

## Introduction

1. In this issue of the Takeovers Bulletin, you will find two Practice Notes that clarify the application of certain provisions of the Codes relating to whitewash transactions and announcements by listed issuers in compliance with Rule 2.07C(1)(a)(iv) of the Listing Rules.
2. This issue also contains a reminder to market practitioners of the importance of complying with Rule 25 of the Takeovers Code.
3. We are also taking this opportunity to draw your attention to the impending introduction of a new Rule 21.7 and the relevance of this to persons with exempt principal trader ("EPT") status under the Codes.
4. Lastly, we take this opportunity to update the market on the activities of the Takeovers Team in the six months ended 31 March 2008.

## Practice Note 10 (PN10) – Reservation of right to waive a whitewash condition (Note 1 on dispensations from Rule 26)

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**"). A party that triggers a mandatory general offer obligation as a result of this type of transaction often structures the transaction so that it is conditional on the Executive granting a whitewash waiver. The question of whether or not a whitewash applicant reserves its right to waive this condition may impact the voting of independent shareholders and is therefore relevant information which must be disclosed in the announcement setting out details of the transaction.

## Highlights

- Practice Note 10 (PN10) –  
Reservation of right to waive  
the whitewash condition
- Practice Note 11 (PN11) –  
Application of Rule 12.1  
to announcements issued  
upon trading suspension in  
compliance with the Listing  
Rules
- Reminder about the  
importance of Rule 25
- Impending introduction of new  
Rule 21.7 and the relevance of  
exempt principal trader ("EPT")  
status
- Update on the activities of the  
Takeovers Team

### Treatment in the event a reservation is made

If the whitewash applicant reserves its right to waive the whitewash condition then the possibility of shareholders receiving a general offer as a result of completion of the transaction cannot be ruled out. In such circumstances:

1. an offer period will commence on the date the transaction is announced;
2. the provisions of the Takeovers Code would apply including the requirement under Rule 3.8 of the Takeovers Code to announce numbers of relevant securities in issue;
3. the Executive will not require a confirmation from the financial adviser that sufficient resources are available to the whitewash applicant to satisfy full acceptance of the offer nor will it require evidence to support this confirmation given the whitewash applicant will not have, at this stage, expressed a firm intention to make an offer;
4. if independent shareholders disapprove the whitewash waiver at the shareholders' meeting, the whitewash applicant will be required to disclose in the announcement of the results of the shareholders' meeting ("**Results Announcement**") whether it intends to complete the transaction in the absence of the whitewash waiver, and hence make an offer upon completion of the transaction;
5. if the applicant has formed a firm intention to complete the transaction in the absence of the whitewash waiver and hence make an offer, it must be in a position to fully comply with Rule 3.5 of the Takeovers Code prior to the shareholders' meeting (including the requirement for financial advisers to confirm that sufficient financial resources are available to the applicant to satisfy full acceptance of the offer) so that an appropriate announcement can be made as soon as reasonably practicable thereafter;
6. if the applicant does not intend to complete the transaction in light of the failure to obtain the whitewash waiver, the Results Announcement should inform shareholders of this decision and the offer period which commenced on the date of the initial announcement would end on the date of publication of the Results Announcement; and
7. if the applicant has not determined whether to complete the transaction in the absence of the whitewash waiver, it must disclose in the Results Announcement that it is still contemplating the possibility of completing the transaction and making a general offer. Under such circumstances, the Results Announcement would constitute an announcement under Rule 3.7 of the Takeovers Code.

### Treatment in the event a reservation is not made

If the whitewash applicant does not reserve its right to waive the whitewash condition and hence the transaction will not complete unless independent shareholders approve it and the whitewash waiver is granted, an offer period will not commence on the date the transaction is announced. The reason for this is that the announcement would not constitute an announcement of a proposed or possible offer within the meaning of the Takeovers Code. In such circumstances the requirement to disclose numbers of securities in issue under Rule 3.8 of the Takeovers Code would not apply. Other relevant provisions of the Takeovers Code would apply (see Whitewash Guidance Note in Schedule VI to the Codes).

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## Practice Note 11 (PN11) – Application of Rule 12.1 of the Takeovers Code to announcements issued in compliance with Rule 2.07C(1)(a)(iv) of the Listing Rules

The purpose of this Practice Note is to explain the Executive's approach in applying Rule 12.1 of the Takeovers Code to announcements issued by listed issuers in compliance with Rule 2.07C(1)(a)(iv) of the Listing Rules.

Under Rule 2.07C(1)(a)(iv) of the Listing Rules, where a listed issuer requests a suspension of trading in its securities, and the suspension has been effected, the listed issuer must immediately submit to and publish through the Stock Exchange of Hong Kong Limited a brief announcement (“**Suspension Announcement**”) informing the public of the suspension and briefly the reason for it. In cases which involve an offer or possible offer (within the meaning of the Takeovers Code), Rule 12.1 of the Takeovers Code provides that all documents must be filed with the Executive for comment prior to release or publication and must not be released or published until the Executive has confirmed that it has no further comments thereon. Given the Suspension Announcement has to be published **immediately** in compliance with the Listing Rules, listed issuers may encounter difficulties in simultaneously complying with Rule 12.1 of the Takeovers Code.

In order to ensure the smooth operation of these two provisions and in view of the fact that trading in the securities of the listed issuer will remain suspended until a detailed announcement is released the Executive has decided to adopt a pragmatic approach. The Executive will not consider the Suspension Announcement in cases involving an offer or possible offer to fall within the ambit of Rule 12.1 of the Takeovers Code on the condition that:

1. the wording of the Suspension Announcement is limited to: “Trading in the securities of the Company has been suspended pending the release of an announcement pursuant to the Takeovers Code/Share Repurchase Code (as applicable).”; and
2. it is provided with a copy of the Suspension Announcement at the same time as it is published.

Notwithstanding this, the requirement for all other documents (as defined in the Takeovers Code) to be filed with the Executive for comment prior to publication under Rule 12.1 of the Takeovers Code continues. In particular, any takeovers related announcement to be issued upon resumption of trading setting out fuller details of the proposed offer must be filed with the Executive for comment and must not be released or published until the Executive has confirmed it has no further comments thereon.

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## Importance of compliance with Rule 25

The Executive would like to take this opportunity to remind market practitioners and listed issuers of the importance of full compliance with Rule 25. This is an extension of General Principle 1 which provides that all shareholders are to be treated even-handedly and all shareholders of the same class are to be treated similarly.

In a recent transaction, an offeror potentially triggered an obligation to make a mandatory general offer for the shares of the company as a result of a conditional acquisition of a controlling interest in a listed issuer. The acquisition was conditional on the sale of certain assets of the offeree company. Subsequent to the completion of the disposal of some of these assets, the board of the offeree company discovered that the purchaser was in fact a shareholder of the offeree company. The disposal therefore constituted a special deal under Rule 25 of the Takeovers Code which provides that *“[E]xcept with the consent of the Executive, neither the offeror nor any person acting in concert with it may make any arrangements with shareholders or enter into arrangements to purchase or sell securities of the offeree company, or which involve acceptance of an offer, either during an offer or when an offer is reasonably in contemplation or for 6 months after the close of such an offer if such arrangements have favourable conditions which are not to be extended to all shareholders.”*

In the above matter, the Executive viewed the disposal as a breach of the Takeovers Code given under Note 4 to Rule 25 the Executive’s consent and independent shareholders’ approval for the disposal should have been obtained. In order to resolve the matter, the board of the offeree company publicly apologised and took steps to rectify the mistake by seeking retrospective consent from the Executive and approval from independent shareholders.

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In determining the appropriate action in respect of this matter, the Executive took into account the fact that the acquisition of the controlling interest had not been completed at that stage and could still be unwound if independent shareholders disapproved the disposal and in consequence, a general offer would not have been triggered. The Executive also took into account the inadvertent nature of the breach, the co-operation of the parties during the course of the Executive's enquiries, the public apology made and the remedial action sought by the board.

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## Impending introduction of the new Rule 21.7 and the relevance of exempt principal trader ("EPT") status

On 25 June 2008, the SFC issued the Conclusions Paper in relation to a number of proposed changes to the Codes. One of the proposals is to introduce a new Rule 21.7 to the Takeovers Code to deal with securities borrowing and lending ("**SBL**") activity involving parties connected to an offer. The new Rule 21.7 will become effective on 1 August 2008.

The introduction of new Rule 21.7 will have implications for entities that conduct SBL activity as part of their business operations which find themselves connected to an offer (i.e. as a result of being in the same group as the financial adviser to the offeror). In particular, such entities will be subject to the restrictions relating to SBL transactions (including the unwinding of such transactions) during an offer period. Some respondents to the consultation have suggested that this is likely to have a significant effect on the daily SBL operations of affected entities. Given this, a respondent suggested that entities with EPT status should be allowed to conduct SBL activity to facilitate client trading during an offer period. After careful consideration of this issue in consultation with the Takeovers Panel, the Executive agrees that an entity with EPT status that carries out SBL transactions (including the unwinding of such transactions) in the ordinary course of its business should not be subject to new Rule 21.7. As a result, relevant amendments will be made to the definition of EPT in the Codes which are detailed in the Conclusions Paper.

In light of the above, entities that conduct SBL activity as part of their business operations and which might be subject to new Rule 21.7 may consider applying to the Executive for EPT status promptly. General guidelines in relation to applications for EPT status can be found on the SFC website at [www.sfc.hk](http://www.sfc.hk) under "Prospectuses, Takeovers & Mergers" – "Takeovers & Mergers" – "Exempt Status (EFM/EPT)". There are also simplified application procedures which are available to entities which form part of complex international financial groups. If an entity forms part of a complex international group and wishes to apply for EPT status, it should consult the Executive on whether the simplified application procedures apply.

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## Update on the activities of the Takeovers Team in the day-to-day administration of the Codes

The work of the Executive includes commenting on takeovers announcements and documents, giving rulings and interpretations under the Codes and monitoring share dealings and movements during an offer period. The Executive is also available for consultation on the application of the Codes so that issues can be addressed and problems solved at an early stage.

In the six months ended 31 March 2008, the Executive dealt with 20 takeovers related cases (including privatisations, voluntary and mandatory general offers and off market and general offer repurchases) and 20 whitewashes. The Executive also received 102 ruling applications.

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The Executive issued two statements of public criticism during the six months of which one related to a breach of Rule 31.3 of the Takeovers Code and the other related to a breach of Rule 3.6 of the Takeovers Code.

The Executive referred one case to the Takeovers Panel for a ruling during this six-month period as there were particularly novel, important and difficult points at issue. In addition, there were two meetings of the Takeovers Panel during this period on proposed amendments to the Codes.

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