From: David M Webb
Sent: Wednesday, September 30, 2009 12:03
To: response
Cc:
Subject: Consultation on Rights Issues and Open Offers
Dear Sir/Madam,

I attach an article and the views of 207 respondents to an opinion poll on Webb-site.com regarding your consultation paper on Rights Issues and Open Offers, which form part of this submission. Any person could participate in the poll with a valid e-mail address and corresponding PIN code.

The poll shows that there is 87% support for setting a maximum discount on open offers, something your consultation did not even propose, but which I think is essential to bring Hong Kong into line with international best practice and prevent abuse of minority shareholders through dilution. 87% of respondents supported adopting 10% as the discount limit, which is the standard in the UK Listing Rules.

There is deep concern about your proposal to shorten the cum-entitlements trading period for open offers to as little as 2 days, given that after the shares go "ex-entitlements", there is no way for the holder to sell his entitlements. 90% of respondents supported requiring a minimum of 7 trading days cum-entitlements (i.e. 10 trading days' notice of book closure) for open offers, which would be equivalent to the existing 14 calendar days notice period for book closure but removes the problem of bank holidays.

75% of respondents supported imposing a requirement that listed companies must strive to protect inactive entitlement-holders by selling the unsubscribed shares in the market if a premium above issue price can be obtained for them, and remitting the proceeds to the holders (subject to a *de minimis* amount). This, again, would bring HK into line with international best practice, as seen in the UK. Under current HK rules, unsubscribed entitlements often just benefit underwriters or the active shareholders who apply for them in an "excess entitlements" system, but this takes value away from those who are entitled to it. The system should protect a person's property even when they are asleep, but the current system is "you snooze, you lose".

Finally, 84% of respondents called for an end to your current practice of allowing stocks to trade "ex-entitlements" even before shareholders have approved the distribution or other entitlement in general meeting. This will reduce the risk of a shareholder selling his house and later discovering that his furniture and car was included in the deal. This is particularly dangerous in the case of large entitlements such as special dividends or deep-discount rights issues, but it should apply in all circumstances.

Yours sincerely,

David M. Webb
Editor, Webb-site.com

HKEx rights issue & open offer proposals

7th September 2009

On 31-Jul-09, HKEx announced a consultation on proposed amendments to the Listing Rules on the timetable of rights issues and open offers. The main proposals are:

- Shorten the notice period for book closure for rights issues and open offers from 14 calendar days to five business days with at least two uninterrupted trading days for trading in securities whose holders are entitled to the subscription rights.
- Amend the minimum subscription period for rights issues and open offers from 14 calendar days to 10 business days.

Poll | Results | More polls | Get PIN

Poll closed: 18:00:00 25-Sep-2009

email address PIN

Fetch

1. Do you agree that there should be a discount limit on open offers, to reduce dilution?

Select

2. If so, then what should the discount limit be?

Select

3. Should we keep at least 7 business days to sell shares before they go "ex" an open offer?

Select

4. After a rights issue or open offer closes, should any net premium from sale of unsubscribed entitlements be paid to their holders?

Select

5. Should HKEx allow trading "ex" an entitlement even before shareholders have approved it?

Select

Taking these in reverse, *Webb-site.com* supports the second proposal, which resolves problems when bank holidays fall in the middle of the offer period, shortening the effective decision time.

As for the first proposal, we support it in relation to rights issues, but not for open offers. In making this proposal, HKEx failed to take account of the fundamental difference between a rights issue and an open offer. Both are offers of new shares proportionate to existing shareholdings, usually at a discount to market price at the time of the announcement, but in a rights issue, the shareholder can choose either to subscribe for his entitlement, or to sell his rights in the market. This allows him to recover the value of the discount at which shares are offered, if he chooses not to invest more cash in the company. In an open offer, the entitlements cannot be separated from the existing shares. The holder must either put up the cash or suffer dilution from the discount at which the shares are issued to other shareholders or to the underwriters. The only way out of this is to sell his shares before the open offer starts, and even then, the anticipated weight of hostages rushing for the exit may crush him on the way out.

Now, the HKEx proposal makes this problem even worse. At present, you normally have at least 7 business days in which to sell your shares before they start trading without the entitlement to the new shares, or "ex-entitlement". Once the shares trade ex-entitlement, the share price will reflect the full impact of the discount in the open offer or rights issue. For a rights issue, this is OK, because *ceteris paribus* (all other things being equal) the value lost in the share price is matched by the value of your rights, which you can sell in the market. But for an open offer, that's the end of the game. **Under HKEx's proposal, you might have only two trading days in which to rush for the exit and sell your shares before they go ex-entitlement for the open offer.**

Dilution damage calls for discount limit

Because of the dilution damage caused by deep-discount open offers, UK Listing Rule 9.5.10 limits the discount to 10% to market price. **Hong Kong continues to disrespect shareholder rights and the consultation paper makes no proposal to limit the discount on open offers**, even though we have been making this point since 1999. Until this changes, HK shareholders will continue to be held hostage to the discount gun of open offers. A few years ago, HK even introduced a 20% discount limit for placings under the general mandate, a feeble step in comparison to the 5% limit in the UK, but still there is no limit whatsoever for open offers.

You might think that you would still have some forewarning of an open offer, because the company would need to call a shareholders' meeting first. Think again. A HK-listed company can launch a rights issue or open offer involving an increase of up to 50% in the number of issued shares (or 1 new share for every 2 shares held) without shareholder approval, provided that it has sufficient authorised but unissued share capital, as most do.

You snooze, you lose

The paper also fails to address another problem with HK rights issues and open offers, namely that companies do not have to account to holders for the value of their entitlements which are not subscribed. So in a HK rights issue, if you snooze, you lose. Someone else will take your rights, and you won't be paid for them. In HK, the unsubscribed rights either go straight to the underwriter (even if a premium could have been obtained in the market) or are allocated by the board to so-called "excess applications".

By comparison, HSBC, which is bound by the UK Listing Rules, paid holders (including HK holders) the value of their unsubscribed rights. The 172.7m shares were placed in the market at 448p/HK$51.83, and the difference from the 254p issue price was paid to the rights holders, worth about GBP335m (HK$3.88bn) less expenses. This is an important protection if you are unaware of the rights issue or open offer or missed a deadline.

Trading ex-entitlements which may not come

There's one more thing. In HK, the stock exchange still allows shares to be traded ex-entitlements even before a shareholder meeting to approve the distribution, whether it is a dividend, rights issue, open offer or demerger. The implication is either that the Exchange thinks shareholder meetings in a controlled-company environment are a trivial formality and nearly-certain to approve things, or the Exchange is reckless in allowing people to sell their shares without knowing whether they will get the entitlement they think is coming to them. The uncertainty of trading ex-entitlements when an entitlement might be voted down creates the risk of disorderly markets. For example, if a company proposes a special dividend conditional on a connected transaction being approved, then independent shareholders might buy the shares ex-dividend and then vote down the deal, benefitting from the company's retention of its cash.

For a buyer ex-entitlements, this is like buying an empty home and then discovering that that the previous owner has left it fully-furnished, against his wishes.

Take the opinion poll

Respond directly to HKEx

Poll results: Rights issues & open offers

Current time:	11:22:45 30-Sep-2009
Closing time:	18:00:00 25-Sep-2009
Time remaining:	**Poll closed**

Introduction

Read our article on the HKEx proposals for rights issues and open offers, and then submit your votes. The poll results (without names) will be submitted to HKEx.

Questions

1. Do you agree that there should be a discount limit on open offers, to reduce dilution?

Answer	Responses	Share
Yes	181	87.4%
No	21	10.1%
Undecided	5	2.4%
Total	207	100.0%

2. If so, then what should the discount limit be?

Answer	Responses	Share
10% (UK limit)	166	87.4%
20%	17	8.9%
More than 20%	7	3.7%
Total	190	100.0%

3. Should we keep at least 7 business days to sell shares before they go "ex" an open offer?

Answer	Responses	Share
Yes	185	90.2%
No	12	5.9%
Undecided	8	3.9%
Total	205	100.0%

4. After a rights issue or open offer closes, should any net premium from sale of unsubscribed entitlements be paid to their holders?

Answer	Responses	Share
Yes	154	75.1%
No	32	15.6%
Undecided	19	9.3%
Total	205	100.0%

5. Should HKEx allow trading "ex" an entitlement even before shareholders have approved it?

Answer	Responses	Share
Yes	20	9.7%
No	174	84.5%
Undecided	12	5.8%

Total	206	100.0%