

Practice Note 25 (PN25) – Guidance Note on the application of the Codes on Takeovers and Mergers and Share Buy-backs (Codes) following the abolition of the Special Regulations and the Mandatory Provisions and other matters relating to offers for A and H shares of a listed issuer

Background

1. On 17 February 2023, the State Council of the PRC and the China Securities Regulatory Commission (**CSRC**) announced the implementation of the New PRC Regulations¹ for overseas listings of Mainland enterprises. The New PRC Regulations, which will become effective on 31 March 2023, replace the Special Regulations² and the Mandatory Provisions³.
2. Under the Special Regulations, the ordinary shares of PRC issuers are divided into: (i) domestic shares (including listed A shares) which are denominated in RMB; and (ii) overseas listed foreign shares which are denominated in foreign currencies, such as H shares being denominated in HK\$.
3. The Mandatory Provisions provide the standard provisions that must be incorporated in the articles of association of overseas listed PRC-incorporated companies. These provisions set out the rights and obligations of these issuers and their shareholders, including shareholder protection requirements. The Mandatory Provisions also deem domestic shares and H shares as different classes of shares, despite both being ordinary shares. Therefore, class meeting requirements apply where a PRC issuer proposes to vary or abrogate the rights attached specifically to one particular class of shares.
4. The New PRC Regulations require PRC H Share Issuers to conform their articles of association to a new set of standard articles of association. Under the new standard articles of association, domestic shares and H shares are no longer deemed as different classes of shares, effectively removing the class meeting requirements now applicable to domestic shares and H shares.

¹ The “Decision of the State Council to Repeal Certain Administrative Regulations and Documents” (《國務院關於廢止部分行政法規和文件的決定》) issued by the State Council of the PRC on 17 February 2023 and the “Trial Administrative Measures of Overseas Securities Offering and Listing by Domestic Companies” (《境內企業境外發行證券和上市管理試行辦法》) and related guidelines issued by the CSRC on 17 February 2023 (together, **the New PRC Regulations**).

² The Special Regulations on the Overseas Offering and Listing of Shares by Joint Stock Limited Companies (《國務院關於股份有限公司境外募集股份及上市的特別規定》) issued by the State Council of the PRC on 4 August 1994, as amended, supplemented or otherwise modified from time to time (**Special Regulations**).

³ The Mandatory Provisions for Companies Listing Overseas set forth in Zheng Wei Fa (1994) No. 21 (《到境外上市公司章程必備條款》) (證委發(1994) 21 號文件) issued on 27 August 1994 by the State Council Securities Policy Committee and the State Commission for Restructuring the Economic System (**Mandatory Provisions**).

5. Following the repeal of the Special Regulations and the Mandatory Provisions and the implementation of the New PRC Regulations (**PRC Rule Change**), the Executive believes that the current application of the Codes to PRC issuers will remain largely the same, with certain modifications. The Executive recognises that domestic shares (in particular, A shares) and H shares are traded in separate markets with different regulatory and market environments. Therefore, although H shares and domestic shares are one single class of shares under PRC law, the fact that H shares and domestic shares are not directly fungible with each other warrants a different approach when applying certain provisions of the Codes to PRC H Share Issuers.

Purpose

6. The purpose of this Guidance Note is to provide guidance to PRC H Share Issuers and market practitioners on the application of the Executive's approach towards a number of relevant Codes provisions following the PRC Rule Change. For the purpose of this Guidance Note, a **PRC H Share Issuer** is a company whose H shares are listed on the Hong Kong Stock Exchange (**Stock Exchange**).

Relevant Rules under the Codes

Takeovers Code provisions

Definition of "Associate" and Rule 22 – Disclosure of dealings during an offer period

7. Class (6) associates is defined under the Codes to include a person who owns or controls 5% or more of any class of relevant securities (as defined in paragraphs (a) to (d) in Note 4 to Rule 22 of the Takeovers Code) issued by an offeror or potential offeror or the offeree company, including a person who as a result of any transaction owns or controls 5% or more.
8. Dealings by a person who holds a substantial stake in an offeree company is material and relevant information in the context of an offer. This is particularly so when a person has a veto right in a take-private offer or delisting proposal. Following the PRC Rule Change, the Stock Exchange has proposed that the Listing Rules will retain the requirement for shareholders' approval for a withdrawal of listing of H shares to be approved only by holders of H shares⁴. Similarly, and as further explained below, the Executive will continue to require the relevant H share delisting resolutions to remain limited to voting by holders of H shares only.
9. In the light of the above, for the purpose of determining whether a party is a class (6) associate under the Codes, H shares will be treated as a separate class of shares from domestic shares (whether unlisted or A shares). In other

⁴ See the Consultation Paper on "Rule Amendments Following Mainland China Regulation Updates and Other Proposed Rule Amendments Relating to PRC Issuers" published by the Stock Exchange on 24 February 2023.

words, whether a holder of H shares is a class (6) associate should be determined by reference to the total issued H shares only, and not to the entire issued share capital of the PRC H Share Issuer. This ensures material and relevant information from dealings by a person holding a substantial stake in H shares are captured and disclosed under Rule 22 of the Takeovers Code. For A shares and unlisted domestic shares, given that the base position under PRC law is that they are the same class of shares, the Executive will treat A shares and unlisted domestic shares as the same class for the purposes of determining any such class (6) associates.

Rules 2.2 and 2.10 – Delistings and privatisations

10. Rule 2.2 of the Takeovers Code provides that *“[i]f after a proposed offer the shares of an offeree company are to be delisted from the Stock Exchange, neither the offeror nor any persons acting in concert with the offeror may vote at the meeting, if any, of the offeree company’s shareholders convened in accordance with the Listing Rules. The resolution to approve the delisting must be subject to:–*
 - (a) *approval by at least 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy at a duly convened meeting of shareholders;*
 - (b) *the number of votes cast against the resolution being not more than 10% of the votes attaching to all disinterested shares; and*
 - (c) *the offeror being entitled to exercise, and exercising, its rights of compulsory acquisition.”*
11. Rule 2.10 provides that *“[e]xcept with the consent of the Executive, where any person seeks to use a scheme of arrangement or capital reorganisation to acquire or privatise a company, the scheme or capital reorganisation may only be implemented if, in addition to satisfying any voting requirements imposed by law:–*
 - (a) *the scheme or the capital reorganisation is approved by at least 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy at a duly convened meeting of shareholders; and*
 - (b) *the number of votes cast against the resolution to approve the scheme or the capital reorganisation at such meeting is not more than 10% of the votes attaching to all disinterested shares.”*
12. Note 6 to Rule 2 further provides that *“[f]or the purpose of Rules 2.2, 2.10 and 2.11, “disinterested shares” means shares in the company other than those which are owned by the offeror or persons acting in concert with it. Where an offeree company has more than one class of share capital, the requirements in Rules 2.2, 2.10 and 2.11 will normally apply separately in respect of each class.”*

13. A take-private offer or a delisting proposal of the H shares for a PRC H Share Issuer (and for this purpose includes take-private by way of a merger by absorption under PRC law) affects the interests of its holders of H shares to a much larger extent compared to its other shareholders.
14. Prior to the PRC Rule Change, a separate class approval from holders of H shares is required for transactions that would result in a delisting of H shares, pursuant to the requirement under Note 6 to Rule 2. This ensures that the interests of holders of H shares are adequately protected.
15. This approach with respect to Rules 2.2 and 2.10 will remain after the PRC Rule Change. As any proposal to privatise or delist H shares will significantly impact holders of H shares and their interests are considered to be materially different compared to holders of domestic shares (whether unlisted or A shares), the Executive considers that holders of H shares should continue to benefit from the protection that it had prior to the PRC Rule Change. Accordingly, any approvals under Rules 2.2 and 2.10 should be decided by holders of H shares only.

Rule 14 – Offers for more than one class of equity shares

16. Rule 14 stipulates that “[w]here a company has more than one class of equity share capital, a comparable offer must be made for each class whether such capital carries voting rights or not. The Executive must be consulted in all such cases. The comparable offer or proposal for each class of share capital required by this Rule 14 should normally be subject to similar conditions. It may, however, be put by way of a scheme to be considered at meetings separately in respect of each class of the equity share capital.”
17. A Rule 14 comparable offer for A shares is usually required during an offer made for H shares of a PRC H Share Issuer unless waived by PRC regulatory authorities. We also normally waive the requirement to make a Rule 14 comparable offer for other classes of equity securities if agreed by all holders of such other classes of securities of the PRC H Share Issuer, such as in the form of an undertaking not to accept the offer.
18. Similarly, when an offer is made for the A shares of a PRC H Share Issuer, the Takeovers Code will require a comparable H share offer to be made contemporaneously.
19. Given the inherent differences in the trading prices and currencies of, and the markets for, A shares and H shares of PRC H Share Issuers, and the fact that A shares and H shares are not directly fungible, the practice of treating A shares, H shares and other equity securities of a PRC H Share Issuer separately will remain after the PRC Rule Change. Accordingly, comparable offers for such different securities pursuant to Rule 14 will remain after the PRC Rule Change.
20. Set out below is the Executive’s approach to calculating the offer price for the H shares of a PRC H Share Issuer by reference to the A share offer price, taking into account the disparity of trading prices in the two markets:

Step 1

To convert the offer price per A share into HK\$. This is done using the RMB to HK\$ exchange rate quoted by The People's Bank of China (**PBOC**) on the date of the Rule 3.5 announcement (or if none, on the most recent date quoted by the PBOC prior to the date of the Rule 3.5 announcement).

Step 2

To determine the ratio (**R**) of the average daily VWAP (volume weighted average trading price) per H share for the last 6 months ending on the last trading day prior to the publication of the Rule 3.5 announcement to the average daily VWAP per A share over the same period, that is:

$$R = \frac{\text{average daily VWAP per H share for the last 6 months ending on the last trading day prior to the publication of the Rule 3.5 announcement}}{\text{average daily VWAP per A share for the last 6 months ending on the last trading day prior to the publication of the Rule 3.5 announcement}}$$

Note 1: *In calculating the above denominator, the daily VWAP per A share must first be converted from RMB to HK\$ using the RMB to HK\$ exchange rate quoted by the PBOC on each applicable date (i.e. the VWAP per A share on each trading date must first be converted into HK\$ using the applicable PBOC exchange rate quoted on the same date before taking the average of all the VWAP during the relevant period).*

Note 2: *If there are material differences in the number of trading days for the A shares and the H shares during the applicable 6 month period, practitioners should consult the Executive for alternative trading periods for the purpose of calculating "R".*

Step 3

To determine the offer price for H shares. This is done by multiplying the figure in Step 1 to the ratio R calculated in Step 2.

21. The Executive will apply the same approach in:
 - (a) determining the applicable fee for a whitewash document relating to PRC H Share Issuers (for example, where a mandatory general offer obligation is triggered as a result of a subscription of A shares and the offeror seeks a whitewash waiver from such obligation, the value of the H share offer being "whitewashed" will be calculated using the above approach); and

- (b) determining the applicable “highest price” for an H share offer resulting from purchases of A shares (e.g. under Rules 24 and 26.3).
22. With respect to determining the H share offer price by reference to a purchase of domestic shares, the principles set out in the Panel’s Sanmenxia Decision⁵ will apply. In summary, the Executive will simply convert the RMB purchase price for the domestic shares into HK\$ at the applicable PBOC exchange rate.

Rule 23 – Nature of consideration to be offered

23. Rule 23.1 envisages a scenario where a cash offer is required. It provides that “[e]xcept with the consent of the Executive ..., a cash offer is required where:–
- (a) *the shares of any class under offer in the offeree company purchased for cash (but see Note 5 to this Rule 23.1) by an offeror, and any person acting in concert with the offeror, during the offer period and within 6 months prior to its commencement carry 10% or more of the **voting rights** (emphasis added) currently exercisable at a class meeting of **that class** (emphasis added) in which case the offer for that class shall be in cash or accompanied by a cash alternative at not less than the highest price paid by the offeror or any person acting in concert with it for shares of that class during the offer period and within 6 months prior to its commencement;*
- (b) *subject to paragraph (a) above, shares of any class under offer in the offeree company are purchased for cash (but see Note 5 to this Rule 23.1) by an offeror or any person acting in concert with it during the offer period, in which case the offer for that class shall be in cash or accompanied by a cash alternative at not less than the highest price paid by the offeror or any person acting in concert with it for shares of that class during the offer period; or*
- (c) *in the view of the Executive there are circumstances which render such a course necessary in order to give effect to General Principle 1.”*

Rule 23.2 further provides that “[w]here purchases of any class of the offeree company shares carrying 10% or more of the voting rights currently exercisable at a class meeting of that class have been made by an offeror and any person acting in concert with it in exchange for securities in the 3 months prior to the commencement of and during the offer period, such securities will normally be required to be offered to all other holders of shares of that class...”

24. Prior to the PRC Rule Change, A shares, H shares and unlisted domestic shares are regarded as separate classes of shares. The application of Rule 23.1(a) and 23.2 will not be triggered unless the offeror and a party acting in concert with it made purchases carrying 10% or more of the voting rights of a particular class. Purchases of different class of securities will not be considered

⁵ Panel’s decision in relation to Sanmenxia Tianyuan Aluminum Company Limited (2007).

on an aggregated basis. Similarly, Rule 23.1(b) is applied by reference to the class of shares being acquired during an offer period.

25. The primary purpose of the Codes is to afford fair treatment for shareholders who are affected by takeovers, mergers and share buy-backs. If an offeror or any person acting in concert with it purchased shares in an offeree company during an offer period or acquired significant amount of voting rights in an offeree company prior to its commencement, other independent shareholders should also be given the same treatment. This is consistent with General Principle 1.
26. Following the PRC Rule Change, while domestic shares (whether unlisted or A shares) and H shares are treated as one class, for reasons similar to those explained in relation to Rules 2.2 and 2.10, the Executive will continue to treat domestic shares and H shares as separate classes when applying Rule 23. This is illustrated as follows:
 - (a) Assume a PRC H Share Issuer has issued share capital comprising 75% A shares and 25% H shares, and an offer is made for both A shares and H shares.
 - (b) An acquisition of 10% of H shares (i.e. 2.5% of total share capital) by an offeror and its concert parties within the relevant period will trigger the requirement under Rule 23.1(a) with respect to the H share offer. However, subject to (d) below, an acquisition of an aggregate of 10% of the total share capital of the PRC H Share Issuer will not trigger such requirement under Rule 23.1(a) with respect to the H share offer if the total amount of H shares acquired is less than 10% of the total H shares.
 - (c) Similarly, any acquisition of H shares by an offeror and its concert parties during an offer period will trigger the requirement under Rule 23.1(b) with respect to the H share offer. However, subject to (d) below, an acquisition of any A shares during an offer period will not trigger such requirement under Rule 23.1(b) with respect to the H share offer.
 - (d) It is important to note that under Rule 23.1(c), there may be circumstances that the Executive may require a cash offer in order to give effect to General Principle 1. Therefore, although an acquisition of 10% of A shares by an offeror during the relevant period will not, in itself trigger Rule 23.1(a) with respect to the H share offer, if the relevant PRC regulations would result in the offeror being required to make a cash offer for the A share offer, then the Executive considers that Rule 23.1(c) will apply and a cash offer will also be required with respect to the H share offer. In simple terms, if a cash offer is made or required to be made for A shares, in order to give effect to General Principle 1, a cash offer should also be made for the H share offer. The same principles apply for Rules 23.1(b) and 23.2.

Special deals and whitewash waivers

27. For completeness, the Executive confirms that the existing practices relating to special deals under Rule 25 and Practice Note 17, and whitewash waivers under Note 1 on dispensations from Rule 26 and Schedule VI, remain unchanged after the PRC Rule Change. Accordingly, approval by shareholders of special deals pursuant to Rule 25 and Practice Note 17 will not require separate class approval of holders of H shares. Similarly, the “independent vote” by shareholders to approve a whitewash waiver will not require separate class approval of holders of H shares.

Share Buy-backs Code provisions

Rule 2 – Off-market share buy-backs

28. Under Rule 2 of the Share Buy-backs Code, all off-market share buy-backs must be approved by the Executive before a repurchasing company acquires any shares pursuant to such share buy-back. The Executive’s approval will normally be conditional upon, among others, the approval of the proposed off-market share buy-back by at least three-fourths of the votes cast on a poll by disinterested shareholders in attendance in person or by proxy at a general meeting of shareholders duly convened and held to consider the proposed transaction.
29. The Share Buy-back Code is silent on who would be regarded as “disinterested shareholders” for the purpose of off-market share buy-backs. Inferences may be drawn from Rule 3.2 of the Share Buy-backs Code for share buy-backs by way of general offer that independent shareholders are those who do not have a material interest in the share buy-back proposal which is different from the interests of all other shareholders.
30. For the purposes of off-market share buy-backs, the Executive normally considers “disinterested shareholders” to be those shareholders whose relevant securities will not be bought back under the off-market share buy-backs proposal (i.e. excluding those shareholders whose relevant securities will be bought back and their concert parties). These shareholders, regardless of what type of shares they hold, so long as they are “disinterested shareholders”, are entitled to cast their votes at the general meeting. No distinction needs to be made for different classes of relevant securities and no separate class meetings for the approval of off-market share buy-backs by PRC H Share Issuers was required.
31. The above approach will remain following the PRC Rule Change with domestic shares (whether unlisted or A shares) and H shares being regarded as one class of shares.

Rule 3 – Shareholder approval

Rule 3.1 General meeting to approve a share buy-back by general offer

32. Rule 3.1 of the Share Buy-backs Code states: “[a] share buy-back by general offer on the other hand must be approved by a majority of the votes cast by shareholders in attendance in person or by proxy at a general meeting of the shareholders duly convened and held to consider the proposed share buy-back. Such general meeting shall be convened by a notice of meeting which is accompanied by the offer document. If shareholders do not approve the share buy-back, the offer must lapse.”
33. Every shareholder should have an equal right to choose whether to receive an offer and the poll results of such resolution will affect all shareholders equally. The current approach requires approval at a general meeting, where all shareholders regardless of the type of shares they hold are entitled to attend and vote at such meeting. This approach will remain after the PRC Rule Change.

Rule 3.3 Approval of delistings and privatisations by independent shareholders

34. Rule 3.3 provides that “[i]f after a proposed share buy-back the shares of an offeror are to be delisted from the Stock Exchange or the company is to be privatised...
- (b) the share buy-back by general offer must be approved by:–
- (i) at least 75% of the votes attaching to the shares owned by independent shareholders that are cast either in person or by proxy at a duly convened general meeting; and
- (ii) number of votes cast against the resolution being not more than 10% of the votes attaching to the shares owned by independent shareholders.”
35. Rule 3.4 provides that “[i]f the offeror has more than one class of equity share capital, the Executive should be consulted as it may require the share buy-back to be made subject to approval by a majority of the votes cast by holders of each class of shares in attendance in person or by proxy at separate class meetings of such shareholders duly convened and held to consider the proposed share buy-back.”
36. Similar to delisting or take-private proposals of H shares for PRC H Share Issuers as illustrated in paragraphs 13 to 15 above, if a PRC H Share Issuer proposes to buy-back all of its H shares by way of a general offer resulting in a delisting of H shares, the rights of holders of H shares will be significantly impacted and their interests are considered to be materially different from the holders of domestic shares (whether unlisted or A shares). In such circumstances, the requirements under Rule 3.3 should be approved at a general meeting by holders of H shares only. This approach will remain after the PRC Rule Change.

Early consultation

37. Finally, if parties are in any doubt about the interpretation and application of any provisions under the Codes following the PRC Rule Change, early consultation with the Executive is strongly recommended so that any issues may be identified and resolved as soon as possible.

29 September 2023