



Takeovers Bulletin

Highlights

- Practice Note 7 (PN 7) revised to take into account treatment of right-of-use assets
- Public censures of CLSA Limited, CITIC Securities Brokerage (HK) Limited, Beijing Enterprises Holdings Limited and their representatives for Share Buy-backs Code breaches
- Note 2 on dispensations from Rule 26 of the Takeovers Code
- Appointments and reappointments to the takeovers-related committees
- Quarterly update on the activities of the Takeovers Team

Revisions to PN 7 – Treatment of right-of-use assets

PN 7 has been revised to clarify that right-of-use (ROU) assets recognised under International Financial Reporting Standard 16 (IFRS 16) 'Leases'¹ should not be regarded as a company's property assets for the purposes of Rule 11.1(f) of the Takeovers Code.

In Issue No. 3 (December 2007) of the *Takeovers Bulletin*, we reminded parties and their advisers to consult the Executive at the outset of transactions when in doubt as to whether certain assets should be taken into account for the purpose of calculating the 15% and 50% property interest thresholds under Rule 11.1(f).

Rule 11 of the Takeovers Code governs asset valuations and provides that when valuations of assets are given in connection with an offer, details of the valuations must be included in the relevant document and should be properly supported by

the opinion of a suitably qualified independent valuer. The rule helps ensure that shareholders are provided with sufficient information to reach an informed decision on an offer as required by General Principle 5 of the Codes on Takeovers and Mergers and Share Buy-backs (Codes).

Rule 11.1(f) sets out the circumstances when a property valuation report is required. In particular, when an offeror is an interested party and the offeree company has significant property interests (and in the case of a securities exchange offer, when the offeror has significant property interests), a property valuation will be required. Rule 11.1(f) provides further guidance on the meaning of "significant property interests":

"As a general guide, a company has "significant property interests" if the book value of its consolidated property assets **exceeds 15% of its consolidated total assets**" (emphasis added).

¹ The equivalent of Hong Kong Financial Reporting Standard 16 (HKFRS 16) 'Leases'.

Recently, we have been consulted on a number of occasions about whether ROU assets as defined under IFRS 16 should be regarded as a company's property assets for the purposes of Rule 11.1(f).

Previously, under International Accounting Standard 17 (IAS 17) 'Leases', a lessee was required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). In January 2016, the International Accounting Standards Board issued IFRS 16 to supersede IAS 17. Under IFRS 16, the lessee is required to recognise an ROU asset for its right to use the asset under a lease and its corresponding liability without the need to differentiate between a finance lease and an operating lease. In essence, unless exemptions apply, lessees are required to bring all contracts which meet the definition of a "lease" under IFRS 16 onto the balance sheet. The accounting treatment for lessors remains largely unchanged.

IFRS 16 became effective for annual reporting periods beginning on or after 1 January 2019.

Although IFRS 16 treats the right to use the asset under a lease as an asset on the company's balance sheet, the lessee does not have legal ownership of the underlying leased asset as it remains with the lessor. For this reason, ROU assets should not normally be regarded as a company's property assets for the purposes of the Takeovers Code. It follows that the values of these ROU assets should normally be excluded when determining whether a company has significant property interests of 15% and 50% under Rule 11.1(f).

If in doubt, the Executive should be consulted at the earliest opportunity.

Public censures of CLSA, CSB, Beijing Enterprises and others for Share Buy-backs Code breaches

On 30 December 2019, we publicly censured nine entities and individuals for share buy-back transactions in Beijing Enterprises Holdings Limited conducted in 2016 in breach of the Code on Share Buy-backs.

The censured parties were:

- CLSA Limited
- Andrew James WALTERS
- Stuart Richard WILSON
- CITIC Securities Brokerage (HK) Limited (CSB)
- Ka Yip Eddy LAU
- King Yuen LAU
- Stephanie LI
- Beijing Enterprises Holdings Limited
- Woon Cheung Eric TUNG

In February and May 2016, CLSA on behalf of its institutional clients and CSB on behalf of Beijing Enterprises carried out coordinated trades which allowed Beijing Enterprises to buy back more than 18 million of its shares on The Stock Exchange of Hong Kong Limited. These on-market trades were in fact pre-arranged and pre-agreed, and in substance off-market share buy-backs which required approvals from the Executive and Beijing Enterprises' independent shareholders under Rules 1 and 2 of the Code on Share Buy-backs.

In effecting the pre-arranged trades, the conduct of CLSA, CSB and their licensed persons fell short of the standards expected of them under the Codes, and shareholders of Beijing Enterprises were deprived of the opportunity to vote on an important corporate action.

The parties accepted that they failed to comply with the Code on Share Buy-backs and consented to the disciplinary action taken against them.

Practitioners and parties who wish to take advantage of the securities markets in Hong Kong are reminded to conduct themselves in accordance with the Codes. If there is any doubt about their application, the Executive should be consulted at the earliest opportunity.

A copy of the Executive Statement can be found in the "Regulatory functions - Listings & takeovers - Takeovers & mergers - Decisions and statements - Executive decisions and statements" section of the SFC website.

Note 2 on dispensations from Rule 26

We have noted a recent increase in the number of cases where lenders enforced security over controlling stakes in listed companies. In some cases, relevant parties overlooked possible Takeovers Code implications, and we wish to take this opportunity to clarify them.

Under Rule 26.1(a) of the Takeovers Code, subject to the granting of a waiver by the Executive, when 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, that person shall extend offers on the basis set out in Rule 26 of the Takeovers Code to the holders of each class of equity share capital of that company. When a lender takes enforcement actions following a loan default, it may acquire 30% or more of the voting rights of a company and trigger a mandatory offer obligation under Rule 26.1 unless otherwise waived. A lender that has acquired voting rights will nevertheless trigger an offer obligation even if he does not exercise them.

As noted in a number of Panel decisions, once an offer obligation under Rule 26.1 is triggered, that forms the starting point to any analysis. A lender

may consider applying for a waiver under Note 2 on dispensations from Rule 26 and should do so before the acquisition of any voting rights of a company which would trigger a general offer.

Note 2 on dispensations from Rule 26 sets out circumstances when a lender's obligation to make an offer may be waived. It provides that *"[w]here a shareholding in a company is charged to a bank or lending institution on an arm's length basis and in the ordinary course of its business as security for a loan and, as a result of enforcement, the lender would otherwise incur an obligation to make a general offer under this Rule 26, the Executive will normally waive the requirement, provided that the security was not given at a time when the lender had reason to believe that enforcement was likely."*

The note further states that *"[a]lthough a receiver or liquidator of a company is not required to make an offer when he takes control of a holding of 30% or more of the voting rights of another company, the provisions of this Rule 26 apply to a purchase from such a person"*.

We construe "bank or lending institution" narrowly. An authorised institution within the meaning of the Banking Ordinance (Cap. 155) lending money in the ordinary course of business will normally be considered to be a "bank or lending institution" by the Executive for the purposes of Note 2. However, the holding of a money lenders licence under the Money Lenders Ordinance (Cap. 163), in itself, is unlikely to allow an institution to fall within the definition. The Executive will scrutinise the purpose of the loan, the nature of the lender's business (if any) and all relevant circumstances relating to the loan before making a determination.

The second paragraph of Note 2 operates independently from the first paragraph. We note that it is quite common for lenders to appoint independent receivers (and in some instances, liquidators) to take over the secured assets following a loan default. The primary duty of a receiver or liquidator is to safeguard the value of security

assets and, if appropriate, realise them to satisfy the outstanding debt in whole or in part. Therefore, the second paragraph of Note 2 envisages that no general offer obligation will be triggered upon a receiver or liquidator acquiring control over a secured controlling stake in an offeree company.

Where a lender appoints (or purports to appoint) its own employees, officers or related parties (or employees or officers of such related parties) as receivers or liquidators of a controlling stake in an offeree company, we do not consider that these receivers or liquidators can rely on the second paragraph of Note 2. In such cases, that lender is likely to have triggered an obligation to make a mandatory general offer under Rule 26.1 upon enforcement of the security.

In cases where an independent receiver or liquidator is appointed, it will normally be looking to dispose of the secured assets, which may or may not ultimately lead to a change of control of the relevant offeree company, and this will give rise to a possible offer. Therefore, an offer period will commence as soon as the independent receiver or liquidator takes control of 30% or more of the voting rights of a company. An announcement under Rule 3.7 of the Takeovers Code is also expected to be published when this happens.

Once an offer period commences, the name of the relevant offeree company will be included in the Offer Periods Table on the SFC website. The name of the offeror will be added when such information becomes available, as with other cases where an offer period commences following the publication of a talks announcement with an unnamed potential offeror. The offer period will cease when an offer is completed or when the possibility of a general offer has been ruled out.

As always, the Executive should be consulted when in doubt.

Appointments and reappointments to the takeovers-related committees

We welcome new appointments and reappointments of members to the following committees with effect from 1 April 2020:

Takeovers and Mergers Panel (Panel) and the Takeovers Appeal Committee (Appeal Committee)

New appointments – Ms Celia LAM and Mr Mark SCHWILLE (Deputy Chairmen of the Panel), Mr Paul CHOW, Ms Pauline LEUNG, Ms Victoria LLOYD, Mr Timothy STEINERT, Mr Philip TYE and Mr Richard WONG

Reappointments – Ms Teresa KO, JP and Mr John MAGUIRE (Deputy Chairmen of the Panel and members of the Appeal Committee), Mr Conrad CHAN, Ms Julia CHARLTON, Mr Edward CHENG, GBS, JP, Mr Lawrence LEE, BBS, JP, Mr David NORMAN, Mr Nicholas NORRIS, Mr Martin SABINE, Mr Richard WINTER, Mr Julian WOLHARDT, Mr Alex WONG and Ms Benita YU

Disciplinary Chair Committee

Reappointments – Mr Victor DAWES, SC, Mr JAT Sew Tong, SC, JP, Mr Douglas LAM, SC, Mr Paul SHIEH, SC, and Mr Anson WONG, SC

Nominations Committee

Reappointments – Mr Tim LUI, SBS, JP and Dr William WONG, SC, JP

Full list of members of takeovers-related committees

Members are appointed for a term of two years until 31 March 2022 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 SFC.

Chairman

Mr CLARK Stephen Edward*

Deputy Chairmen

Mr CHAN Yuk Sing, Freeman*

Ms KO Teresa Yuk Yin, JP

Ms LAM Chor Lai, Celia

Mr MAGUIRE John Martin

Mr SCHWILLE Mark Andrew

Mr WEBB David Michael*

Members

Ms BIDLAKE Alexandra*

Ms BROWN Melissa*

Mr CHAN Che Chung

Ms CHARLTON Julia Frances

Mr CHENG Wai Sun, Edward, GBS, JP

Mr CHOW Koon Ying

Mr IP Koon Wing, Ernest*

Mr LEE Kam Hung, Lawrence, BBS, JP

Ms LEUNG Po Wah, Pauline

Mr LIU Yun Bonn*

Ms LLOYD Victoria Sally Tina

Mr NORMAN David Michael
Mr NORRIS Nicholas Andrew
Ms PARK Yoo-kyung*
Mr SABINE Martin Nevil
Mr SHAH Asit Sudhir*
Mr STEINERT Timothy A.
Mr TYE Philip Andrew
Mrs VAS Chau Lai Kun, Judy*
Mr WINTER Richard David
Mr WOLHARDT Julian Juul
Mr WONG Richard
Mr WONG Wai Ming*
Mr WONG Yu Tsang, Alex
Mr WOO Ka Biu, Jackson*
Ms YU Ka Po, Benita
Mr YUEN Ka Fai*

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 counsels. 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 DAWES Victor, SC

Mr JAT Sew Tong, SC, JP

Mr LAM Douglas Tak Yip, SC

Mr SHIEH Wing Tai Paul, SC

Mr WONG Man Kit, Anson, SC

* Reappointed on 1 April 2019 for a two-year term until 31 March 2021.

Nominations Committee

The Nominations Committee nominates members of the Panel, 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 LUI Tim-leung Tim, SBS, JP
Dr WONG Ming Fung William, SC, JP

Alternate members to CLARK Stephen Edward

Mr CHAN Yuk Sing Freeman
Ms KO Teresa Yuk Yin, JP
Ms LAM Chor Lai, Celia
Mr MAGUIRE John Martin
Mr SCHWILLE Mark Andrew
Mr WEBB David Michael

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

Quarterly update on the activities of the Takeovers Team

In the three months ended 31 December 2019, we received 14 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer share buy-backs), three whitewashes and 67 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 – Newsletters – Takeovers Bulletin' on the SFC website at www.sfc.hk.

Feedback and comments are welcome and can be sent to takeoversbulletin@sfc.hk.

If you want to receive the *Takeovers Bulletin* by email, simply click Subscribe at www.sfc.hk and select Takeovers Bulletin.

Securities and Futures Commission
35/F, Cheung Kong Center
2 Queen's Road Central
Hong Kong

(852) 2231 1222
enquiry@sfc.hk
www.sfc.hk