

An SFC newsletter to help participants in Hong Kong's financial markets better understand the Codes on Takeovers and Mergers and Share Buy-backs

Feedback and comments:
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Reminder to keep trading suspensions to the minimum

It is important that parties to an offer or transaction under the Codes make every effort to take steps to avoid unnecessary trading suspensions.

Trading suspensions designed to facilitate negotiations between parties are not acceptable.

Where a company has requested suspension of its trading pending publication of a Code-related announcement, the suspension should be kept as short as possible. As the Hong Kong Stock Exchange made clear in its Guidance Letter issued in December 2015, "[t]he duration of any trading halt should be for the shortest possible period. Listed issuers are obliged to ensure that trading of their securities resume as soon as practicable following the publication of an announcement or when the reasons for the trading halt no longer apply". We encourage you to read the Guidance Letter (HKEx-GL83-15) and our Corporate Regulation Newsletter (March 2016) for further guidance.

We have set out below some non-exhaustive guidance on good practices to help keep trading suspensions to a minimum during Codes transactions:

Consult the Executive

- Consult the Executive and inform us about any points of difficulty and/or Code issues at the earliest opportunity.

Appoint advisers

- Appoint professional advisers that are conversant with the requirements of the Codes at an early stage.

Highlights

- Trading suspensions should be kept to a minimum
- New Practice Note 21–Waivers under Note 6(a) to Rule 26.1
- Executive publicly censures Goldman Sachs for breaches of Takeovers Code
- Appointment and reappointments to the Takeovers Panel and related committees
- Quarterly update on the activities of the Takeovers Team

Maintain confidentiality

- Make every effort to maintain secrecy and put in place effective containment procedures at the earliest possible opportunity.

Comply with statutory requirements

- Ensure compliance with relevant statutory requirements regarding, amongst other things, disclosure of inside information under Part XIVA of the Securities and Futures Ordinance (SFO) and disclosure of interests under Part XV of the SFO.

Prepare draft announcements ahead of time

- Prepare draft announcements in advance and ensure they are ready to be issued promptly if the need arises. Practice Note 20 also provides useful guidance in relation to announcements and documents issued under the Codes.
- Provide copies of draft announcements to the Executive as required under Rule 12.1 of the Takeovers Code in advance of signing significant agreements.
- Ensure first drafts of announcements are of good quality (use short sentences with clear and concise language) in order to facilitate the vetting process and market understanding after publication.
- Afford reasonable time to the Executive for consideration of a draft announcement.

Financial Resources

- Only sign transactional documents (including memoranda of understanding) when the relevant parties are ready to announce in compliance with the Takeovers Code including where relevant Rule 3.5 and when sufficient financial resources are available.
- The financial adviser to the offeror (or another appropriate party) should provide the Executive with a confirmation of sufficiency of financial resources at the same time as the submission of the first draft of an announcement of a firm intention to make an offer. The confirmation should cover both the financial resources for completing the purchase of shares which gives rise to the offer obligation and for satisfying full acceptance of the offer (see Note 3 to Rule 3.5 and Practice Note 15).
- In the rare event that transactional documents are signed before the financial resources confirmation can be provided (and hence it is not possible to issue an announcement under Rule 3.5), an announcement up-dating the market should be issued under Rule 3.7 to enable trading of the offeree company securities to be resumed as soon as possible. In such circumstances, if the announcement contains any details of the terms on which an offer might be made, the potential offeror will be bound by those terms if an offer for the offeree company is subsequently made.

Announcement content

- Ensure announcements contain sufficient information to enable shareholders to make an informed assessment and do not include immaterial information.
- A firm intention announcement must contain all information required under Rule 3.5 (including the confirmation by the offeror's financial adviser about sufficiency of financial resources) or negative statements as appropriate.
- Ensure the relevant requirements of Rules 3.8 and 9.3 are also complied with as appropriate.

Internal approval

- Obtain the appropriate level of approval (eg, from client or board of directors) of a variety of draft announcements to be released depending on the circumstances at the relevant time.
- Ensure all relevant directors and relevant authorized personnel are readily contactable at all times and are in a position to answer our enquiries.

Practice Note 21 – 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:–

(i) 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;

(ii) the price paid for the shares acquired; and

(iii) 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.

Goldman Sachs (Asia) L.L.C. publicly censured for Takeovers Code breaches

On 2 February 2016, we publicly censured Goldman Sachs (Asia) L.L.C. for breaching Rules 22 and 21.5 as well as Note 4 to Rule 8.1 and Rule 10 of the Takeovers Code.

A copy of the Executive's 2 February statement can be found in the section "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Decisions & statements – Executive decisions and statements" of the SFC website.

Reminder to market practitioners

We wish to take this opportunity to remind practitioners and parties who wish to take advantage of the securities markets in Hong Kong that they should conduct themselves in accordance with the Codes in matters relating to takeovers, mergers and share buy-backs. In particular, we expect financial and other professional advisers to have the competence, professional expertise and adequate resources to fulfil their roles and to discharge their responsibilities under the Codes.

Appointment and reappointments of members to the Takeovers and Mergers Panel and related committees

We welcome the following new appointment and reappointments to the Takeovers and Mergers Panel (Panel), the Takeovers Appeal Committee (Appeal Committee), Disciplinary Chair Committee and the Nominations Committee with effect from 1 April 2016:

Panel and Appeal Committee

New appointment - Mr Lawrence K.H. Lee, JP

Reappointments - Ms Teresa Ko, JP, Mr Liu Chee Ming and Mr John Maguire (Deputy Chairmen of the Panel and members of the Appeal Committee), Mr Conrad Chan, Ms Julia Charlton, Mrs Angelina Lee, SBS, JP, Mr Liu Che Ning, Mr David Norman, Mr Nicholas Norris, Mr Jon Perry, Mr Martin Sabine, Mr Mark Schwillie, Mr James Soutar, Mr Richard Winter and Ms Benita Yu

Disciplinary Chair Committee

Reappointments - Mr Edward Chan, SC, Mr Jat Sew Tong, SC, JP, Ms Gladys Li, SC, Mr Paul Shieh, SC and Mr Horace Wong, SC

Nominations Committee

Reappointments - Mr Carlson Tong, SBS, JP and Dr William Wong, SC

Full list of members of takeovers-related committees

Members are appointed for a term of two years until 31 March 2018 unless otherwise stated. The membership lists for the Panel, the Appeal Committee, the Disciplinary Chair Committee and the Nominations Committee are set out below.

Panel

The Panel hears disciplinary matters in the first instance, reviews rulings by the Executive at the request of any party dissatisfied with such a ruling and considers novel, important or difficult cases referred to it by the Executive. It also reviews, upon request by the SFC, the provisions of the Codes and the Rules of Procedure for hearings under the Codes and recommends appropriate amendments to the Codes and Rules to the SFC.

Chairman

Mr Clark Stephen Edward*

Deputy Chairmen

Mr Chan Yuk Sing, Freeman*

Ms Ko, Teresa Yuk Yin, JP

Mr Liu Chee Ming

Mr Maguire John Martin

Mr Webb David Michael*

Members

Ms Brown Melissa*

Mr Chan Che Chung

Ms Charlton Julia Frances

Mr Denny Roger Michael*

Mr Fu Yat Hung, David*

Mr Ip Koon Wing, Ernest*

Mr Lam Sung Lai, Edward*

Mr Lee Kam Hung, Lawrence, JP

Mrs Lee Pui Ling, Angelina, SBS, JP

Mr Liu Che Ning

Mr Liu Yun Bonn*

Mr Norman David Michael

Mr Norris Nicholas Andrew

Ms Park Yoo-kyung*

Mr Perry Jonathan Garth

Mr Sabine Martin Nevil

Mr Schwille Mark Andrew

Mr Soutar James Alexander

Mrs Vas Chau Lai Kun Judy*

Mr Winter Richard David

Ms Yu Ka Po, Benita

* Reappointed/appointed on 1 April 2015 for a term of 2 years until 31 March 2017

Appeal Committee

The Appeal Committee reviews disciplinary rulings of the Panel for the sole purpose of determining whether any sanction imposed by the Panel is unfair or excessive. It comprises a Chairman who is a member of the Disciplinary Chair Committee and other members of the Panel who are selected on a case-by-case basis.

Disciplinary Chair Committee

Members are nominated by the Nominations Committee on the basis that they are duly experienced Senior Counsel. Their role is to act as Chairman of the Panel in disciplinary proceedings under the Codes or of the Appeal Committee on a case-by-case basis.

Members

Mr Chan King Sang, Edward, SC

Mr Jat Sew Tong, SC JP

Ms Li Gladys Veronica, SC

Mr Shieh Wing Tai, Paul, SC

Mr Wong Yuk Lun, Horace, SC

Nominations Committee

The Nominations Committee nominates members of the Panel, the Appeal Committee and Disciplinary Chair Committee.

Ex officio Members

Mr Alder Ashley Ian, JP (Chairman)

Mr Clark Stephen Edward

Mr Ho Yin Tung, Brian

Members

Mr Tong Carlson, SBS, JP*

Dr Wong Ming-fung William, SC*

Alternate members to Mr Clark Stephen Edward

Mr Chan Yuk Sing, Freeman

Ms Ko, Teresa Yuk Yin, JP

Mr Liu Chee Ming

Mr Maguire John Martin

Mr Webb David Michael

* Reappointed on 1 April 2016 for a term of 2 years until 31 March 2018

A full list of members of the Panel, the Appeal Committee, the Disciplinary Chair Committee and the Nominations Committee can be found in the "Regulatory functions" – "Listings & takeovers" – "Takeovers & Mergers" – "Takeovers Panel & related committees" section of the SFC website.

Quarterly update on the activities of the Takeovers Team

In the three months ended 31 December 2015, we received 16 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer share buy-backs), 10 whitewashes and 79 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 – Industry-related publications – *Takeovers Bulletin*' on the SFC website at www.sfc.hk.

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