be made when control is acquired or consolidated and that all shareholders should be similarly treated so that all shareholders have the opportunity to dispose of their shares at the same price in these circumstances.
19. The same principles apply when control is acquired indirectly under the Chain Principle set out in Note 8 to Rule 26.1. In this case New Holdco will on the implementation of the Restructuring Plan acquire statutory control of a company, in this case SCGI, the first company, thereby acquiring control, as defined in the Takeovers Code, of Greenheart, the

set no time limits to the arrangements and there was no immediate obligation to realise the interest in SCGI or Greenheart given the objective was to maximise the return to creditors by avoiding an immediate liquidation. This would mean that the assets may be held by New Holdco for an indefinite period and the directors of New Holdco and its subsidiaries would have a much more permanent and active role than a receiver or liquidator.

25. Further, it appeared that Note 2 of the Notes on dispensations from Rule 26 is specific in its reference to a liquidator or receiver and not to the role of directors where actions in certain circumstances may be analogous to the role of a liquidator or receiver. In fact the Note reiterates the requirement to make an offer in the event that a controlling interest in a company to which the provisions of the Takeovers Code apply is acquired from a liquidator or receiver.
26. In the course of the hearing, reference was also made to the guidance on rescue operations set out in the second paragraph of Note 3 to the Notes on dispensations from Rule 26. This Note makes it apparent that the financial circumstances of a major shareholder are not normally reason to waive an offer obligation which may arise from actions taken to address its difficulties as is the case now with Sino-Forest. This was consistent with the Takeovers Executive's understanding of the operation of the Chain Principle set out in Note 8.

#### **The case of the Ad Hoc Committee in summary**

27. The Restructuring Plan was proposed by Sino-Forest and has now been sanctioned by the Ontario Court and its ultimate purpose is to satisfy as far as it is able the claims of creditors. In essence the shareholders of Sino-Forest are to be replaced by its creditors. The mechanics of the Restructuring Plan are designed to effect this as efficiently as possible. The proposed transfer of SCGI with its controlling interest in Greenheart is one element in the Restructuring Plan and should not be seen separately from it. SCGI is also not a core element of the Restructuring Plan, given its value relative to the total assets of the Sino-Forest Group to be transferred under the Restructuring Plan. In assessing the proposed transfer of SCGI to New Holdco in the context of the Takeovers Code, it is the substance of the transaction, being the effective substitution of the shareholders of Sino-Forest by its creditors, that should be examined, not its form.
28. Taken as a whole, the transfer of control of Greenheart was not significant. While Sino-Forest had stated publicly that its financial statements could not be relied upon, in its written submissions to the Takeovers Executive, the advisers to the Ad Hoc Committee considered that, notwithstanding this serious qualification, in the absence of any other financial information the test for significance could only be calculated by reference to the information available. Using this financial information, by any measure the controlling interest in Greenheart constituted less than 5% of the assets to be transferred to New Holdco. At the hearing, the Panel was told that on the basis of the assets with a known value, being principally cash and bank balances, the controlling interest in Greenheart represented approximately 10% of these assets. So on this measure too, Greenheart was not significant.
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30. The Restructuring Plan was in response to the insolvency of Sino-Forest. It offered a better prospect of higher recoveries for creditors than an immediate sale of assets. This had been attempted but had elicited offers which did not differ materially from the cash and bank balances of the Sino-Forest Group. The CCAA process is an insolvency procedure. It is an alternative to an immediate liquidation and, in its absence, immediate liquidation would be the only available option. However, the Restructuring Plan is a process to return to creditors what is owing to them and should, therefore, be viewed as being analogous to a liquidation, where the benefit of the Sino-Forest Group's assets belongs entirely to its creditors. Although, unlike a liquidation, New Holdco is not under a legal obligation or subject to a court supervised process to liquidate assets as soon as practicable, the ultimate objective of the Restructuring Plan was to realise assets to their best advantage.
31. On the parallels drawn with the A-S China transaction in 2007, the Ad Hoc Committee believed that the transactions between Sino-Forest and New Holdco were very different. The A-S China transaction was a commercial transaction entered into voluntarily between a willing buyer and willing seller. It was open for the purchaser not to buy the company controlling A-S China and it is apparent that the purchase price for the entire business was determined at least in part by the value of A-S China. It would also appear that the purchaser wanted to acquire all the shares in A-S China and to withdraw its listing in Hong Kong. Unlike the A-S China transaction, the Restructuring Plan was not being pursued for discretionary strategic reasons but rather as a method of achieving recoveries for creditors as a result of circumstances not of their making.

#### **The decision and reasons for it**

32. The Panel agrees with the Takeovers Executive's interpretation of Note 8 to Rule 26.1 in that its focus is quite narrow and that it simply looks at a transaction, whether it is an element of a larger one or not, in which statutory control of one company results in the acquisition or consolidation of control, as defined in the Takeovers Code, of a second company. It is apparent also that this has been how the Note has been interpreted in the past.
33. While it is undoubtedly part of a larger series of transactions, all of which are inter-conditional, New Holdco will acquire statutory control of SCGI and this company holds a controlling interest in Greenheart. In any circumstances when the control of a company which is subject to the provisions of the Takeovers Code is to be acquired consideration must be given to the possibility of a mandatory offer obligation arising. This is fundamental to the Takeovers Code, of which General Principles 1 and 2 and Rule 26.1 are at its heart. Note 8 states that a mandatory offer will not normally arise except if one of two criteria is met. Notwithstanding this, there is an injunction in all cases that come within the scope of the Note, irrespective of significance or purpose, for the Takeovers Executive to be consulted. Since it must have been apparent before applications were made to the Ontario Court that an element of the Restructuring Plan would come within the scope of the Note, the Ad Hoc Committee or its advisers ought to have consulted the Takeovers Executive at the outset. Much trouble may have been avoided had this been done.
34. The requirement under the Note to consult the Takeovers Executive is consistent with the provisions of Rule 26. Any acquisition of control gives rise to the potential of a mandatory offer and in all circumstances the Takeovers Executive needs be informed and the mandatory offer obligation will arise unless a waiver is granted by the Takeovers Executive. The wording of Note 6 to Rule 26.1 is instructive in this regard. The acquisition from one member of a concert group by another of a shareholding which equals or exceeds the percentage thresholds set out in Rule 26.1 will normally result in a

mandatory offer obligation arising unless this obligation is waived by the Takeovers Executive. This would include the acquisition of a controlling interest by one wholly-owned subsidiary from another. While a waiver is normally granted by the Takeovers Executive in this circumstance, the Panel was told by the Takeovers Executive that it would not be if the purpose was to restructure a group of companies in order to avoid a chain principle offer. In all cases, applicants are required to give the reasons for an inter-group transfer before a waiver is granted by the Takeovers Executive.

35. Further, the Panel considers that Note 8 to Rule 26.1 does not differentiate one kind of transaction from another on the basis of the circumstances that caused it to be entered into. It applies equally to a debt restructuring as to any other commercial arrangement which comes within its scope.
36. If the transaction involving the transfer to New Holdco of statutory control of SCGI comes within the scope of Note 8 to Rule 26.1 and the Note is to be read with this transfer in isolation view, then it is clear that the controlling interest in Greenheart is significant when compared to SCGI as Greenheart constitutes more than 60% of SCGI's assets and revenues. Since the test of significance is met, it is not necessary to look to the main purposes of the transaction.
37. The Panel also agrees with the Takeovers Executive that the Restructuring Plan is not analogous to the appointment of a liquidator or receiver and that accordingly the dispensation under Note 2 of the dispensations from Rule 26 will not be available to New Holdco. In normal circumstances the Note only applies to the appointment of a liquidator or receiver as these terms are generally understood in Hong Kong.
38. It was also apparent that arrangements involving companies and parties which for the most part have no connection with Hong Kong have become snagged by the provisions of the Takeovers Code. The Panel, therefore, has considered whether to exercise its discretion to waive the requirement for New Holdco to make a mandatory offer for the shares in Greenheart not owned by it or parties acting in concert with it immediately after the Restructuring Plan is implemented. This discretion is given in Section 2.1 of the Introduction to the Takeovers Code, quoted above, and in the wording of Rule 26.1 itself.
39. While the Panel has considerable sympathy for the predicament in which the Ad Hoc Committee now finds itself, the Panel considers that the meaning of the wording of Note 8 to Rule 26.1 and its implications for parties considering the acquisition of statutory control of a company which in turn holds a controlling interest in another company to which the provisions of the Takeovers Code applied were clear; they were operating in the manner for which they were designed and how they had been interpreted previously. In view of this it does not appear that there were proper grounds to modify the application of Note 8 based on the provisions of Section 2.1 of the Introduction to the Takeovers Code. The Note is intended to place parties on notice that the transfer of an indirect holding of a controlling interest always comes within the provisions of the Takeovers Code which is why the Takeovers Executive should always be consulted. Clearly this consultation is more sensibly made in advance of the finalisation of arrangements, rather than afterwards, as in the present case.
40. While Rule 26.1 itself allows for the waiver of the mandatory offer obligation the Panel considers that it would be setting a dangerous precedent were it to waive a mandatory offer obligation for reasons other than those specifically set out in Rule 26 and its Notes. For these reasons, the Panel decides that it is not appropriate for it to exercise its discretion to waive the mandatory offer obligation on the part of New Holdco in relation to Greenheart and, accordingly, were the Restructuring Plan to be implemented in accordance with its present terms, a mandatory offer obligation for Greenheart would be triggered.



Parties to the hearing:

The Takeovers Executive

Moelis & Company – Financial advisers to the Ad Hoc Committee

Hogan Lovells – Legal advisers to the Ad Hoc Committee in Hong Kong

Goodmans LLP (by telephone) – Legal advisers to the Ad Hoc Committee in Canada

31 January, 2013