

## “Disqualifying transactions” under paragraph 3 of the Whitewash Guidance Note (Schedule VI of the Codes)

Under Note 1 on dispensations from Rule 26 of the Takeovers Code, the Executive may waive an obligation to make a general offer (whitewash waiver) which arises as a result of an issue of new securities as consideration for an acquisition, or a cash subscription, or the taking of a scrip dividend if there is an independent vote at a shareholders' meeting (whitewash). The Whitewash Guidance Note (set out in Schedule VI of the Codes) sets out the procedures to be followed and a number of safeguards which must be met if the Executive is to be asked to grant a whitewash waiver. The Executive will normally waive the obligation to make a general offer subject to these safeguards, one of which is approval of the proposals by independent shareholders.

A further and fundamental safeguard in a proposed whitewash transaction is that there must have been no “disqualifying transactions” in the previous six months. This requirement is set out in detail in paragraph 3 of the Whitewash Guidance Note which provides that:

*“Notwithstanding the fact that the issue of new securities is made conditional upon the prior approval of a majority of the shareholders independent of the transaction at a general meeting of the company:-*

- (a) *the Executive will not normally waive an obligation under Rule 26 of the Takeovers Code if the person to whom the new securities are to be issued or any person acting in concert with him has acquired voting rights in the company (save for subscriptions for new shares which have been fully disclosed in the whitewash circular) in the 6 months prior to the announcement of the proposals but subsequent to negotiations, discussions or the reaching of understandings or agreements with the directors of the company (which would include informal discussions) in relation to the proposed issue of new securities; and*

## Highlights

- “Disqualifying transactions” under paragraph 3 of the Whitewash Guidance Note (Schedule VI of the Codes)
- Application of Rule 20.1(b) to share repurchases by partial offer
- Quarterly update on the activities of the Takeovers Team

*(b) a waiver will not be granted or if granted will be invalidated if, without the prior consent of the Executive, any acquisitions or disposals of voting rights are made by such persons in the period between the announcement of the proposals and the completion of the subscription.”*

The prohibitions under paragraphs 3(a) and (b) against any acquisition of voting rights by the whitewash applicant and its concert parties aim to ensure equal treatment of shareholders in that the whitewash applicant or its concert parties may not provide an exit to some shareholders which is not available to others. This is consistent with General Principle 1 which states:

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

Given that the whitewash applicant is proposing to increase its shareholding interest in the subject company through the whitewash transaction, disposals of voting rights before the completion of the whitewash proposal are prohibited as they would be contrary to the intended effect of the proposal. If the whitewash applicant or its concert parties were permitted to dispose of voting rights during the period between the announcement of the whitewash proposal and completion of the subscription of the new securities, it would also not be possible to provide shareholders with precise details of the proposed shareholding position of the whitewash applicant. As such shareholders would not be in a position to reach an informed decision when voting on the whitewash.

In cases where holders of convertible securities who are independent of the whitewash applicant and its concert parties exercise their conversion rights during the restricted period under paragraph 3(b), the shareholding interest of the whitewash applicant together with its concert parties in the subject company will decrease as a result of the dilution. The Executive would like to clarify that, in such circumstances, the resultant decrease in the shareholding interest of the whitewash applicant and its concert parties would not constitute a disqualifying transaction under paragraph 3(b) since the decrease would not have been caused by an actual disposal of voting rights by the whitewash applicant and/or its concert parties.

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## Application of Rule 20.1(b) to share repurchases by partial offer

The Executive has recently been consulted about the application of Rule 20.1(b) to a listed company which repurchases its shares by a partial offer.

Rule 20.1(b) provides that *“[s]hares represented by acceptances in a partial offer shall not be acquired by the offeror before the close of the partial offer. Such shares must be paid for by the offeror as soon as possible but in any event within 7 business days following the close of the partial offer.”*

For practical reasons, accepting shareholders in a partial offer do not receive consideration until seven business days after the final closing day as the ultimate number of shares that they are entitled to sell and hence the consideration they are entitled to receive can only be determined at that stage. In a full general offer, accepting shareholders must receive payment within seven business days following the later of the date on which the offer becomes, or is declared, unconditional and the date of receipt of a duly completed acceptance.

A proposal by a listed company to repurchase its shares by a partial offer is essentially an offer to shareholders to buy a specified number (but not all) of the shares which carry voting rights of a company and is therefore in substance a partial offer. It follows that Rule 20.1(b) applies to all partial offers which include share repurchases by partial offer.

Practitioners should note that Rule 20.1(b) must be read in conjunction with Rule 28.4 which provides that: *“Rule 15 normally applies to partial offers. If on a closing day acceptances received exceed the precise number of shares stated in the offer document under*

Rule 28.7, subject to the application of Rule 28.5, the offeror must declare the partial offer unconditional as to acceptances and comply with Rule 15.3 by extending the final closing day to the 14th day thereafter. **The offeror cannot further extend the final closing day.** If the acceptance condition is fulfilled an offeror may also declare a partial offer unconditional as to acceptances prior to the first closing day, provided that he fully complies with Rule 15.3. **The offeror cannot extend the final closing day to a day beyond the 14th day after the first closing day.** The offer document must contain specific and prominent reference to the requirements in this Rule 28.4.” (emphasis added)

Once acceptances exceed the number of shares stated, Rule 28.4 helps to ensure that accepting shareholders are not treated unfairly by preventing an extension of the final closing date (Rule 15.3 should still apply and the final closing date should be 14 days after the offeror declares the partial offer unconditional). Any extension would dilute or affect the ultimate number of shares that the accepting shareholders are entitled to sell through the partial offer. Furthermore, an extension would delay accepting shareholders’ receipt of consideration for their shares. The Executive believes that the same philosophy should apply to share repurchases by partial offer.

Practice Note 1 has been revised to reflect the above and can be found in the “Regulatory functions – Listings & takeovers – Takeovers & Mergers – Practice notes” section of the SFC website.

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## Quarterly update on the activities of the Takeovers Team

In the three months ended 31 March 2013, the Executive received eight takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer repurchases), eight whitewashes and 33 ruling applications.

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