

TAKEOVERS AND MERGERS PANEL

Panel Decision

In relation to a referral by the Takeovers Executive to the Takeovers and Mergers Panel (the “Panel”) for a ruling on whether Broadford Global Limited (“Broadford”) is permitted under the terms of its possible offer for the ‘H’ Shares in Dalian Port (PDA) Company Limited (the “Company”) set out in its Rule 3.5 possible [offer announcement dated 4th June, 2019](#) (the “Rule 3.5 Announcement”) to deduct the dividend paid on 16th August, 2019 from the offer price in cash of HK\$1.0127 for each ‘H’ Share in the Company, other than ‘H’ Shares owned by or agreed to be acquired by Broadford and parties acting in concert with it.

Purpose of the hearing

1. The Panel met on 11th September, 2019 to consider a referral by the Takeovers Executive under Section 10.1 of the Introduction to the Codes on Takeovers and Mergers and Share Buy-backs (the “**Takeovers Code**”) which relates to a particularly novel, important or difficult point at issue.
2. The Panel was asked to consider whether Broadford may deduct the final dividend declared and paid by the Company in respect of its financial year ended 31st December, 2018 from the amount to be paid to the relevant holders of ‘H’ shares in the Company (“**H’ Shares**”) under its possible mandatory general offer (the “**Offer**”) for the ‘H’ Shares announced on 4th June, 2019.

Background and facts

3. The Company is a joint stock company incorporated in the People’s Republic of China (the “**PRC**”), the ‘H’ Shares of which are listed on the Main Board of The Stock Exchange of Hong Kong Limited under stock code 2880 and the ‘A’ Shares of which are listed on the Shanghai Stock Exchange. As at 31st July, 2019 the Company had a total of 12,894,535,999 shares in issue of which 5,158,715,999 are ‘H’ Shares, representing approximately 40% of its total issued share capital.
4. Broadford is a company incorporated in Hong Kong and is indirectly wholly-owned by China Merchants Group Limited (“**CMG**” which together with its subsidiaries is referred to as the “**CMG Group**”), which is a state-owned enterprise established under the laws of the PRC and under the direct control of the State-owned Assets Supervision and Administration Commission of the State Council of the PRC (“**SASAC**”). The CMG Group currently holds approximately 21.05% of the shares in the Company.
5. Broadford indirectly owns a 49.9% interest in Liaoning Port Group Limited (“**Liaoning Port Group**”), a limited liability company established in the PRC. The remaining 50.1% of Liaoning Port Group is owned by the State-owned Assets Supervision and Administration Commission of the Liaoning Provincial Government (“**Liaoning SASAC**”). In turn, among other port interests, Liaoning Port Group holds indirectly a 46.78% shareholding interest in the Company.

6. In an [announcement by the Company dated 2nd June, 2019](#) and the Rule 3.5 Announcement it was announced that it was proposed that Liaoning SASAC will transfer a 1.1% equity interest in Liaoning Port Group to Broadford for a nil consideration (the “**Transfer**”). The Transfer was subject to a number of pre-conditions being (i) the approval of the Transfer by SASAC and the indirect acquisition of the shares in the Company, as they are listed shares; (ii) the approval of the Transfer by the Liaoning Provincial Government; and (iii) a waiver from the China Securities Regulatory Commission of the mandatory general cash offer obligation of CMG Group in respect of the ‘A’ Shares of the Company and the ‘A’ Shares of Yingkou Port Liability Company Limited. It was anticipated these conditions would take some months to be fulfilled. In the Rule 3.5 Announcement it was stated that application had been made to the Takeovers Executive to extend the deadline for the despatch of the offer document to the seventh day after the completion of the Transfer or 7th October, 2019 whichever is the earlier. The Takeovers Executive’s approval of the extension was confirmed in an announcement by the Company dated 10th July, 2019. It was apparent at the hearing that there was never a realistic prospect of these pre-conditions being fulfilled within a month of the publication of the Rule 3.5 Announcement.
7. On completion of the Transfer, a mandatory general offer obligation under Rule 26.1 of the Takeovers Code will arise for Broadford under the chain principle of the Takeovers Code as Broadford will acquire statutory control of Liaoning Port Group which holds a controlling interest in the Company. The Transfer will have the effect of increasing CMG Group’s indirect voting interest in the Company to 67.83%. Since the Transfer will be effected at a nil consideration and no purchases of shares in the Company directly or indirectly have been made by Broadford or parties acting in concert with it within six months of the Rule 3.5 Announcement, the offer price for the ‘H’ Shares was determined with the agreement of the Takeovers Executive to be the volume weighted average price (“**VWAP**”) of the ‘H’ Shares on 31st May, 2019, the last trading day before any announcement was made referring to the Transfer and the possibility of a mandatory general offer obligation. The VWAP was calculated to be HK\$1.0127. The share prices used on that date were cum the final dividend, as more fully described below.
8. It should be noted that in advance of the publication of the Rule 3.5 Announcement there had been extensive consultation commencing in March, 2019 between the legal advisers to Broadford and the Takeovers Executive and, in particular, whether a mandatory general offer would be triggered on the implementation of the Transfer and, if so, at what price.
9. On 26th March, 2019 the Company [announced](#) its annual results for the year ended 31st December, 2018 in which it stated that the directors proposed to distribute a final dividend of RMB1.9 cents per share, equivalent to HK2.163 cents which was determined at the prevailing exchange rate on 27th June, 2019, the date on which shareholders [approved](#) the payment of the final dividend at the Company’s annual general meeting. The final dividend of HK2.163 cents was inclusive of the PRC’s Enterprise Income Tax.
10. On 10th May, 2019, the Company published a [circular](#) to its shareholders in which it set out the timetable for the distribution of the final dividend. A resolution was to be proposed at the Company’s annual general meeting to be held on 27th June, 2019. Subject to the passing of the resolution, the ‘H’ Shares were to be traded ex the entitlement to the final dividend on 3rd July, 2019 and the dividend was expected to be paid on 16th August, 2019. Given the time in which it was expected to fulfil the pre-conditions to which the Transfer was subject, the mandatory general offer to be made

on behalf of Broadford was from the outset almost certainly be made for 'H' Shares which would then be trading ex the entitlement to the final dividend.

11. In its Rule 3.5 Announcement Broadford stated that *“The H Shares to be acquired under the Possible H Shares Offer shall be fully paid and free from all liens, charges, encumbrances, rights of pre-emption and any other third party rights of any nature and together with all rights attaching to them as at the date of this announcement, including the right to receive in full all dividends and other distributions, if any, declared, made or paid on or after the date of this announcement”* (the **“Relevant Statement”**). No reference was made to the final dividend which the Company had declared on 26th March, 2019 or how Broadford intended to exercise its right to receive all dividends and distributions, if at all.
12. On 14th June, 2019 the advisers to Broadford contacted the Takeovers Executive seeking its confirmation that the terms of the Offer permitted Broadford to deduct the gross amount of the Company’s final dividend from the offer price so that the offer price would be reduced from HK\$1.0127 to HK\$0.99107. A number of written submissions were then made by Broadford to the Takeovers Executive which resulted in the matter being referred to the Panel.

Relevant provisions of the Takeovers Code

13. All persons concerned with a takeover offer or possible offer are required to make prompt disclosure of all relevant facts so as to avoid the creation of a false market. This is set out in General Principle 6 which states:

“All persons concerned with offers should make full and prompt disclosure of all relevant information and take every precaution to avoid the creation or continuance of a false market. Parties involved in offers must take care that statements are not made which may mislead shareholders or the market.”

14. The Takeovers Code requires that any announcement made during the course of an offer must satisfy the highest standards of accuracy. This is set out in Rule 9.1 which reads as follows:

“Each document issued or statement made in relation to an offer or possible offer or during an offer period must, as is the case with a prospectus, satisfy the highest standards of accuracy and the information given must be adequately and fairly presented. This applies whether it is issued or made by the company direct, or by an adviser on its behalf, or by any other relevant person. Those who issue or make any such document or statement must ensure that it remains accurate and up to date throughout the offer period, and must notify shareholders of any material changes as soon as possible.”

15. Unlike the London City Code there are no provisions in the Takeovers Code setting out how an offeror should describe how any dividend declared or paid during an offer period will impact on the price being offered. The only reference to the potential alteration of an offer price resulting from the payment of a dividend, which is retained by assenting shareholders, is in Note 3 to Rule 26.3 which states:

“When accepting shareholders are entitled under the offer to retain a dividend declared by the offeree company but not yet paid, the offeror, in establishing the level of the cash offer, may deduct from the highest price paid the net dividend to which offeree company shareholders are entitled.”

16. While Note 3 to Rule 26.3 refers only to a specific circumstance when an offeror is permitted to deduct a dividend from the price paid for shares in an offeree company to determine the highest price paid for the shares in order to establish the level of a cash offer, the Note does support the notion that there may be other circumstances when the deduction of a dividend from the offer price may be appropriate, although the Takeovers Code does not particularise what those circumstances might be.
17. Note 3 also refers to the deduction of the net dividend to which offeree company shareholders are entitled. In advance of the hearing the parties were asked, in the event that Broadford were to be permitted to deduct the Company's final dividend from its offer price, whether allowance should be made for the deduction of a 10% withholding tax which applied to most of the holders of the 'H' Shares.
18. All announcements of a firm intention to make an offer, including a pre-conditional or possible offer, must be made in accordance with Rule 3.5 of the Takeovers Code. While it is not considered necessary to set out the Rule and its Notes in full, Rule 3.5 requires, amongst other things, that the offeror set out the full terms and conditions of its offer or possible offer and that it include a confirmation by its financial adviser or another appropriate third party that resources are available to the offeror sufficient to satisfy full acceptance of the offer.
19. Before there is a firm intention to make an offer, any announcement made by a potential offeror is made in accordance with Rule 3.7 of the Takeovers Code. It is not required for an announcement made in accordance with this rule to make reference to either the value of the offer or its terms and conditions. Also, no financial sufficiency statement is required.

Other possible precedents

20. In both the submissions of the Takeovers Executive and Broadford reference was made to the consultation by the Code Committee of the London Panel in May 2015 to amend the London City Code to clarify the application of the existing provisions of the London City Code, as it related to an offeror's ability to deduct dividends subsequently paid on the shares which are subject to an offer and to align it with the existing practice of the Panel Executive. The London City Code was subsequently amended to reflect the results of the consultation in November, 2015.
21. In summary new rules were introduced to the London City Code which provided that an offeror may reserve the right to reduce the offer consideration by the amount or part of a dividend subsequently paid by the offeree company and, if an offeror does not reserve that right, it will not normally be permitted to reduce the offer consideration by all or a part of a dividend which is subsequently paid by the offeree company.
22. Although the Takeovers Code originated from the London City Code, both codes have evolved in response to the particular character and circumstances of their respective markets. Consequently, while the practice in London can offer a useful insight into the application of a code which is broadly similar to our own, it does not provide a precedent that should automatically be followed here.
23. In Hong Kong it has not been considered necessary to codify how dividend payments are to be treated during the course of an offer and reliance has been made on the requirement of an offeror to provide accurate, timely and complete information during the course of an offer in accordance with General Principle 6 and Rule 9.1.

Comparisons with the Maanshan transaction

24. At around the same time as the publication of the Rule 3.5 Announcement, a similar transaction between Baosteel Hong Kong Investment Company Limited (“**Baosteel**”) and Maanshan Iron & Steel Company Limited (“**Maanshan**”) was announced, under which 51% of the holding company of Maanshan, holding 45.54% of its share capital, was to be transferred to Baosteel for a nil consideration. When the transaction was first announced on 2nd June, 2019 in accordance with Rule 3.7 no indicative offer price was mentioned, although at that time the shares in Maanshan were trading cum the entitlement to a final dividend in respect of its 2018 financial year.
25. Following the [decision of the Panel](#) which ruled on 19th June, 2019 that the proposed transaction on completion will give rise to a mandatory general offer obligation for Baosteel, it published a joint announcement in accordance with Rule 3.5 setting out the terms of its possible offer for the ‘H’ shares in Maanshan on 22nd July, 2019. As with the Offer, the offer price for the ‘H’ shares in Maanshan was determined by the VWAP on 31st May, 2019, the last trading day before the publication of its first announcement on 2nd June, 2019.
26. The basis on which the ‘H’ shares in Maanshan were to be acquired was stated in very similar terms to those used in the Rule 3.5 Announcement and in identical terms as it related to dividends, if any, declared, made or paid on or after the date of the announcement. By that date, however, the ‘H’ shares in Maanshan were ex the entitlement to its final dividend and this dividend was specifically excluded from the VWAP calculation with the agreement of the Takeovers Executive.

The case of the Takeovers Executive in summary

27. The Relevant Statement referring to the right to receive dividends declared, made or paid in the Rule 3.5 Announcement was ambiguous. While it stated the offeror’s right to receive all dividends, it omitted to explain how the right would be exercised and made no reference whatsoever to the possibility that the offer price might be reduced.
28. The Relevant Statement was drafted in conventional terms except that it is more usual for the right to any dividends declared, made or paid to be from the date of the offer document rather than the announcement made in accordance with Rule 3.5. The Relevant Statement was merely a description of the nature of the ‘H’ Shares to be acquired under the Offer. It was illogical for Broadford to claim to be entitled to dividends which have been paid before it had become a shareholder of the Company. Given that the publication of the offer document was only expected to be made in October, 2019, that is three months after the ‘H’ Shares had traded ex the entitlement to the final dividend, it would be manifestly unfair to a shareholder who had acquired the ‘H’ Shares ex the final dividend in the expectation of an offer price as stated in the Rule 3.5 Announcement to find that it had been reduced by the amount of a dividend it had not received.
29. The Maanshan transaction did not provide a useful precedent for Broadford. In the Maanshan case, the Takeovers Executive had been consulted on how to deal with the Maanshan’s final dividend which is why the VWAP was calculated using 31st May, 2019 prices but deducting from them the final dividend. The Takeovers Executive wished to

make it clear that, had Broadford consulted with it before the publication of the Rule 3.5 Announcement, it would have agreed to a price which had deducted from it the Company's final dividend.

30. It was apparent that the question of the final dividend had been overlooked during the period before the publication of the Rule 3.5 Announcement and, having failed to have made an accommodation for the final dividend which would not be reflected in the price of the 'H' Shares when its offer was made, Broadford was trying to find a way, any way, of clawing back the dividend. In this regard, in addition to attempting to use the language of the Relevant Statement to support the deduction of the final dividend from the announced offer price, it also considered requesting the Company to postpone the payment of its final dividend until after its offer had been completed. This idea was not pursued as it raised a number of difficult regulatory issues both under the Takeovers Code and the Stock Exchange Listing Rules.
31. There was no circumstantial evidence before the publication of the Rule 3.5 Announcement that Broadford had ever considered the consequences of the final dividend on its offer price even though it was almost certain that, when its offer was made, the 'H' Shares would be trading ex the entitlement to the final dividend. The board minutes of Broadford make no reference to any dividend and the financial resources confirmation required by Rule 3.5 made by Broadford's financial adviser was made on the basis of the full offer price even though, when the offer was made, the final dividend would almost certainly have been paid.
32. The Takeovers Executive believed that the trading in the 'H' Shares also supported its view that the market was trading in the expectation that the offer price would be as originally stated and the final dividend would not be deducted from it. Before the publication of the Rule 3.5 Announcement on 31st May, 2019, the 'H' Shares closed at HK\$1.01. On the day of publication of the Rule 3.5 Announcement the 'H' Shares closed at HK\$1.03. On 2nd July, 2019, the last day the 'H' Shares traded cum the entitlement to the final dividend, the price closed at HK\$1.03. On the ex-dividend date of 3rd July, 2019, the 'H' Shares closed at HK\$1.01, which appears to be higher than would be the case had there been an expectation that the offer price would be reduced by the amount of the dividend.
33. Turning to the treatment of dividends under the London City Code, it is clear both before the application of the existing practice was clarified by the amendment to the London City Code in November, 2015, and thereafter the Relevant Statement would not have been sufficient to enable the offeror to reduce its offer price as a result of the payment of a dividend. Both before and after the amendment of the London City Code, the offeror had to state that it reserved the right to reduce the offer price, in whole or in part, as a result of the payment of a dividend, or it had no such right subsequently to do so.
34. Hong Kong does not have these provisions in the Takeovers Code and the Takeovers Executive was not attempting to impose the London City Code requirements in this case. Instead the Takeovers Executive's position was similar to that adopted in London before the London City Code was amended. Unless the possibility of a reduction is referred to specifically in the preliminary announcement of the offer in accordance with Rule 3.5, the offer price cannot be reduced. The rationale for this is simple. Unless shareholders are warned at the outset of the possibility of a reduction in the offer price, they would be making investment decisions based on what had been announced but unaware that a reduction could be made. This is plainly unsatisfactory. In the Relevant Statement there is no reference of any kind to the possibility of a reduction. Further, the Takeovers Executive did not believe that the ambit of Note 3 to Rule 26.3 can be extended to permit such a reduction.

35. The Takeovers Executive does not believe that its position is equivalent to compelling the offeror to increase its offer. Its position does not increase the offer in any way. The offer price was stated clearly in the announcement and the market has traded on this basis. While the Takeovers Executive has sympathy with the predicament in which Broadford finds itself and this will increase the cost of its offer, this could have been avoided had Broadford considered the issue and raised it with the Takeovers Executive before it published the Rule 3.5 Announcement.
36. Lastly, on the questions of what the net dividend should be, were a deduction of the final dividend to be permitted by the Panel, the Takeovers Executive considered that the net dividend should be 90% of the gross dividend per 'H' Share to reflect the deduction of a 10% withholding tax in the PRC.

The case of Broadford in summary

37. Broadford did not believe that the Relevant Statement was ambiguous. It was clear that the offeror was entitled to the final dividend declared by the Company and paid in August, 2019. A reduction in the offer price was the only feasible way to implement the Offer in accordance with its stated terms when the 'H' Shares were to be acquired ex the entitlement to the final dividend.
38. The offer price was not derived through purchases or negotiation which is how an offer price is generally determined. Instead, at the direction of the Takeovers Executive a formula was used being the VWAP of the 'H' Shares on 31st May, 2019. At that time, the 'H' Shares were trading cum the final dividend so that was how the offer price was determined.
39. Note 3 to Rule 26.3 permits an offeror to reduce an offer price as a result of the payment of a dividend by the net amount of that dividend. Unlike many provisions in the Takeovers Code, there was no requirement to consult the Takeovers Executive to make such an adjustment. All Broadford was asking was to use an established mechanism to reflect what it had intended from the outset as set out in the Relevant Statement.
40. The Relevant Statement was a contractual term of the Offer, rather than an assertion of a shareholder's rights, and the only practical way of enforcing the contractual right to dividends was by making the deduction to the offer price. If anything, the pattern of trading in the 'H' Shares which had settled in a narrow band of HK\$0.99 to HK\$1.01 confirmed the expectation that the Offer would be at a price net of the final dividend.
41. The amendments to the London City Code did not codify existing practice but effectively introduced new requirements for an offeror in making statements relating to dividends. In Hong Kong no such provisions exist and it would require the amendment of the Takeovers Code to impose them in this instance.
42. The present case differs from the Maanshan case in that by the time Baosteel and Maanshan made their joint announcement in accordance with Rule 3.5 the 'H' shares in Maanshan were already trading ex the entitlement to its final dividend and a deduction for that dividend had been included in the formula offer price so the question of a deduction simply did not arise.
43. On the question of the amount of the dividend to be deducted, Broadford should be entitled to deduct the full dividend as the Company was effectively paying withholding

tax on behalf of certain shareholders. Any deduction for taxes would require the offeror to know the tax status of individual shareholders and it was in no position to do this.

The Panel's decision and its reasons for it

44. Note 3 to Rule 26.3 applies specifically to the determination of the highest price paid by the offeror, when accepting shareholders are entitled under the offer to retain a dividend declared by the offeree company. While it may indicate that the Takeovers Code accepts the concept that a dividend may be deducted in certain circumstance when establishing an offer price, it does not give an offeror any general right to deduct a dividend from its offer price in any other circumstance other than in establishing the highest price paid by an offeror and it certainly does not permit such a deduction without prior consultation with the Takeovers Executive. Broadford could not, therefore, rely on the provisions of the Note to justify the reduction of its stated offer price by deducting from it the Company's final dividend payment.
45. Nowhere in the Rule 3.5 Announcement was there any reference to the Company's final dividend, the full details of which should have been known by the offeror, or to any possibility that the offer price was subject to reduction to reflect the payment of the final dividend. The Relevant Statement is simply silent on the point. In view of this it is difficult to see how shareholders and potential investors could have parsed this conventionally-worded Relevant Statement to mean that the offeror is permitted to reduce the offer price by the gross amount of the final dividend.
46. In the Rule 3.5 Announcement, prominence is given to the offer price in the summary section, which omitted any reference to the Relevant Statement, and in a number of places in the full text of the announcement. The expectation of anyone reading the Rule 3.5 Announcement would have been that shareholders will be offered HK\$1.0127 per 'H' Share irrespective of what is stated in the Relevant Statement and when payment of the final dividend was made.
47. Given the requirement of the Takeovers Code that all statements made during the course of an offer must satisfy the highest standards of accuracy, shareholders and potential investors in normal circumstances should be confident that the offer price stated in an announcement made in accordance with the provisions of Rule 3.5 should not be reduced unless there is an explicit statement to the contrary.
48. Accordingly, the Panel has determined that, if the Transfer is completed, Broadford must make the Offer on the basis of the offer price of HK\$1.0127 as stated in the Rule 3.5 Announcement and that it is not permitted to deduct the Company's final dividend paid in August, 2019 from this price.
49. As the Panel has determined that a deduction of the final dividend is not permitted, it has not become necessary to determine whether such deduction should be net of withholding tax or gross.

30th September, 2019

Parties:

The Takeovers Executive

Broadford

Linklaters – Legal advisers to Broadford

China International Capital Corporation Hong Kong Securities Limited – Financial advisers to Broadford

Freshfields Bruckhaus Deringer – Legal advisers to China International Capital Corporation Hong Kong Securities Limited

The Company

Paul Hastings – Legal advisers to the Company