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## Welcome Message

Welcome to the first issue of the Hong Kong SFC's Takeovers Bulletin. This is the first of a series of periodic newsletters which will contain short informative articles and information relating to takeovers in Hong Kong. They will also contain Practice Notes on relevant issues under the Codes. These Notes are intended to provide informal guidance as to how the Takeovers Executive normally interprets and applies certain provisions of the Codes. They should not, however, be considered as an alternative to consulting the Executive to establish how the Codes apply to a particular case. As always when there is any doubt as to whether a proposed course of conduct is in accordance with the Codes, parties or their advisers should consult the Executive in advance.

Since this is our first bulletin we have included a brief description of the Codes and the role of the Executive. We hope those of you who are less familiar with this area will find this helpful. We would welcome any suggestions or comments in relation to this bulletin.

## The Takeovers Executive and the Codes

The Codes on Takeovers and Mergers and Share Repurchases are issued by the SFC and regulate takeovers, mergers and share repurchases affecting public companies in Hong Kong (see section 4.2 of the Introduction to the Codes) and companies with their primary listing in Hong Kong. The Codes are designed to afford fair treatment for shareholders by requiring equality of treatment of shareholders, mandating disclosure of timely and adequate information to enable shareholders to make an informed decision as to the merits of an offer and ensuring that there is a fair and informed market in the shares of companies affected by takeovers, mergers and share repurchases. The Codes also provide an orderly framework within which takeovers, mergers and share repurchases are to be conducted.

The Codes do not have the force of law and are framed so far as possible in non-technical language. The Codes represent a 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 takeovers, mergers and share repurchases.

Those who wish to take advantage of the securities markets in Hong Kong should conduct themselves in matters relating to takeovers, mergers and share repurchases in accordance with the Codes. If they do not do so they may find, by way of sanction, that the facilities of such markets are withheld. The Listing Rules expressly require compliance with the Codes.

The Executive comprises staff of the Corporate Finance Division of the SFC and administers the Codes on a day-to-day basis. 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 available for consultation on the application of the Codes so that issues can be addressed and problems solved at an early stage.

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## Practice Note 1 (PN1) – Partial offers

Although partial offers are relatively rare in Hong Kong the Takeovers Executive has received a number of enquiries recently about the application of Rule 28 of the Takeovers Code and would like to clarify its application in certain areas.

A partial offer is an offer to shareholders to buy a specified number (but not all) of shares which carry voting rights of a company not already held by the offeror and its concert parties. In addition to the General Principles and Rules of the Takeovers Code a partial offer is specifically governed by Rule 28 of the Takeovers Code.

A partial offer may be made in the following two ways:

- **Share register method** – This is the typical way that partial offers are made in Hong Kong. This is where an offer is made for a specific proportion of each shareholder's shares that are registered in his name on the record date. In this instance an accepting shareholder is assured that a minimum number of the shares held by him on the record date will be accepted by the offeror if the offer becomes unconditional.

For example, if an offeror holding no shares offers to buy 40% of the offeree company's shares an accepting shareholder holding 100 shares on the pre-determined record date may tender 40 shares (i.e. 40% of his holding) or less and be assured that, if the offer completes, all of those shares will be taken up by the offeror. The shareholder is therefore free to hold on to or sell his remaining 60 or more shares. Alternatively, in anticipation of some shareholders not accepting the offer, the shareholder may tender some or all of his remaining shares as excess applications for the offeror to take up and reach his target of 40%.

- **Common pool method** – The Executive has been consulted about this alternative mechanism for making a partial offer. The "common pool method" is where the number of shares taken up by the offeror from each shareholder is determined by the total number of shares tendered for acceptance (the pool).

For example in an offer to buy 40% of the offeree company's shares (again by an offeror holding no shares) where the offeree company has 100 million issued shares, 40% would represent 40 million shares. If **all** shareholders tender **all** their shares in acceptance the offeror must take up 40% of each shareholder's tendered shares. However, if for example, the offeror receives a total of 50 million shares tendered for acceptance, 80% (i.e. 40 million ÷ 50 million) of the shares tendered for acceptance by each shareholder must be taken up by the offeror ensuring that all accepting shareholders share the offer on an equal basis. There is no record date nor reference to the share register. Provision for excess applications is not required.

In general the Executive views both types of offer mechanism as acceptable for Takeovers Code purposes because in both cases shareholders are treated equally and are fully informed of the mechanism and terms of the partial offer. Given the drafting of Rule 28.8 the Executive may, depending on the circumstances of the case, grant a waiver from strict compliance with that Rule in the case of common pool partial offers. As with all transactions under the Codes there is an overriding concern that shareholders are treated equally.

In all partial offers the Executive should be consulted at the earliest opportunity.

### **Odd lots**

One consequence of accepting a partial offer is that shareholders may be left holding odd lots of shares which can be difficult to sell or only be sold at a lower price than the market price or involve greater transaction costs per share to sell than board lots of shares. In these circumstances a designated broker may be appointed to match sales and purchases of odd lot holdings. The designated broker may not, however, itself make an offer to buy the odd lots from shareholders. The reason for this is that if odd lot holders were to receive an offer for their shares and this offer was not extended to all other shareholders this would amount to unequal treatment of shareholders in breach of General Principle 1 and Rule 28.3 (as the designated broker is likely to be acting in concert with the offeror) of the Takeovers Code. In cases of doubt the Executive should be consulted.

### **Shareholder approval for partial offers for 30% or more**

Rule 28.5 of the Takeovers Code provides that any partial offer which could result in the offeror holding 30% or more of the shares which carry voting rights of a company must normally be conditional on the approval of the offer, by independent shareholders holding over 50% of the shares (i.e. this is calculated by reference to the total issued shares of the company and not limited to shares held by shareholders attending the meeting). The reason for this is to ensure that over 50% of the independent shareholders approve the offeror's proposal to acquire 'control' by means of a partial offer (which can be regarded as an exception of the requirement to make a mandatory offer under Rule 26.1 of the Takeovers Code). A shareholder who wishes to approve the offer must tick the separate box on the acceptance form and indicate the number of shares in respect of which the offer is approved. The approval process is viewed as separate from the acceptance process and therefore it is possible to have a shareholder who accepts a partial offer but does not approve it or who does not accept the offer but approves it.

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## **Practice Note 2 (PN2) – Treatment of profit forecasts required by overseas jurisdictions**

During the course of a Code-related transaction, an offeree company may be required under the laws and regulations of an overseas jurisdiction to include certain financial projections in documents that are sent to shareholders containing details of the transaction. Such financial projections would normally be regarded as profit forecasts under Rule 10 of the Takeovers Code and would therefore need to be 'reported on' by both the offeree company's financial advisers and its accountants or auditors. In particular (i) the offeree company's financial advisers would have to satisfy themselves that the profit forecasts were prepared with due care and consideration by the directors of the company, and (ii) the offeree company's accountants or auditors would have to satisfy themselves that the profit forecasts, so far as accounting policies and calculations are concerned, were properly prepared on the basis of the assumptions made.

Notwithstanding this, if the only reason for the publication of the profit forecasts is that they are required to be published under the laws and regulations of certain overseas jurisdictions (and are not otherwise proposed to be published by the offeree

company), the Executive will normally be prepared to permit publication of the forecasts without full compliance with Rule 10. In this instance the profit forecasts must be accompanied by an appropriate warning that they do not meet the standard required by Rule 10 and that shareholders and potential investors should exercise caution in placing reliance on such forecasts in assessing the merits and demerits of the transaction. In all cases involving this issue the Executive should be consulted at the earliest opportunity.

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## Takeovers Executive publishes a statement on its ruling in relation to PCCW Limited

Today the Takeovers Executive published a statement on its ruling under the Codes regarding whether certain parties were acting in concert in respect of PCCW Limited. The Executive received the application for the ruling in early November 2006 and raised numerous enquiries with the various parties. After carefully considering the information before it including the parties' responses to its enquiries, the Executive ruled that there was insufficient evidence to conclude that certain parties were acting in concert in respect of PCCW. The statement sets out the reasons for that decision.

Section 16.3 of the Introduction to the Codes provides that, subject to confidentiality considerations, it is the policy of the Executive to publish its important rulings and the reasons for them so that its activities may be understood by the public.

A copy of the Statement can be found under 'Takeovers & Mergers' – 'Panel and Executive Decisions/Statements' of the SFC website at <http://www.sfc.hk>.

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The Takeovers Bulletin is available under 'Speeches, Publications & Consultations' – 'Publications' of the SFC website at <http://www.sfc.hk>.

Feedback and comments are welcome and can be sent to [takeoversbulletin@sfc.hk](mailto:takeoversbulletin@sfc.hk).

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