



Takeovers Bulletin

Highlights

- New Practice Note 22
- Structure of offer price should not be oppressive to offeree shareholders
- Quarterly update on the activities of the Takeovers Team

Season's Greetings

We wish all readers a happy and healthy 2019!

Practice Note 22 – Material contracts and documents on display

1. Practice Note 22 aims to provide guidance on the interpretation of material contracts under the Code requirements.
2. Paragraph 9 of Schedule II to the Takeovers Code requires disclosure in the offeree board circular of details of every material contract entered into by the offeree company or any of its subsidiaries after the date two years before commencement of the offer period. A similar requirement exists for the offeror during a securities exchange offer under paragraph 26 of Schedule I.
3. Under Note 1(i) to Rule 8 of the Takeover Code, material contracts must be made available for inspection on the website of the issuer of the offer document or offeree board circular from the time the relevant document is published until the end of the offer period, along with other documents required under Note 1. Typically, these documents are also displayed on the websites of the SFC and the Stock Exchange (in the form of a hyperlink to the SFC's website) during the period.
4. Under the Codes, material contracts do not include contracts that are entered into in the ordinary course of business carried on or intended to be carried on by the offeree company or any of its subsidiaries (or the offeror or any of its subsidiaries, in the case of a securities exchange offer).
5. To assist issuers of documents and their advisers in complying with the Code requirements and to ensure consistent practice in the market, going forward, the Executive would expect that as a starting point, all contracts relating to discloseable transactions under the Listing Rules should normally be treated as material contracts for the purposes of the Code. Obviously, contracts for transactions with percentage ratios that reach the thresholds for major

transactions, very substantial disposals, very substantial acquisitions and reverse takeovers under the Listing Rules would normally also be covered. However, this is not an exhaustive list. If any contract that falls below the tests for discloseable transactions but is otherwise material and not entered into in the ordinary course of the offeree company's business (or of the offeror, as appropriate), such contract remains subject to the disclosure requirements under the Codes.

6. The requirement to disclose details of material contracts and arrange for them to be put on display facilitates transparency and is consistent with General Principle 5, which provides that shareholders must be given sufficient information, advice and time to reach an informed decision on an offer.
7. The Executive also notes that the reference to Listing Rules thresholds in the context of Code matters has also been adopted in Rule 4 (no frustrating action). Under Note 6 to Rule 4, in determining whether a disposal or acquisition is of a "material amount" to constitute a frustrating action during an offer period, the same tests as those set out in the Listing Rules to determine whether a transaction is a discloseable transaction are applied. The Executive believes that this approach will help to align the two sets of regulatory requirements and therefore facilitate compliance by issuers and market practitioners.
8. Following the close of an offer period, the documents on display on the SFC website, as well as the hyperlink on the Stock Exchange's website, will be removed in accordance with Note 1 to Rule 8 of the Takeovers Code.
9. If any party is in doubt as to whether a contract should be included or excluded as a material contract, the Executive should be consulted at the earliest opportunity.

Structure of offer price should not be oppressive to offeree shareholders

The Codes provide an orderly framework within which takeovers, mergers and share buy-backs are to be conducted. Parties are required to ensure that the structure of transactions under the Codes conforms to this framework.

In a recent case, the Executive was consulted on whether an offeror can increase the offer price after making an offer on the condition that the offer became or was declared unconditional on or before a stipulated date which was before the first closing date of the offer. If the condition was not met, the offer price would revert back to the lower original offer price.

In other words, offeree shareholders would be entitled to receive the increased offer price only if the offer became or was declared unconditional by the stipulated date and they would receive the lower original offer price if the offer became or was declared unconditional at a later date.

The Executive was of the view that this proposed arrangement was offensive to the orderly framework laid down by the Codes and oppressive to offeree shareholders as explained below.

The Takeovers Code specifically contains provisions for the timing of offers including the timing of the despatch of relevant documents. Such provisions aim to enable offeree shareholders to have adequate time and information to reach a properly informed decision as to the merits of an offer and ensure that there is a fair and informed market.

Under Rule 15.1, where an offer document and offeree board circular are posted on the same date or are combined in a composite document, the offer must be open for acceptance for at least 21 days following the despatch of the document. Rule 15.1 further provides that where the offeree board circular is issued after the offer document, the offer must be open for acceptance for at least 28 days from the date on which the offer document is posted. Rule 8.4 allows the offeree company 14 days after the despatch of the offer document to issue its offeree board circular.



Under these Rules, offeree shareholders are given at least 21 days to consider the composite document or at least 14 days to consider the offeree board circular before an offer can close.

In this recent case, the offeror, by proposing to structure the offer price so that offeree shareholders would receive a higher price only if the offer became

or was declared unconditional by a stipulated date, is in effect pressuring offeree shareholders to accept the offer at an earlier time than that which the Takeovers Code allows them to consider the offer. In some instances, this may even result in offeree shareholders having to decide whether they should accept the offer in order to obtain the higher price before having the chance to review key information (for example, if the stipulated date is set before the despatch of the offeree board circular).

The Executive finds this unacceptable and considers it to be oppressive to offeree shareholders. In particular, General Principle 5 stipulates that *"shareholders should be given sufficient information, advice and time to reach an informed decision on an offer."*

If an offeror wants to incentivise shareholders to accept an offer without delay, it should do so in a way provided for in the Takeovers Code.

An offeror can consider issuing a "no extension statement" (Rule 18.2) that an offer would not be extended beyond a specified date or a "no increase statement" (Rule 18.3) that the offer price represented the best price being offered by the offeror. Other statements or structures that may exert pressure on offeree shareholders to accept an offer would not normally be acceptable. If in doubt, the Executive should be consulted at the earliest opportunity.

Quarterly update on the activities of the Takeovers Team

In the three months ended 30 September 2018, we received 18 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer share buy-backs), two whitewashes and 61 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 – Industry-related publications – Takeovers Bulletin' on the SFC website at www.sfc.hk.

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