

## TAKEOVERS AND MERGERS PANEL

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### **Panel Decision in Relation to a Proposed Partial Offer for Kong Wah Holdings Limited ("Kong Wah")**

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On 27 June 1995, the Panel considered a proposal under which consent was sought for the making of a partial offer for 51% of the issued share capital of Kong Wah.

Since this is the first occasion on which a partial offer has been proposed since the coming into force of the current Code on 1 April 1992, the Executive referred the application to the Panel under section 10.1 of the Introduction to the Code as a novel matter.

Under the proposal, the offeror would subscribe in cash for a number of shares in Kong Wah that would represent approximately 30% of the share capital as enlarged by the subscription and would make a partial offer for approximately 51% of the existing issued capital of Kong Wah. The proposed partial offer and subscription would be interconditional on each other. The proposed subscription would also be conditional, inter alia, on approval by shareholders of Kong Wah. The proposed partial offer would also be conditional on approval of the offer, signified by means of a separate box on the form of acceptance, being given by shareholders holding over 50% of the voting rights not held by the offeror and persons acting in concert with it, as well as on the specified number of acceptances being received. It was proposed that the existing controlling shareholder of Kong Wah, who, together with its associates, currently holds c.59.7% of Kong Wah's capital, would vote in favour of the proposed subscription, as well as the partial offer and would accept the partial offer in respect of 51% of its shareholding and no more. It was also proposed that it be a term of the subscription that the controlling shareholder would not sell or dispose of any of its remaining shareholding in Kong Wah for a term of not less than 2 years from the date of completion without the offeror's consent. The controlling shareholder also undertook not to sell or otherwise dispose of any of its remaining shareholding to the offeror or any of its concert parties for 2 years from the close of the offer.

The combined effect of the subscription and the acceptance by the existing controlling shareholder of the proposed partial offer would be that the offeror would hold 51.3% of Kong Wah, the existing controlling shareholder 20.5%, and the public 28%, on the

assumption that no minority shareholders accepted the proposed offer. On the assumption that all the existing shareholders of Kong Wah accepted the offer in full in respect of 51% of their shares, the respective percentages would be 65.7%, 20.5% and 13.7%. In other words, the offeror would acquire statutory control of Kong Wah by virtue of its agreement with the controlling shareholder, even if all of the minority shareholders were opposed to the proposal. Minority shareholders would not receive a general offer for all of their shares, but a partial offer for 51% of them.

The provisions of the Code concerning partial offers are set out in Rule 28, which replaces Rule 36 and Practice Note 4 of the former Code. The Takeovers Committee's practice under the provisions of the former Code was to grant approval to the making of a partial offer only if the applicant could demonstrate to the Committee that the case was so exceptional that a dispensation should be granted from the general obligation in Rule 33 that a general offer should be made where control was changed or consolidated.

The language of Rule 28 closely follows that of the corresponding provision of The City Code on Takeovers and Mergers, Rule 36, but is not identical to it. Copies of Rules 28, 36 and Practice Note 4 and of Rule 36 to the City Code are annexed to this Decision.

The applicant sought rulings on the interpretation of several of the provisions of Rule 28, but in the event the Panel's decision turned solely on the approach to be adopted in considering the granting of consent under Rule 28.1, which provides :

*"The Executive's consent is required for any partial offer. In the case of a partial offer which could not result in the offeror and persons acting in concert with it holding 35% or more of the voting rights of a company consent will normally be granted".*

The applicant argued that, since Rule 28 of the Code was modelled on Rule 36 of the City Code, the Panel should follow the approach of the City Panel under Rule 36 and should normally grant its consent to the making of a partial offer that otherwise complied with the provisions of Rule 28. It should no longer be necessary to demonstrate an "exceptional case".

The Panel did not accept the submission that it should merely follow the approach of the City Panel to the exercise of its discretion under Rule 36. The City Panel's approach has evolved over a long period in a different market environment. The Panel could find no evidence that when the language of the Hong Kong Code was brought more into line with that of the City Code it was intended that practice in Hong Kong should necessarily follow

the practice in London. The Panel considered that it should use the discretion conferred upon it under the Code so as to evolve its own body of precedent and practice in a manner appropriate to the Hong Kong market and in accordance with the "consensus of opinion of those who participate in Hong Kong's financial markets and the SFC regarding standards of commercial conduct and behaviour considered acceptable for takeover transactions in Hong Kong". Under Rule 28.1 the Executive (or the Panel) are required to exercise a discretion before allowing a partial offer to proceed and, in exercising that discretion, regard must be given to the spirit of the Hong Kong Code as it operates in the Hong Kong market, to the expectations of those participating in the Hong Kong market and to the merits of the case under consideration. General Principle 2 of the Code provides that *"If control of a company changes or is acquired or is consolidated, a general offer to all other shareholders is normally required"*. Minority shareholders have a legitimate expectation that they will receive a general offer for their shares and so have a reasonable opportunity to exit from the company if control of a company is to change. In considering an application for consent to the making of a partial offer, the Panel must weigh the interests of the applicant against the interests of minority shareholders in receiving a general offer. The onus is on the applicant to persuade the Panel that the particular circumstances of the transaction he proposes are such as to justify depriving minority shareholders of one of the fundamental protections the Code is designed to afford them.

The applicant submitted that it was in the interests of the company that the existing controlling shareholder should retain a significant stake, since this would reduce the problems that might otherwise flow from a change of management and that a full general offer might result in a prolonged period of suspension of trading of the company's shares whilst the offeror placed down sufficient shares to ensure that 25% of the shares were in public hands as required by the Listing Rules of the Stock Exchange. It was submitted that such period of suspension would not be in the interests of the company and would also be unwelcome to the existing controlling shareholder. The use of the partial offer mechanism proposed would reduce the likelihood that such a period of suspension would be necessary.

The Panel did not consider that these reasons were sufficient to justify it in granting consent to the partial offer proposed. It noted that it was not unusual for a general offer to be structured so that the existing controlling shareholder retained a significant stake by specific agreement with the controlling shareholder. The factors that concerned the applicant are within the control of the offeror and it is normal in Hong Kong for persons seeking control of listed companies to accept them.

Since the Panel refused its consent to the application, it was unnecessary for the Panel to rule on the other points of interpretation of Rule 28 raised by the applicant, although it was also noted that, if consent had been granted, the proposal would also have required waivers from two other sections of Rule 28.

3 July 1995

Encls

Extracts from Hong Kong Code on Takeovers & Mergers

**28. Partial offers**

**28.1 Executive's consent required**

The Executive's consent is required for any partial offer. In the case of an offer which could not result in the offeror and persons acting in concert with it holding 35% or more of the voting rights of a company, consent will normally be granted.

**28.2 Acquisitions prior to the offer**

In the case of an offer which could result in the offeror and persons acting in concert with it holding 35% or more, but which must result in their holding less than 100%, of the voting rights of a company, such consent will not normally be granted if the offeror or persons acting in concert with it have acquired, selectively or in significant numbers, voting rights in the offeree company during the 6 months preceding the application for consent or if voting rights have been acquired at any time after the partial offer was reasonably in contemplation.

**28.3 Acquisitions during and after the offer**

The offeror and persons acting in concert with it may not acquire voting rights in the offeree company during the offer period. In addition, in the case of a successful partial offer, neither the offeror, nor any person who acted in concert with the offeror in the course of the partial offer, nor any person who is subsequently acting in concert with any of them, may, except with the consent of the Executive, acquire voting rights of the offeree company during the 12 month period immediately following the end of the offer period.

**28.4 Offer for between 35% and 50%**

In the case of an offer which could result in the offeror holding not less than 35%, and which must result in a holding of not more than

50%, of the voting rights of a company, consent will not normally be granted.

**28.5 Offer for 35% or more requires independent approval**

Any offer which could result in the offeror holding 35% or more of the voting rights of a company must normally be conditional, not only on the specified number of acceptances being received, but also on approval of the offer, signified by means of a separate box on the form of acceptance, being given by shareholders holding over 50% of the voting rights not held by the offeror and persons acting in concert with it. This requirement may be waived if over 50% of the voting rights of the offeree company are held by one shareholder.

**28.6 Control position warning**

In the case of a partial offer which could result in the offeror holding more than 50% of the voting rights of the offeree company, the offer document must contain specific and prominent reference to this and to the fact that, if the offer succeeds, the offeror will be free, subject to this Rule, to acquire further shares without incurring any obligation to make a general offer.

**28.7 Precise number of shares to be stated**

A partial offer must be made for a precise number of shares, such number must be stated, and the offer may not be declared unconditional as to acceptances unless acceptances are received for not less than that number.

**28.8 Pro rata entitlement**

Partial offers must be made to all shareholders of the class and arrangements must be made for those shareholders who wish to do so to accept in full for the relevant percentage of their holdings. Shares tendered in excess of this percentage must be accepted by

the offeror from each shareholder in the same proportion as the number tendered to the extent necessary to enable him to obtain the total number of shares for which he has offered.

**28.9** Comparable offer

When an offer is made for a company with more than one class of equity share capital which could result in the offeror holding shares carrying 35% or more of the voting rights, a comparable offer must be made for each other class.

Extracts from former Takeovers Code

36. (1) For the purposes of this rule:—
- (a) 'offeror' shall be deemed to include persons acting in concert with the offeror;
  - (b) the announcement or making of an offer which would result in the offeror's holding shares carrying less than 35% of the voting rights in an offeree company does not require the prior approval of the Committee;
  - (c) the announcement or making of an offer which would result in the offeror's holding shares carrying from 35% to 50% of the voting rights in an offeree company is not permitted;
  - (d) a partial offer means an offer which would result in the offeror's holding shares carrying more than 50% but less than 100% of the voting rights in an offeree company and no such partial offer shall be announced or made without the prior approval of the Committee; and
  - (e) 'full offer' means an offer for shares carrying 100% of the voting rights of an offeree company.
- (2) In considering whether or not to allow a partial offer the Committee shall have due regard to the provisions of Rule 33.
- (3) If the Committee in a particular case allows the making of a partial offer then the following provisions will apply:—
- (a) the offeror shall not purchase securities in the offeree company during the offer period;
  - (b) it must be a condition of any such offer that the offer will not become or be declared unconditional as to acceptances unless the offeror has acquired or agreed to acquire (either pursuant to the offer or by shares acquired or agreed to be acquired before or during the offer) shares carrying over 50% of both the voting rights attributable to the equity share capital, and of all of the voting rights of the offeree company;
  - (c) subject to paragraph 3(b) hereof, the offer must state the precise number of shares offered for, and the offer may not be declared unconditional as to acceptances unless acceptances are received for not less than that number;
  - (d) any such offer must be made to all shareholders of the class concerned and arrangements must be made for those shareholders who wish to do so to accept in full for the relevant percentage of their holdings. Shares tendered in excess of this percentage must be accepted by the offeror from each shareholder in the same proportion to the number tendered to the extent necessary to enable it to obtain the total number of shares for which it has offered;
  - (e) any such offer must also be conditional upon the prior approval thereof by over 50% of the shareholders of the offeree company (other than the offeror) present and voting on the matter at a general meeting of the offeree company; unless one such shareholder (other than the offeror) holds over 50% of all of the voting rights of the offeree company. An offer document containing the full terms of the offer and competent independent advice thereon must be forwarded to shareholders at least 7 days prior to the said general meeting;



- (f) any such offer must also be conditional on approval of the offer, normally signified by means of a separate box on the Form of Acceptance and Transfer, being given by shareholders holding over 50% of the voting rights not held by the offeror. This requirement may on occasion be waived if over 50% of all the voting rights of the offeree company are held by one shareholder (other than the offeror);
- (g) the offer document must contain a prominent statement advising shareholders that, if the offer succeeds, statutory control will pass to the offeror which will be free to exercise that control and acquire further shares without incurring any mandatory offer obligations under the Code;
- (h) where such an offer is made for a company with more than one class of equity share capital, an offer comparable as to price payable, proportion of shares sought, and minimum level of acceptances possible, under the offer must be made for each class; and
- (i) subject to the provisions of this Rule, all other provisions of the Code apply to partial offers approved under this Rule. (*Added, 3 March 1983*)

Extracts from former Takeovers Code**PRACTICE NOTE No. 4****Rule 36**

The following are some of the factors which the Committee will take into account in considering whether to dispense with the application of Rule 33 in the case of a partial offer:—

- (a) the reasons why a full offer is undesirable or unnecessary; limited funds on the part of the offeror alone would not be considered a sufficient reason in this regard;
  - (b) the price to be offered under a partial offer; a very high price would tend to suggest that a premium is being paid for effective control of the company;
  - (c) the proportion of securities sought under a partial offer; a comparatively low proportion would be unacceptable to the Committee;
  - (d) the nature and spread of the shareholdings in the offeree company; the holdings of the offeror in the offeree company immediately prior to an offer are particularly relevant, and, if the offeror during the 12 months preceding the application for approval has acquired selectively or in significant numbers securities in the offeree company, then the Committee will refuse the application;
  - (e) any benefits likely to accrue to offeree company shareholders if a partial bid is permitted; and
  - (f) how the interests of the general body of shareholders in both the offeror and offeree companies respectively will be best protected and promoted.
- (Added, 3 March 1983)*

Extracts from City Code

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**SECTION O. PARTIAL OFFERS**

**RULE 36**

**36.1 PANEL'S CONSENT REQUIRED**

The Panel's consent is required for any partial offer. In the case of an offer which could not result in the offeror holding shares carrying 30% or more of the voting rights of a company, consent will normally be granted.

**36.2 BUYING BEFORE THE OFFER**

In the case of an offer which could result in the offeror holding shares carrying 30% or more but less than 100% of the voting rights of a company, such consent will not normally be granted if the offeror or persons acting in concert with it have acquired, selectively or in significant numbers, shares in the offeree company during the 12 months preceding the application for consent or if shares have been purchased at any time after the partial offer was reasonably in contemplation.

**36.3 BUYING DURING AND AFTER THE OFFER**

The offeror and persons acting in concert with it may not purchase shares in the offeree company during the offer period. In addition, in the case of a successful partial offer, neither the offeror, nor any person who acted in concert with the offeror in the course of the partial offer, nor any person who is subsequently acting in concert with any of them, may, except with the consent of the Panel, purchase such shares during a period of 12 months after the end of the offer period.

**NOTES ON RULE 36.3**

*1. Discretionary clients*

*Dealings for discretionary clients by fund managers connected with the offeror, unless they are exempt fund managers, may be relevant (see Rule 7.2).*

*2. Partial offer resulting in less than 30%*

*The consent of the Panel will normally be granted for share purchases within 12 months of the end of the offer period when a partial offer has resulted in a holding carrying less than 30% of the voting rights of a company.*

O<sub>2</sub>**RULE 36 CONTINUED****36.4 OFFER FOR BETWEEN 30% AND 50%**

When an offer is made which could result in the offeror holding shares carrying not less than 30% and not more than 50% of the voting rights of a company, the precise number of shares offered for must be stated and the offer may not be declared unconditional as to acceptances unless acceptances are received for not less than that number.

**36.5 OFFER FOR 30% OR MORE REQUIRES 50% APPROVAL**

Any offer which could result in the offeror holding shares carrying 30% or more of the voting rights of a company must normally be conditional, not only on the specified number of acceptances being received, but also on approval of the offer, normally signified by means of a separate box on the form of acceptance, being given by shareholders holding over 50% of the voting rights not held by the offeror and persons acting in concert with it. This requirement may on occasion be waived if over 50% of the voting rights of the offeree company are held by one shareholder.

**36.6 WARNING ABOUT CONTROL POSITION**

In the case of a partial offer which could result in the offeror holding shares carrying over 49% of the voting rights of the offeree company, the offer document must contain specific and prominent reference to this and to the fact that, if the offer succeeds, the offeror will be free, subject to Rule 36.3, to acquire further shares without incurring any obligation under Rule 9 to make a general offer.

**36.7 SCALING DOWN**

Partial offers must be made to all shareholders of the class and arrangements must be made for those shareholders who wish to do so to accept in full for the relevant percentage of their holdings. Shares tendered in excess of this percentage must be accepted by the offeror from each shareholder in the same proportion to the number tendered to the extent necessary to enable it to obtain the total number of shares for which it has offered.

**36.8 COMPARABLE OFFER**

When an offer is made for a company with more than one class of equity share capital which could result in the offeror holding shares carrying 30% or more of the voting rights, a comparable offer must be made for each class.

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**RULE 36 CONTINUED****NOTES ON RULE 36****1. Allotted but unissued shares**

*When shares of a company carrying voting rights have been allotted (even if provisionally) but have not yet been issued, for example, under a rights issue when the shares are represented by renounceable letters of allotment, the Panel should be consulted. It is likely that such shares, and the acquisition of such shares, will be taken into account for the purpose of this Rule.*

**2. Dual consideration offers for 100%**

*If a certain consideration is offered for part of each shareholder's holding and a lower consideration for the balance, such an offer may be treated as a form of partial offer in spite of the fact that the offer is being made for all voting equity share capital not already held. Rule 36.5 may apply and the Panel's consent must be sought if any such offer is contemplated.*