SFC 證監會

TAKEOVERS BULLETIN

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An SFC newsletter to help participants in Hong Kong's financial markets better understand the Codes on Takeovers and Mergers and Share Buy-backs

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Takeovers Panel rules that Alibaba Group breached the Takeovers Code

The Takeovers Panel has ruled that Alibaba Group Holdings Limited (together with its subsidiaries or any of them referred to as Alibaba Group) breached the Takeovers Code in its acquisition of CITIC 21CN Company Limited (CITIC 21CN), later renamed as Alibaba Health Information Technology Limited, in 2014.

We referred the matter to the Panel under section 10.1 of the Introduction to the Takeovers Code as it involved novel, important and difficult issues. The Panel met on 22 and 23 April 2016 to consider the referral.

The Panel found that during the acquisition process, Alibaba Group entered into certain agreements with a shareholder of CITIC 21CN, namely Mr Chen Wen Xin, to acquire his solely owned Hebei Huiyan Medical Technology Co. Ltd. Mr Chen is the younger brother of Ms Chen Xiao Ying, an executive director and vice chairman of CITIC 21CN.

The Panel ruled that the agreements between Alibaba Group and Mr Chen constituted a special deal with favourable conditions which were not extended to all shareholders and was a clear breach of Rule 25 of the Takeovers Code.

The Panel also found that in consequence the whitewash waiver granted to Alibaba Group in April 2014 was invalidated, and therefore a mandatory general offer obligation had been triggered unless waived.

Highlights

However, in light of the difficulties in placing a precise value on the favourable conditions received by Mr Chen, and the prevailing market price of CITIC 21CN's shares since the whitewash transaction was announced, the Panel noted that any additional value to the subscription price Alibaba Group paid to acquire a majority interest in CITIC 21CN was most unlikely to be material in the context of the prevailing market price, and therefore waived the mandatory general offer obligation.

Rule 25 reflects a fundamental principle in the Takeovers Code that all shareholders should be treated equally (General Principle 1). Special deals are generally not permitted under the Takeovers Code unless the Executive consents to them.

Parties and their advisers are encouraged to identify all relevant Code issues and consult the Executive as early as possible in order to ensure compliance with the Takeovers Code. Section 6.1 of the Introduction to the Takeovers Code 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 Panel's written decision published on 18 May 2016 can be found in the "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Decisions & statements – Takeovers and Mergers Panel and Takeovers Appeal Committee decisions and statements" section of the SFC website.

Confidentiality, talks announcement and minimum suspensions

The Executive has noticed a growing trend of "talks" announcements being issued under Rule 3.7 of the Takeovers Code. Although clear warnings are usually contained in "talks" announcements stating that an offer is a possibility only and that it may or may not materialise, the publication of these announcements nevertheless has an impact on the market price of the subject offeree companies. In light of this, we would like to remind parties and their advisers and also subject offeree companies that Rule 3.7 announcements should not be issued as a matter of convenience.

Rule 3.7 provides for a brief "talks" announcement to be issued if an obligation to issue an announcement under Rule 3.1, Rule 3.2 or Rule 3.3 is triggered (ie, as a result of rumour or speculation about a possible offer or an undue movement in the share price), but no firm intention to make an offer has been reached because the parties are still in "talks" or negotiation.

In general, when parties are in negotiation and until a firm intention to make an offer is announced under Rule 3.5, it is vitally important that parties maintain confidentiality in compliance with Rule 1.4. If confidentiality is maintained, there should not be a need to issue a "talks" announcement as the obligation to make an announcement under the other provisions of Rule 3 should not arise. This should also apply if the board of directors of the subject offeree company has been approached about, or informed of, a possible offer (including a possible privatisation proposal) which is being contemplated or negotiated. As such, when parties and their advisers or the subject offeree company are deciding whether to issue a Rule 3.7 announcement, they should carefully consider whether such an announcement is required to be made.

In the event that the obligation to make a Rule 3.7 announcement arises, we would normally expect the announcement to be relatively short and to disclose no more than the fact that talks are taking place. In cases where the board of directors of the subject offeree company has been informed of the indicative offer price and/or the form of consideration, we would not normally find it acceptable for such information to be disclosed in the Rule 3.7 announcement. This is because the possible offer (or whitewash transaction) is still in the negotiation stage and may or may not materialise, and the parties are under an obligation to keep such information confidential until a firm intention to make an offer is announced.

In light of the above, it is imperative that parties maintain confidentiality and take all necessary steps to ensure there is no leakage of information prior to the announcement of a firm intention to make an offer. In cases where there is leakage of information, we may conduct an investigation and take disciplinary action if appropriate.

Finally, as mentioned in Issue No. 36 (March 2016) of the *Takeovers Bulletin*, every effort should be made to avoid unnecessary trading suspensions. Trading suspensions to facilitate negotiations between parties are not acceptable. If trading in the shares of the offeree company has been suspended, an announcement should be made as soon as possible so that trading can resume without delay. In exceptional circumstances where it is necessary for trading to remain suspended for an extended period of time, a holding announcement should be issued to inform shareholders and the market of the reasons for the delay in resuming trading.

Engagement of financial advisers on Code-related transactions

The Executive believes that it is most important that both offeree and offeror companies retain a financial adviser to assist them in transactions which involve the issue of an offer document, offeree board circular, whitewash document, share buy-back offer document or off-market share buy-back circular. Under section 1.7 of the Introduction to the Codes, financial advisers must possess the competence, professional expertise and adequate resources to fulfil their role and to discharge their responsibilities under the Codes. It follows that before accepting a mandate to advise on a Code-related transaction, a financial adviser must satisfy itself that it is fully conversant with the Codes and thus well-positioned to ensure that its client understands and abides by the requirements of the Codes. The fact that a legal adviser may have been retained at the same time to advise on a transaction does not absolve the financial adviser from its obligations under section 1.7.

It is common for a potential offeror or an offeree company to engage a financial adviser in Code-related transactions at an early stage. Under the Corporate Finance Adviser Code of Conduct, a financial adviser is encouraged to record the terms of its engagement in writing with its client. However, there are instances where a financial adviser is already working with its client on a Code-related transaction before the signing of formal engagement letters.

The Executive takes the view that for Code purposes, a financial advisory relationship arises as soon as an adviser starts working with its client. The signing of an engagement letter, of itself, should not be determinative of when an advisory relationship arises. Accordingly, a financial adviser should ensure proper policies and procedures are in place to allow prompt communication among all its relevant departments, including the compliance department, to ensure the provisions of the Takeovers Code are observed, in particular Rules 21 and 22.

Whitewash waiver may not be granted if there is non-compliance with the Listing Rules or other applicable rules and regulations

The Executive may not grant a whitewash waiver in respect of a transaction involving the issue of new securities under Note 1 on dispensations from Rule 26 if the subject transaction does not comply with other applicable rules and regulations (including the Listing Rules) notwithstanding that all relevant requirements under the Takeovers Code may have been complied with.

In particular, since all whitewash transactions involve the issue of new securities, parties and their advisers should take all measures to ensure that they comply with the Listing Rules' requirements relating to the issue of securities, public float and (where the issue of new securities involves a cash subscription and/or relates to a material asset acquisition) cash companies and/or reverse takeovers. In cases where there are concerns about compliance with these rules, the Executive would not normally grant the whitewash waiver until the parties confirm that any relevant issues under the Listing Rules have been resolved. In case of doubt, The Stock Exchange of Hong Kong Limited should be consulted at the earliest opportunity.

In a whitewash transaction, if there are any concerns about compliance with other applicable rules and regulations, parties and their advisers should consult the relevant authority as soon as possible with a view to resolving such concerns. The Executive should also be informed about any relevant matters.

In light of the above, a Rule 3.5 announcement relating to a whitewash waiver should include the following statement or a statement to similar effect:

"As at the date of this announcement, the [Company] does not believe that the [proposed transaction(s)] gives rise to any concerns in relation to compliance with other applicable rules or regulations (including the Listing Rules). If a concern should arise after the release of this announcement, the Company will endeavour to resolve the matter to the satisfaction of the relevant authority as soon as possible but in any event before the despatch of the whitewash circular. The Company notes that the Executive may not grant the whitewash waiver if the [proposed transaction(s)] does not comply with other applicable rules and regulations."

The Executive publicly criticises China New Way Investment Limited and related parties for breach of Takeovers Code

On 26 May 2016, we publicly criticised China New Way Investment Limited (Offeror), Wei Judong (Mr J Wei), Zhang Xiaoliang (Mr Zhang), Yang Weizhi (Ms Yang), Wei Lidong (Mr L Wei) and Xu Jianhua (Mr Xu) (together referred to as the Parties) for acquiring shares in China City Construction Group Holdings Limited, formerly known as Chun Wo Development Holdings Limited (Chun Wo) within six months after the close of an offer (restriction period) at above the offer price in contravention of Rule 31.3 of the Takeovers Code.

The Offeror is wholly owned by New Way International Investment Holdings Limited, which is beneficially owned by Mr J Wei, Mr Zhang, Ms Yang and Huinong Financial Holdings Limited (a company indirectly wholly owned by Mr L Wei), who each holds 25% of its issued shares. At the material time, Mr Xu was the sole director of the Offeror.

On 2 January 2015, the Offeror made an unconditional mandatory general offer in cash for the shares of Chun Wo at $1.099 per share. The offer closed on 23 January 2015.

On 6 and 7 July 2015, during the restriction period, the Offeror made a series of on-market acquisitions of a total of 2,930,000 shares at prices ranging from $1.19 to $1.50 per share.

The Parties submitted that the breaches were not intentional but accepted that they have breached the Takeovers Code and agreed to the current disciplinary action taken against them.

We wish to remind all those involved in takeovers and mergers in Hong Kong once again of the prohibition imposed by Rule 31.3 of the Takeovers Code. Rule 31.3 affords equality of treatment to shareholders in an offer in accordance with General Principle 1 of the Takeovers Code. The rule provides shareholders with certainty that the offeror will not pay a price higher than the offer price for the shares in the offeree company in the six-month period after the close of the offer, and as a result it ensures that all shareholders of the offeree company are treated even-handedly. If there is any doubt about the application of the Takeovers Code, the Executive should be consulted at the earliest opportunity.

A copy of the Executive Statement dated 26 May 2016 can be found in the "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Decisions & statements – Executive decisions & statements" section of the SFC website.

Bank of America, National Association and Merrill Lynch International publicly censured for Takeovers Code breaches

On 29 June 2016, we publicly censured Bank of America, National Association and Merrill Lynch International for breaching the dealing disclosure requirements under Rule 22 of the Takeovers Code.

A copy of the Executive Statement dated 29 June 2016 can be found in the section "Listings & takeovers" – "Takeovers & Mergers" – "Decisions & statements" – "Executive decisions and statements" of the SFC website.

Reminder to market practitioners

The disclosure obligations under Rule 22 of the Takeovers Code are intentionally onerous to reflect the fact that a high degree of transparency is essential to the efficient functioning of the market in an offeree company's shares, and in the case of a securities exchange offer an offeror company's shares as well, during the critical period of an offer or possible offer. Timely and accurate disclosure of information in relation to dealings by an offeree company's or an offeror company's associates including advisers plays a fundamental role in ensuring that takeovers are conducted within an orderly framework and that the integrity of the markets is maintained.

Parties who wish to take advantage of the securities markets in Hong Kong should conduct themselves in matters relating to takeovers, mergers and share buy-backs in accordance with the Codes. In case of doubt as to the application of Rule 22, the Executive should be consulted.

Fourth Asia Pacific Takeovers Regulators Conference hosted in Hong Kong

In May 2016, we hosted the fourth Asia Pacific Takeovers Regulators Conference in Hong Kong. The conference provided a forum for takeovers regulators to discuss recent developments in the region and exchange ideas and views.

More than 20 participants from Australia, Bangladesh, India, Indonesia, Hong Kong, Malaysia, New Zealand, Singapore and Thailand attended the two-day conference. Topics on the agenda included shareholders' activism, crowd-funding, special deals and waivers from mandatory offers.

The first three Asia Pacific Takeovers Regulators Conferences were held in Kuala Lumpur (2012), Bangkok (2013) and Melbourne (2015). These conferences are an excellent demonstration of collaboration among member jurisdictions. Despite different rules and systems, members often face similar issues and can learn a lot from one another. This in turn helps protect the public in takeovers matters throughout the Asia Pacific region.

We also co-host, with the Securities Commission Malaysia, the Asia Pacific Takeovers Regulators Forum, which is an e-platform designed to facilitate the exchange of ideas and views regarding takeovers and related matters among regulators in the Asia-Pacific region. For more information, please see the Forum's website at www.takeoversforum.com.

Quarterly update on the activities of the Takeovers Team

In the three months ended 31 March 2016, we received 16 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer share buy-backs), 12 whitewashes and 74 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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