

Introduction

1. Since the last issue the Takeovers Panel has met to consider possible contingency measures in light of current market conditions. On 29 October 2008 the Executive issued a statement setting out the Takeovers Panel's strong recommendation not to relax the trigger and creeper provisions in the Takeovers Code. The full text of the Executive's Statement is set out in this issue.
2. The Executive has also sought the views of the Panel on possible additional measures regarding confirmation of financial resources in Code transactions. In this regard the Executive has issued Practice Note 15 which is set out in this issue.
3. We would like to remind market practitioners of the importance of highlighting Code issues to the Executive at the earliest opportunity.
4. This issue contains two revised Practice Notes (Practice Note 1 (Partial Offers) and Practice Note 14 (Meaning of "reporting on in accordance with Rule 10 of the Takeovers Code")).
5. We would also like to take this opportunity to update the market on the activities of the Takeovers Team in the six months ended 30 September 2008.
6. Finally we would like to wish all our readers a Happy and Healthy New Year.

Takeovers Panel's strong recommendation not to relax the trigger and creeper provisions

On 29 October 2008, the SFC issued the following statement:

General offer trigger point and creeper under Takeovers Code upheld

The Securities and Futures Commission (SFC) has noted recent suggestions from some market participants that, in light of

Highlights

- The Takeovers Panel's recommendation not to relax the trigger and creeper provisions in the Takeovers Code
- Practice Note 15 (PN15) - Confirmation of financial resources in cash offers
- Reminder about importance of highlighting issues to the Executive
- Revised Practice Notes
- Update on the activities of the Takeovers Team

current market conditions, the 30% general offer trigger point and 2% creeper under the Takeovers Code should be relaxed temporarily. It has been suggested that relaxation of the relevant provisions would allow companies and their major or controlling shareholders to exhibit their confidence in the prospects of the company without incurring a mandatory takeover offer.

Rule 26.1 of the Takeovers Code provides that a person and his concert parties will incur a general offer obligation if they acquire voting rights that will increase their holdings to 30% or more of a company. For those who are holding voting rights between 30% and 50%, a general offer will be required if they acquire more than 2% in 12 months.

The cornerstone of Rule 26.1 is the affordability of fair treatment for shareholders. The underlying principle is that: if control of a company changes, a general offer to all other shareholders is normally required. The general offer trigger and creeper thresholds were reduced from 35% and 5% to 30% and 2% on 19 October 2001 respectively following extensive market consultation. The reductions were driven by market expectations of an alignment of the Hong Kong regulations with those adopted in other leading markets including the United Kingdom. The United Kingdom regulations are indeed stricter as they do not have a creeper provision.

The Takeovers Code does not have the force of law. It represents 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.

The Takeovers Panel has met at the request of the Takeovers Executive to give its view on whether, and if so to what extent, the trigger and creeper provisions in the Takeovers Code should be relaxed in light of current market conditions. The Takeovers Panel consists of 27 members drawn from the financial and investment community.

The Takeovers Panel by a substantial majority was opposed to any relaxation of the provisions of the relevant rules for the following reasons:

1. The proposals ran counter to General Principle 1 of the Takeovers Code which requires equality of treatment for all shareholders; this is an absolutely fundamental principle underpinning the regulation of takeovers and mergers in Hong Kong;
2. No jurisdiction that had a similar regulatory framework as Hong Kong had proposed temporary waivers of important provisions of their takeovers regulations in response to recent market conditions;
3. The proposals, were they to be implemented, would likely reflect poorly on Hong Kong as an international financial centre. In this regard, it is noted that the temporary waiver of the 35% trigger and 5% creeper in 1987 was subject to criticism;
4. While the stock market had experienced substantial declines in prices, there was no suggestion that it was not functioning properly;
5. The proposals were opportunistic in that they appeared to be motivated more by the interests of major or controlling shareholders than the market as a whole;
6. They would be seen as favouring big business interests at the expense of other stock market participants and, in fact, may work against their interests; and
7. There was no evidence to indicate that support for the proposals was widespread or that the proposals would boost confidence in the market for the shares of particular companies or the market as a whole.

The Takeovers Panel also noted that off-market company share repurchases, share repurchases by general offer and partial offers that are conducted in compliance with the current provisions of the Takeovers and Share Repurchases Codes, could all be employed to increase a major or controlling shareholder's interest without triggering a mandatory takeover offer. Market participants are reminded that there is a mechanism in the Takeovers Code for shareholders' approval of any partial offers, which could result in the offeror holding 30% or more of the voting rights in the company. These existing provisions of the Takeovers Code allow companies and their major or controlling shareholders to exhibit their confidence in the prospects of the company in a manner that does not violate the fundamental principle of fair treatment of shareholders or give rise to the possible adverse

consequences, as described above, and does not require any temporary waiver of important provisions of the Takeovers Code.

Practice Note 15 (PN15) – Confirmation of financial resources in cash offers

Rule 3.5 of the Takeovers Code provides “[t]he announcement of an offer should include confirmation by the financial adviser or by another appropriate third party that resources are available to the offeror sufficient to satisfy full acceptance of the offer.”

Note 3 to Rule 3.5 of the Takeovers Code provides “[t]he Executive may require evidence to support a statement that resources are available to satisfy the offeror’s obligations in respect of the offer. The Executive may also require evidence that the offeror has sufficient resources to complete the purchase of shares which gives rise to the offer obligation.

A financial adviser, in discharging its duties under Rule 3.5 to confirm financial resources, should observe the highest standard of care to satisfy itself of the adequacy of resources, including performance of due diligence. The financial adviser confirming that resources are and will continue to be available will not be expected to produce the cash itself if, in giving the confirmation, it acted responsibly and took all reasonable steps to assure itself that the cash was available.

This confirmation will be required not only when the consideration is in cash, or includes an element of cash, but also when the consideration consists of, or includes, any other assets except new securities to be issued by the offeror.”

In view of the credit crunch and current market conditions the Executive sought the Panel’s views on possible additional safeguards which might be adopted regarding a financial adviser’s confirmation of sufficiency of financial resources. Taking into account the prevailing uncertainties in the current financial market the Panel recommended the following:

- i) The Executive should make rigorous enquiries to satisfy itself that the financial adviser has performed the necessary due diligence in providing the financial resources’ confirmation.
- ii) Market practitioners should be mindful of the importance of the requirement in paragraph 11 of Schedule 1 of the Takeovers Code that the financial adviser should confirm in the offer document that there have been no material changes to the availability of financial resources since the date of the confirmation was first given.
- iii) No subjective conditions should be attached to any financing in the context of the financial adviser’s confirmation of financial resources in a Rule 3.5 announcement.

As a matter of practice in all cash offers, irrespective of whether they are accompanied by an alternative form of consideration, the Executive would expect to be provided with documents confirming that the offeror has sufficient cash available. Examples of such documents include a financial adviser’s letter of confirmation of sufficiency of financial resources, the basis for such confirmation including evidence of funds such as bank facilities letters relating to the cash required. Any such facilities must not be subject to any subjective condition.

That said, the Executive would like to remind market practitioners that it is the sole responsibility of financial advisers to ensure sufficient financial resources are available to satisfy an offeror’s obligations in respect of an offer. Financial advisers should observe the highest standard of care to satisfy themselves of the sufficiency of financial resources.

Importance of highlighting issues to the Executive

The Executive would like to remind market practitioners of the importance of bringing all relevant facts and issues to the Executive’s attention at the earliest possible opportunity. This applies in all cases including applications for the Executive’s ruling,

preparation of documents in Code-related transactions and consultation with the Executive on Code-related matters.

In a number of recent cases the Executive has been disappointed that parties and their advisers consulted the Executive on particular issues at a very late stage or have kept silent on specific Code issues identified by them until they were raised by the Executive. At times the Executive has not been provided with all relevant information to enable it to reach a fully informed view.

Section 6.1 of the Introduction to the Codes highlights the importance of early consultation by providing the following:

“When there is any doubt as to whether a proposed course of conduct is in accordance with the General Principles or the Rules, parties or their advisers should always consult the Executive in advance. In this way, the parties can clarify the basis on which they can properly proceed and thus minimise the risk of taking action which might be a breach of the Codes.”

The success of the consultation process relies upon the Executive being given all appropriate and relevant information.

Likewise in relation to applications for a ruling section 8.1 of the Introduction to the Codes provides that an application for a ruling *“should be comprehensive and contain all relevant information which the Executive will require to render a fully informed decision. Such information should normally include, among others, the issues for consideration by the Executive which should be described and analysed, and all arguments advanced in support of the ruling being sought.”*

Similarly in the context of document vetting Note 1 to Rule 12 of the Takeovers Code states that *“the first draft of the document submitted to the Executive should be in advanced form and points of difficulty should be drawn to the attention of the Executive as early as possible.”*

Sections 6.1 and 8.1 of the Introduction to the Codes and Note 1 to Rule 12 reflect General Principle 10 which provides *“all parties concerned with transactions subject to the Codes are required to co-operate to the fullest extent with the Executive...and to provide all relevant information.”* Ultimately in all cases it is the primary responsibility of parties and their advisers to identify Code issues and to bring them to the attention of the Executive as early as possible in order to ensure compliance with the Codes.

Revised Practice Notes

As mentioned in the first issue of the Takeovers Bulletin published in May 2007, Practice Notes contained in the Takeovers Bulletin are intended to provide informal guidance as to how the Executive normally interprets and applies certain provisions of the Codes. The Executive will review these Practice Notes periodically and will revise or withdraw the relevant Note(s) as appropriate.

Revised Practice Note 1 (PN1) - Partial Offer

The Executive has received a number of recent enquiries about whether consent would be granted under Rule 28 of the Takeovers Code for partial offers which might result in the offeror holding 30% or more of the voting rights of a company.

The Executive would like to clarify that as a matter of practice, the Executive normally grants consent under Rule 28.1 to partial offers which could result in an offeror holding 30% or more of the voting rights attaching to the shares in a company provided that the partial offer is conditional on approval of independent (i.e. not the offeror or its concert parties) shareholders holding over 50% of the voting rights and subject to compliance with other relevant provisions of the Codes. The approval process is signified by means of a separate tick box on the acceptance form which states the number of shares in respect of which the offer is approved.

Relevant clarification has been incorporated in Revised Practice Note 1 (PN1).

Revised Practice Note 14 (PN14) - Meaning of “reporting on in accordance with Rule 10 of the Takeovers Code”

The Executive would like to clarify that financial advisers are not normally required to provide a written confirmation to the Executive confirming that the profit forecast has been made with due care and consideration. Likewise, auditors or accountants are not normally required to provide a written confirmation to the Executive that the forecast has been properly compiled on the basis of the assumptions made. In both cases it is normally sufficient for the relevant written confirmations, which form part of the report referred to in Rule 10.4 of the Takeovers Code, to be published in the document addressed to shareholders containing the profit forecast.

Revised Practice Note 14 (PN14) has been amended to clarify the position.

Update on the activities of the Takeovers Team in the day-to-day administration of the Codes

Further to our update on the activities of the Takeovers Team in the June 2008 issue of the Takeovers Bulletin, in the six months ended 30 September 2008, the Executive dealt with 21 takeovers related cases (including privatisations, voluntary and mandatory general offers and off market and general offer repurchases) and 21 whitewashes. The Executive also received 116 ruling applications.

The Executive referred two cases to the Takeovers Panel for rulings during this six-month period as there were particularly novel, important and difficult points at issue. The Panel decision in relation to one of the two cases has not been published due to price sensitive and confidentiality considerations of a commercial nature. The decision will be published when it is appropriate to do so. The Takeovers Panel met on one occasion during this period on policy related issues.

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

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