

Practice Note 21 (PN21) – Note 6(a) to Rule 26.1 – Acquisitions of voting rights by members of concert group

1. The purpose of this Practice Note is to provide guidance on the grant of waivers of the mandatory offer obligation under Note 6(a) to Rule 26.1 of the Takeovers Code.
2. Rule 26.1 lies at the heart of the Code and sets out circumstances when a mandatory takeover offer obligation is incurred. This reflects a fundamental principle of the Takeovers Code that all shareholders must be treated equally as set out in General Principle 1 which reads:

“All shareholders are to be treated even-handedly and all shareholders of the same class are to be treated similarly.”

3. Rule 26.1 requires a general offer to be made in the event that a person acquires 30% or more of the voting rights attaching to the shares of a company to which the Takeovers Code applies, unless such obligation is waived as follows:

“Subject to the granting of a waiver by the Executive, when

- (a) any person acquires, whether by a series of transactions over a period of time or not, 30% or more of the voting rights of a company;*
- (b) two or more persons are acting in concert, and they collectively hold less than 30% of the voting rights of a company, and any one or more of them acquires voting rights and such acquisition has the effect of increasing their collective holding of voting rights to 30% or more of the voting rights of the company;*
- (c) any person holds not less than 30%, but not more than 50%, of the voting rights of a company and that person acquires additional voting rights and such acquisition has the effect of increasing that person’s holding of voting rights of the company by more than 2% from the lowest percentage holding of that person in the 12 month period ending on and inclusive of the date of the relevant acquisition; or*
- (d) two or more persons are acting in concert, and they collectively hold not less than 30%, but not more than 50%, of the voting rights of a company, and any one or more of them acquires additional voting rights and such acquisition has the effect of increasing their collective holding of voting rights of the company by more than 2% from the lowest collective percentage holding of such persons in the 12 month period ending on and inclusive of the date of the relevant acquisition;*

that person shall extend offers, on the basis set out in this Rule 26, to the holders of each class of equity share capital of the company, whether the class carries voting rights or not, and also to the holders of any class of voting non-equity share capital in which such person, or persons acting in concert with him, hold shares (see also Rule 36)...

4. The Takeovers Code treats persons acting in concert as being the equivalent of a single person and aggregates their shareholdings. However, there will be circumstances when the acquisition of voting rights by one member of a group acting in concert from another member of the concert group or from a non-member may give rise to an obligation to make a general offer under Rule 26.1 of the Takeovers Code. In addition, if the holdings or make-up of the group changes, a general offer may be required. This is provided for in Note 1 to Rule 26.1 which states:

“...There may also be circumstances where there are changes in the make-up of a group acting in concert that effectively result in a new group being formed or the balance of the group being changed significantly. This may occur, for example, as a result of the sale of all or a substantial part of his shareholding by one member of a concert party group to other existing members or to another person. The Executive will apply the criteria set out below, and in particular in Note 6(a) and Note 7 to this Rule 26.1 and may require a general offer to be made even when no single member holds 30% or more.”

5. Note 1 reflects the broad principle that changes in a concert party group structure should not be used as a back door route to gain or consolidate control. Note 1 further provides that the Executive will apply the criteria set out in the notes to Rule 26.1 with particular attention paid to Note 6(a) and Note 7 in examining whether control has effectively been obtained or consolidated even though no single member holds 30% or more.
6. Given its central importance in the regulation of takeovers and mergers in Hong Kong, Rule 26.1 is very strictly regulated. Under Note 6(a) to Rule 26.1, the Takeovers Code envisages that acquisitions by one member of a concert party from another which cause the purchaser's shareholding to cross a threshold in the Code will “normally” result in an obligation to make a general offer for the outstanding shares in the relevant company. This is the starting position. Waivers are therefore a concession which are granted only in a comparatively narrow range of circumstances. Note 6(a) sets out the criteria used to support the grant of a waiver of the mandatory offer obligation.
7. Any application for a ruling under the Takeovers Code or Share Buy-backs Code (collectively the “Codes”) must be made in accordance with section 8 of the Introduction to the Codes. The submission should be comprehensive and contain all relevant information including the certification required under section 8.3. Applicants are reminded to provide details of any relevant dealings in the previous six months as required by section 8.1(ix). It may at times be necessary to provide details of relevant dealings for the previous 12 months to establish, for instance, that the concert group has continuously held over 50% in the relevant period.

8. Notes 6(a)(i) and (ii) provide the following:

“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; or*
- (ii) the acquirer is a member of a group of persons comprising an individual, his close relatives and related trusts, and companies controlled by him, his close relatives or related trusts, and the acquirer has acquired the voting rights from another member of such group of persons.”*

9. Points to note about Notes 6(a)(i) and (ii):

- (a) Notes 6(a)(i) and (ii) are confined to acquisitions by a member of a concert group from another member of the concert group when the relationship is particularly close, being either a company with its subsidiaries or an individual together with his/her close relatives, related family trusts and companies controlled by the individual or close relatives.
- (b) Note 6(a)(i) relates to a group consisting of a parent company and its subsidiaries and is interpreted strictly in accordance with the definition of “subsidiary” in the Takeovers Code. The exclusion of associated companies (which are included in class (1) of the presumption of acting in concert in the Codes as presumed concert parties) is intentional. Unless a parent subsidiary or fellow subsidiary relationship can be demonstrated, based on the definition of “subsidiary” in the Takeovers Code, the concession provided for in sub-paragraph (i) will not be available.
- (c) Similarly, Note 6(a)(ii) is interpreted strictly. The application of Note 6(a)(ii) by its wording, and as it has been applied for many years by the Executive, relates specifically to transfers between persons who are closely related, that is family members.

10. If Notes 6(a)(i) and (ii) do not apply, Note 6(a) sets out the following criteria that “will” be taken into account in considering whether to grant a waiver:

“In addition to the factors set out in Note 7 to this Rule 26.1, the factors which the Executive will take into account in considering whether to waive the obligation to make an offer include:–

- (1) 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;*
- (2) the price paid for the shares acquired; and*

- (3) *the relationship between the persons acting in concert and how long they have been acting in concert.”*

11. Points to note:

- (a) Whilst Note 6(a) provides that the above criteria “will” be taken into account, it is clear that the Executive and the Takeovers Panel may also take into account all other relevant facts and circumstances.
- (b) In determining the leader of the concert group for the purpose of Note 6(a)(i) above, the focus will be on the holder or controller of the relevant voting rights. The fact that one member of the concert group may have taken a leading role in terms of managerial and executive decisions is unlikely of itself to be determinative.
- (c) In many cases where a waiver under Note 6(a) is granted, no premium is paid for the acquired shares. A substantial or atypical premium paid for the shares acquired would normally indicate a premium for control and therefore be an important factor in determining whether the grant of a waiver under the Note is appropriate. However, the absence of a control premium is unlikely of itself to be determinative of whether it is appropriate to grant a waiver under Note 6. Each case will rest on its own facts and circumstances.
- (d) The relationship between the persons acting in concert and how long they have been acting in concert are fact specific matters and often necessitate the Executive raising enquiries. The Executive should be given sufficient time to raise enquiries and analyse the responses.
- (e) Note 6(a) provides that the factors set out in Note 7 to Rule 26.1 may also be relevant in considering whether to grant a waiver under Note 6(a). These factors include whether (i) the vendor was an “insider”; (ii) there is a payment of a very high price for the voting rights; (iii) the parties negotiate options over the retained voting rights; and (iv) the purchaser’s nomination of board representation is supported by the vendor. Again these factors are highly fact specific and are examined on a case-by-case basis.

Announcement of ruling granted

12. In the interests of transparency and to ensure an informed market, the Executive strongly encourages an applicant to inform the offeree company promptly about a waiver granted under Note 6. The offeree company should, with regard to other applicable statutory disclosure obligations, consider announcing that the waiver has been granted. The Executive also has the discretion to publish important rulings where the rulings are considered to have general application under section 16 of the Introduction to the Codes.

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