COMMENTS RE ON-MARKET SHARE REPURCHASE WAIVERS

We refer to the November 2004 Consultation Paper on a review of the Codes on Takeovers and Mergers and Share Repurchases. We have been requested by CLP Holdings Limited ("CLP") to make a submission on its behalf in response to the Consultation Paper's proposals with regard to whitewash waivers for on-market share repurchases (paragraphs 120-137 of the Paper which deals with Rule 32.1 of the Takeovers Code and Rule 6 of the Share Repurchases Code).

The independent non-executive directors of CLP have been advised of the Company's intention to make a submission in this respect and have expressed their support. In doing so, CLP and the independent non-executive directors have borne in mind CLP's previous unsuccessful application to the SFC and to the Panel for a whitewash waiver in respect of the Company's own on-market share repurchase programme.

In this regard, we refer to papers and presentations already submitted to the Executive and the Panel, including our submission to the Executive dated 28th October, 2003 (which is also on CLP's website at www.clpgroup.com.)

CLP presented the case that its successful share repurchase programme should be allowed to continue. The programme has been halted since 2002 in circumstances where, without a whitewash waiver, the interest of the Kadoorie family, currently 34.8%, would exceed the trigger point for a mandatory offer (in this case 35%) if CLP were to repurchase a further approximately 11 million CLP shares.

In summary, the arguments presented were :

(i) there are sound financial reasons for companies to operate share repurchase programmes;
(ii) share repurchases by general offer and off-market share repurchases are already whitewashable in Hong Kong;
(iii) international practice is to allow on-market share repurchases to be whitewashable too;
(iv) it seems implausible that on-market share repurchases would be used to consolidate control when more effective means of doing so (asset injections, underwriting, share repurchases by general offer) are already whitewashable;
(v) if there are corporate governance concerns, they can be adequately addressed by administrative rules; and
(vi) the Code as interpreted and applied by the SFC prevents companies giving effect to the overwhelming support given by shareholders in general meeting to share repurchase mandates.

These arguments were given a full hearing during 2003 and we continue to believe they are valid. We note that certain of these points have been mentioned or referred to in paragraphs 120-137 of the November 2004 Consultation Paper. We would like to make the following comments on those paragraphs of the Consultation Paper.

A. General comment

We think it is a pity that the Executive continues to "demonise" on-market share repurchases in particular (as opposed to share repurchases as a general principle). In paragraph 122, "some reservations about extending Rule 32 in this way" are expressed (although none of these were actually given by the Panel in its short ruling against CLP's application for a whitewash waiver). However, the points made in paragraph 122 are relevant to all dispensations from general offers. The Code already allows a broad range of exceptions, a number of which (as has been argued already) lend themselves more readily to abuse, if abuse is intended, than on-market share repurchases. It is no use defending this pass – it has already been sold.

The Executive states in paragraph 122 that there are a number of differences between the London and Hong Kong Codes. However, in all other references in the Consultation Paper, London practice is quoted approvingly or used as corroboration of the point made.

This demonisation is unfortunate conceptually, as it hinders recognition of the clear logic in favour of on-market share repurchases adopted in other markets with takeovers codes, that is :

- share repurchases are a legitimate financial tool;
- shareholders like them and vote readily to grant directors an annual mandate to carry them out;
- if the takeover code trigger point thwarts shareholders wishes in this respect, it is a straightforward matter for shareholders to give a whitewash to accommodate repurchases up to the mandate given.

The demonisation has also become a handicap practically. It leads the Executive to propose (in paragraphs 126ff) a number of (in our view) dubious restrictions on on-market repurchases as though they were inherently dangerous. If on-market share repurchases are to be whitewashable, then they should be whitewashable in a way which allows their benefits to be properly realised and not in a way which discourages their use.

The Executive suggests (in paragraph 120) that whitewashes are effectively only needed by directors and those acting in concert with directors because an unconnected shareholder would not "normally" be regarded as having triggered a mandatory bid obligation as a result only of share repurchases. This is not a satisfactory solution even for unconnected shareholders who have to put their faith in a retrospective exoneration and it does not provide a clear mechanism for the Company which wants to repurchase shares in these circumstances. Advance shareholder approval, through a whitewash, is a bright line test.

B. Comments on specific paragraphs/questions

1. Paragraph 123

It is true that if a whitewash is granted for a 12-month period, circumstances are likely to change during this period. However, international markets such as Singapore and the UK do not seem to view this as a great problem. The Board of the Company concerned would still have to act in the best interests of the Company in actually making any repurchase and would be constrained from repurchases when any unpublished price sensitive information was known to them.

Our answer to question 18 is obviously yes; however, we argue below that the provisions set out in paragraphs 126ff would to a large degree negate the purpose and benefits of making on-market share repurchases whitewashable; we question whether it would be worthwhile with such restrictions. The Code has already one area of considerable complexity – partial offers – where the freedom was given so grudgingly that it has for years mouldered virtually unused.

2. Paragraph 125

It is not clear whether you propose that the disclosure mentioned should relate to announcements of whitewash waivers for <u>all</u> types of share repurchases, or only on-market share repurchases. In the case of a whitewash to facilitate an on-market share repurchase, there may be no "firm intention" to repurchase shares – discretion is being sought to do so in circumstances which would benefit the Company but which may not, in the event, materialise.

The sixth (and longest) bullet point contains some items of doubtful value:

- earnings per share are almost bound to increase in a low interest rate environment;
- quantifying what working capital and liabilities are if the mandate is fully utilised may fall foul of the current harsh interpretation of profit forecast (Rule 10) and the use of pro forma financial information. It goes without saying that if shares are bought back, either cash will diminish or liabilities increase.

Question 19 : agreed, subject to the comments set out above.

3. Paragraph 126

This states that the whitewash is subject to "prior *consent*" by the Executive. It is not clear if this is intended to be more stringent than for a conventional whitewash, which has of course to be granted by the Executive, but is subject inter alia to prior *consultation* with the Executive. We do not think that the Executive should have any more discretion in this instance than it does in respect of other whitewash waivers.

Question 20 : agree, subject to the comment above.

4. Paragraph 127

If the rules are relaxed in respect of on-market share repurchases, it may be, to start with at least, that the relevant circular should contain similar information to other types of whitewash circulars. We note however, as previously drawn to your attention, that in the UK such circulars are very short with often just a passing reference for example to an IFA opinion. This is consistent with the international view that such waivers are routine matters, following on logically from shareholders' vote in favour of the share repurchase mandate.

We would propose, particularly if (as argued below) on-market share repurchase waivers are refreshed annually with the share repurchase mandate, that the fees in Schedule V should not be applied in full but should be capped at say HK$250,000. Some clarification on the method of calculating the fee may be needed, as the precise price of the share repurchase may not be known at the time of the waiver (see comments on paragraph 131 below).

Question 21 : agree, subject to comments above.

5. Paragraph 128

We do not see any useful purpose being served by separating these meetings. It flies in the face of the whole logic for whitewashing on-market share repurchases – that the need to do so stems directly from shareholders' approval, nearly always at the AGM, for the share repurchase mandate itself. In addition, it imposes an extra administrative burden and expense on companies and will no doubt irritate shareholders who are asked to turn up twice in say two days. We vigorously oppose this suggestion. If, although there is no compelling reason to do so, the SFC maintains the concept of split meetings, the consideration of the waiver could take place at an Extraordinary General Meeting convened immediately after the Annual General Meeting.

Question 22 - no in respect of the meeting date;
- yes in respect of the poll and announcement.

Question 23 - as stated above, we see the waiver as inextricably linked with the share repurchase mandate and on these grounds consider the threshold should be (i) 50%, i.e. the same as for the repurchase mandate.

However, if the whole question of introducing whitewashes for on-market share repurchases were considered to turn on having the resolution approved by a super-majority, we would be prepared to accept this as we believe such whitewashes would be overwhelmingly supported by independent shareholders.

6. Paragraph 129

We believe this proposal is little short of disastrous for the proper working of share repurchase programmes. The timing of a share repurchase programme to enhance shareholders' interests is difficult to predict and may depend, inter alia, on volatile market conditions. If directors wait for such conditions to occur before even applying for a waiver, the necessary two months or so for procedures to be completed is likely to be too cumbersome. If directors apply in advance and the validity is only for three months, it is perfectly possible that conditions will not be suitable during the period. They will then have put the Company into the double jeopardy of not being able to propose another waiver for 6 months. We consider that these restrictions so fundamentally misconstrue and undermine the reasons for and benefits of a share repurchase programme that such a change might be worse than the status quo.

Question 24 : we are most strongly opposed to this proposal. We note that you do not even propose an annual validity (12 months period) which we regard as by far the most logical and practical arrangement and which applies in other jurisdictions, notably Singapore and the UK. In any event, we see no reason why the period of validity of the waiver should not coincide with that of the share repurchase mandate.

7. Paragraph 130

We agree that a restriction on total repurchases is appropriate. In keeping with our link of this type of waiver to the share repurchase mandate, we believe a 10% restriction is most appropriate. However, 5% would be acceptable.

8. Paragraph 131

We agree that a price limit at which share repurchases could be made is desirable. However, we do not think it should be linked to the price at the time of the Rule 3.5 announcement. Indeed, as noted in our comment on paragraph 125 above, it is debatable whether any "firm intention" exists at this stage. With respect, we do not think this proposal is consistent with the price restriction in Listing Rule 10.06(2)(a), which clearly refers to the price level at the time of the repurchase (and not, for example, to the price at which the share repurchase mandate was approved). We put forward a proposal on pricing in our 28th October, 2003 submission which was "the higher of 105% of 5 days average or 120% of 30 days average [price before the repurchase takes place]". The reason for two ranges was to cater for circumstances where the price might have fallen steeply just before the repurchases were desired to be made, which is quite possible in volatile conditions, leaving the purchase price stranded.

Question 26 : price restrictions : as previously proposed.

Question 27 : cash consideration only : agree.

Question 28 – we prefer Option 3 (for its maximum flexibility) but would accept Option 2.

Question 29 – extending restrictions on dealings to directors and persons acting in concert with them : agree

Question 30 – restrictions apply from the date of the Rule 3.5 announcement to the end of the mandate period : agree

Question 31 – content of announcement after the repurchase : agree

13th January, 2005