Takeovers Bulletin

Highlights
- Identifying all relevant regulatory approvals for completion of offers
- Additional disclosure in delistings of Mainland issuers under Rule 2.2
- Public censure and cold shoulder order imposed on Ngai Lai Ha and reminder on the operation of Note 17 to Rule 26.1
- Public censure and cold shoulder order imposed on So Yuk Kwan
- Quarterly update on the activities of the Takeovers Team

Season’s Greetings

We wish all readers a healthy and happy 2021!

Conducting sufficient due diligence to identify all relevant regulatory approvals for the completion of offers

In a few recent cases, we note that the offerors and their respective advisers failed to identify certain material regulatory approvals which were required to complete the offers. The offerors also failed to disclose them in the firm intention announcements. In one case, a material regulatory approval was only identified after the disinterested shareholders had approved the transaction at a general meeting.

The failure to identify and disclose material regulatory approvals in the firm intention announcement caused unnecessary delays in the offer timetable. The Executive considers this to be unsatisfactory. Offerors, offeree companies and their respective advisers are reminded that sufficient and thorough due diligence should be conducted at the outset of a transaction so that all regulatory approvals required for the completion of offers are identified early and disclosed appropriately.

Regulatory approvals are often material in nature, without which an offer might be significantly delayed or forced to lapse. As such, obtaining material regulatory approvals is typically set as a pre-condition or condition to an offer.

Rule 3.5(e) of the Takeovers Code provides that a firm intention announcement must contain “all conditions (including normal conditions relating to acceptance, listing and increase of capital) to which the offer is subject”.

Offerors often include generic conditions in the draft firm intention announcement such as “all regulatory approvals, authorisations or consents being obtained”, or “that the implementation of the offer will not be unenforceable, illegal or prohibited”. Given the importance of material regulatory approvals and to ensure the certainty of an offer, we consider such a general disclosure of conditions to be inadequate. Therefore, during our vetting process, it is our practice to request an offeror to specify all material regulatory approvals in the firm intention announcement, and when there are none, a negative statement to this effect should be included. Details to be set out include the types of approvals required, the names of the relevant authorities from which approvals will be sought.
the expected timing and whether or not these approvals can be waived.

The early identification of material regulatory approvals should also assist in the structuring of an offer, for example, whether approval should be set as a pre-condition or a condition to an offer. This could in turn affect the timing of an offer.

General Principle 5 stipulates that “shareholders should be given sufficient information, advice and time to reach an informed decision on an offer”. As such, shareholders should be provided with all relevant information to allow them to make an informed decision on an offer. If the material information is not disclosed at the outset, market confusion or a disorderly market may result. Shareholders may have dealt in the shares or may have accepted or voted on an offer based on incomplete information. In the more undesirable circumstances, where the need for regulatory approval is only discovered and disclosed after the shareholders have accepted an offer, the accepting shareholders’ shares will be locked up for an extended period pending regulatory approvals which may or may not be granted. This is not in line with the spirit of General Principle 5 and is against the interests of shareholders.

If a particular regulatory approval is not specifically disclosed in the firm intention announcement, the Executive may not allow such condition to be invoked under Note 2 to Rule 30.1 of the Takeovers Code to cause an offer to lapse. An offeror might risk having to proceed with an offer in breach of other legal or regulatory requirements. Also, the Executive may or may not consent to an extension of an offer period to accommodate the time required to obtain the omitted regulatory approval. This may also result in a breach of the timetable requirements under the Takeovers Code.

It is therefore important that parties to an offer conduct sufficient and thorough due diligence to identify all the required approvals at the outset of the transaction. The roles and responsibilities of professional advisers, in particular financial advisers, are particularly important in the due diligence process and they should advise their clients appropriately. They must have the competence, professional expertise and adequate resources to discharge their duties under the Codes on Takeovers and Mergers and Share Buy-backs (the Codes). Failure to do so may cast doubts on the professional adviser’s ability and competence under section 1.7 of the Introduction to the Codes.

As usual, if in doubt, the Executive should be consulted at an early stage.

Additional disclosure in delistings of Mainland issuers under Rule 2.2

In July 2018, Rule 2.2 of the Takeovers Code was amended to include a new note to provide a level-playing field for listed companies incorporated in jurisdictions which do not have compulsory acquisition rights, eg, Mainland China. Prior to the change, the Executive granted waivers from compliance with Rule 2.2(c) to Mainland incorporated issuers on the basis that it was technically impossible to comply under Mainland law. This would mean that a Mainland-incorporated issuer could delist by a voluntary general offer without 90% acceptance from disinterested shareholders so long as it obtained 75% approval of the independent shares present and voting, with not more than 10% disapproval by disinterested shares.

Since the introduction of the note to Rule 2.2, we have handled a number of delisting proposals by Mainland issuers who were seeking to delist by way of voluntary general offers and were subject to the
requirements under Rule 2.2. In such cases, waivers to Rule 2.2(c) were granted on the basis that an offeror would make the following arrangements:

(i) the offer would remain open for acceptance for a longer period than normally required by Rule 15.3 after the offer becomes unconditional;

(ii) shareholders who have not accepted the offer would be notified in writing of the extended closing date and the implications of choosing not to accept the offer; and

(iii) the offer would be subject to 90% acceptance of the disinterested shares.

The above arrangements are designed to ensure that minority shareholders are given sufficient time to exit and tender their shares under an offer and that they are aware of the implications of choosing to be shareholders of a private company.

We note that Mainland issuers typically include the following warning to shareholders in Rule 3.5 announcements and offer documents:

"Independent shareholders should note that if they do not accept the H share offer and the offer subsequently becomes unconditional in all respects and the company delisted from the Stock Exchange, this will result in such shareholders holding securities that are not listed on the Stock Exchange and the liquidity of the H shares may be severely reduced. In addition, the company will no longer be subject to the requirements under the Listing Rules and may or may not continue to be subject to the Codes depending on whether it remains as a public company under the Codes."

To enhance independent shareholders’ awareness of their rights in a voluntary general offer by Mainland issuers, or issuers incorporated in jurisdictions where compulsory acquisition does not exist, we will now require all of these issuers to include the following text immediately after the above warning statement:

"Independent shareholders should also note that if they do not agree to the terms of an offer, they can vote against the delisting proposal at the meetings. If more than 10% of the disinterested shares voted against the delisting proposal, the offer would not become unconditional and the company would remain listed on the Stock Exchange of Hong Kong."

The warning to shareholders and the text above should be included in bold in both the summary box and the body of a Rule 3.5 announcement which should be repeated in full in the offer document.

On 2 November 2020, we publicly censured and imposed an 18-month cold shoulder order against Ngai Lai Ha for breaching the mandatory general offer obligation under Rule 26.1 of the Takeovers Code. Ngai is being denied direct or indirect access to the Hong Kong securities market until 1 May 2022.

At the time of the breaches, Ngai was the chairperson and executive director of International Housewares Retail Company Limited. On 6 March 2019, Ngai purchased 170,000 shares in the company and as a result, the shareholding of Ngai and her concert parties (Concert Group) reached 50.5%, representing an increase of more than 2% from the Concert Group’s lowest collective percentage interest of 48.48% in the preceding 12 months. Subsequently, Ngai made 12 additional acquisitions from March to May 2019, crossing the 2% creeper each time. Ngai accepted that she has breached the Takeovers Code and deprived the
company’s shareholders of the right to receive a general offer for their shares. She agreed to the sanctions against her.

Ngai’s breach was caused by her misunderstanding of Note 17 to Rule 26.1. Market practitioners are reminded to pay attention to Note 17 when a person’s or a concert group’s interest crosses over 50%. Note 17 provides that the 2%-creeper provisions under Rule 26.1(c) and (d) continue to apply if at any time during any immediately preceding 12-month period, a person or a concert group holds 50% or less of the voting rights in a company. In other words, the 2% creeper will only cease to apply when a person or a concert group has continuously held more than 50% of the voting rights in a company for at least 12 months.

A copy of the Executive Statement dated 2 November 2020 can be found in the “Regulatory functions – Corporates – Takeovers and mergers – Decisions and statements – Executive decisions and statements” section of the SFC website.

Public censure and cold shoulder order imposed on So Yuk Kwan for breaching the mandatory general offer obligation

On 15 October 2020, we publicly censured and imposed a 24-month cold shoulder order against So Yuk Kwan for breaching the mandatory general offer obligation under Rule 26.1 of the Takeovers Code. So is being denied direct or indirect access to the Hong Kong securities market until 14 October 2022.

So is the chairman, executive director and chief executive officer of AV Concept Holdings Limited. So advanced a loan to a borrower in 2016 and the borrower transferred 25,000,000 AV Concept shares to his nominee as repayment on 8 June 2017. As a result of the share transfer, So’s interest in AV Concept increased from 2.38% to 5.61% while the aggregate interest of So and his concert parties increased from 35.61% to 38.84%. The concert group continued to acquire AV Concept shares until 27 April 2018 where these acquisitions exceeded the 2% creeper and no mandatory general offer was made.

So’s action deprived AV Concept’s shareholders of the right to receive a general offer. So explained that he was unaware that shares held by his nominee were counted as his interest under the Takeovers Code. He agreed to the disciplinary action against him.

A copy of the Executive Statement dated 15 October 2020 can be found in the “Regulatory functions – Corporates – Takeovers and mergers – Decisions and statements – Executive decisions and statements” section of the SFC website.

Parties who wish to take advantage of the securities markets in Hong Kong are reminded that they should conduct themselves in matters relating to takeovers, mergers and share buy-backs in accordance with the Takeovers Code. If not, they may find that the facilities of such markets may be withheld from them by way of sanction in order to protect those who participate in them.
Quarterly update on the activities of the Takeovers Team

In the three months ended 30 September 2020, we received 22 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer share buy-backs), 10 whitewashes and 82 ruling applications.

Useful links
- The Codes on Takeovers and Mergers and Share Buy-backs
- Practice notes
- Decisions and statements
- Previous Takeovers Bulletins

All issues of the Takeovers Bulletin are available under ‘Published resources – Newsletters – Takeovers Bulletin’ on the SFC website at www.sfc.hk.

Feedback and comments are welcome and can be sent to takeoversbulletin@sfc.hk.

If you want to receive the Takeovers Bulletin by email, simply click Subscriptions at www.sfc.hk and select Takeovers Bulletin.