

# TAKEOVER!

Hong Kong

January 2021

## SFC TAKEOVERS BULLETIN NO. 55 ON TAKEOVERS CODE BREACHES AND REGULATORY REMINDERS

The Securities and Futures Commission of Hong Kong (the “SFC”) published Takeovers Bulletin No. 55<sup>1</sup> in December 2020 (the “SFC Takeovers Bulletin 55”). The SFC Takeovers Bulletin 55 covers recent SFC disciplinary actions for breaches of Rule 26.1 of the Code on Takeovers and Mergers published by the SFC (the “Hong Kong Takeovers Code”) as well as providing guidance in relation to (i) the necessity to identify and disclose of necessary regulatory approvals required to complete an offer in a firm intention announcement; and (ii) additional disclosure requirements relevant to Mainland issuers (and other issuers incorporated in jurisdictions where compulsory acquisition rights do not exist) which seek to delist.

### 1. SFC Disciplinary Actions

In the last quarter of 2020, the SFC took disciplinary actions against two chairpersons of companies listed on The Stock Exchange of Hong Kong Limited (the “HKEx”) who breached the Hong Kong Takeovers Code.

#### A. Public Censure and Cold Shoulder Order Imposed On Ngai Lai Ha (“Ngai”) and Reminder on the Operation of Note 17 to Rule 26.1 to the Hong Kong Takeovers Code

Ngai was the chairperson and executive director of International Housewares Retail Company Limited (the “Company”), a company listed on the HKEx. Ngai, together with another executive director of the Company and their controlled

company, Hiluleka Limited (together, the “Concert Group”), had been “acting in concert” under the Hong Kong Takeovers Code since the incorporation of Hiluleka Limited in 2006.

On 6 March 2019, Ngai purchased 170,000 shares in the Company (the “First Acquisition”) and as a result, the collective percentage interest of the Concert Group in voting rights of the Company increased by more than 2% from 48.48% to 50.5%e%. Subsequently, Ngai made 12 additional acquisitions (the “Subsequent Acquisitions”) from March to May 2019, with each acquisition involving more than 2% voting rights in the Company.

In breach of Rule 26.1 of the Hong Kong Takeovers Code, Ngai failed to make a mandatory general offer to acquire the shares of the Company not held by the Concert Group despite triggering the “creeper provision” under Rule 26.1 of the Hong Kong Takeovers Code. Such “creeper provision” applies (i.e. a mandatory general offer obligation arises pursuant to Rule 26.1 of the Hong Kong Takeovers Code) where: (i) a person or two or more persons acting in concert (“Concert Group”) holds 30% to 50% of a company’s voting rights; and (ii) such person or members of the concert group further acquires voting rights in the company which has the effect of increasing their (collective) voting rights by more than 2% from the lowest percentage held in the past 12 month period. Therefore, it would apply to the First Acquisition as well as each of the Subsequent Acquisitions.

Ngai’s breach was caused by her misunderstanding that the “creeper provision” would cease to be applicable from the time the Concert Group collectively holds 50% or more of the voting

<sup>1</sup> <https://www.sfc.hk/-/media/EN/files/CF/pdf/Takeovers-Bulletin/20201230SFC-Takeover-Bulletine.pdf>

rights of the Company. In the SFC Takeovers Bulletin 55, the SFC reminds market practitioners to pay attention to Note 17 to Rule 26.1 of the Hong Kong Takeovers Code which notes clearly that the s“creeper provision” applies to any epreceding 12 month period if at any time during such period a person or a concert group held 50% or less voting rights. Put simply, the “creeper provision” would only cease to apply when a person or a concert group has continuously held more than 50% of the voting rights in a company for at least 12 months. For further details, see Charlton’s presentation on the Takeovers Code.<sup>2</sup>

Ngai accepted that she has breached the Hong Kong Takeovers Code and deprived the Company’s shareholders of the right to receive a general offer for their shares. Ngai was publicly censured by the SFC on 2 November 2020 and a cold-shoulder order (which denies her direct or indirect access to the Hong Kong securities market for 18 months) has been imposed on her.

A copy of the Executive Statement<sup>3</sup> on this case is available on the SFC website.

### **B. Public Censure and Cold Shoulder Order Imposed On So Yuk Kwan (“So”) for Breaching the Mandatory General Offer Obligation under Rule 26.1 to the Hong Kong Takeovers Code**

This case also concerns a breach of Rule 26.1 of the Hong Kong Takeovers Code.

So was the chairman, executive director and chief executive officer of AV Concept Holdings Limited (“**AV Concept**”), a company listed on the HKEx. So lent money to a borrower, who repaid part of the loan by transferring 25,000,000 shares (representing approximately 3.23% in the issued share capital) in AV Concept to a nominee of So (who held the relevant shares on trust on behalf of So) on 8 June 2017 (the “**Transfer**”). As a result of the Transfer, the interests of So and his concert parties (including his nominee) (the “**So Concert Group**”) in voting rights of AV Concept increased from 35.61% to 38.84% (i.e., more than 2%). Following completion of the Transfer, the So Concert Group continued to acquire and dispose of shares, and there were 20 instances where the So Concert Group’s interests in AV Concept increased by more than 2% from the lowest collective percentage interest in the 12-month period prior to the respective acquisitions. The So Concert Group’s

aggregate interest in AV Concept reached 40.81% on 27 April 2018, being the highest shareholding amount prior to So’s voluntary general offer made in 21 February 2020.

As no mandatory general offer was made by So pursuant to Rule 26.1 of the Hong Kong Takeovers Code in respect of the Transfer and subsequent acquisitions exceeding 2%, the SFC concluded that the conduct fell short of the standards expected of him, meriting strong disciplinary action (notwithstanding that he had sincerely apologised for the breach, having claimed that he was unaware that shares held by his nominee on trust would count as his own interest under the Hong Kong Takeovers Code). The SFC publicly censured So on 15 October 2020 and a cold-shoulder order (which denies him direct or indirect access to the Hong Kong securities market for 24 months) was imposed.

This case serves as a reminder that a nominee’s share held on trust for a person is also counted as the person’s own shares under the Hong Kong Takeovers Code.

A copy of the Executive Statement<sup>4</sup> on this case can be found on the SFC website.

The above cases illustrate that the SFC will hold senior management and directors of companies listed on the HKEx accountable to shareholders in respect of complying strictly with the Hong Kong Takeovers Code in discharging their duties. In SFC Takeovers Bulletin 55, the SFC noted that parties who wish to take advantage of the Hong Kong securities market are reminded that they should conduct themselves in matters relating to takeovers, mergers and share buy-backs in accordance with the Hong Kong Takeovers Code, and if they do not, they may find that the facilities of such markets may be withheld from them by way of sanction in order to protect those who participate in them.

## **2. Guidance on Regulatory Matters**

Further, the SFC Takeovers Bulletin 55 provided guidance on two specific issues in relation to provisions of the Hong Kong Takeovers Code, namely (i) the necessity to identify and disclose necessary regulatory approvals to complete an offer in a firm intention announcement; and (ii) additional disclosure requirements relevant to Mainland issuers (and other issuers incorporated in jurisdictions where compulsory acquisition rights do not exist) which seek to delist.

<sup>2</sup> [https://www.charltonslaw.com/media/our\\_work/corporate\\_finance\\_and\\_capital\\_markets/industries/natural\\_resources/Hong-Kong-Takeovers-Code-presentation-103245-v2.pdf](https://www.charltonslaw.com/media/our_work/corporate_finance_and_capital_markets/industries/natural_resources/Hong-Kong-Takeovers-Code-presentation-103245-v2.pdf)

<sup>3</sup> [https://www.sfc.hk/-/media/EN/files/CF/pdf/Cold-Shoulder/Public-Statement\\_EN20201102.pdf](https://www.sfc.hk/-/media/EN/files/CF/pdf/Cold-Shoulder/Public-Statement_EN20201102.pdf)

<sup>4</sup> [https://www.sfc.hk/-/media/EN/files/CF/pdf/Cold-Shoulder/Public-Statement\\_EN20201015.pdf](https://www.sfc.hk/-/media/EN/files/CF/pdf/Cold-Shoulder/Public-Statement_EN20201015.pdf)

## A. Conducting Sufficient Due Diligence to Identify All Relevant Regulatory Approvals for the Completion of Offers under the Hong Kong Takeovers Code

Commenting on recent takeover offers, the SFC noted that some offerors and their advisers have failed to identify all relevant material regulatory approvals that are necessary to complete the relevant offers and disclose them in the firm intention announcements (required to be made in connection with an offer pursuant to Rule 3.5 of the Hong Kong Takeovers Code).

Rule 3.5(e) of the Hong Kong Takeovers Code provides that a firm intention announcement must contain “*all conditions (including normal conditions relating to acceptance, listing and increase of capital) to which the offer is subject*”.

The SFC was aware that offerors often included generic conditions in the draft firm intention announcement (such as “*all regulatory approvals, authorisations or consents being obtained*”, or “*that the implementation of the offer will not be unenforceable, illegal or prohibited*”) which the SFC considers to be inadequate given the importance of material regulatory approvals which will affect the certainty. Therefore, offerors will be requested during the vetting process to specify all material regulatory approvals in the firm intention announcement (or include a negative statement where no such approvals are required). Details to be set out include the types of approvals required, the names of the relevant authorities from which approvals will be sought, the expected timing and whether or not these approvals can be waived.

The failure to identify and disclose material regulatory approvals entails serious consequences for offerors:

- i) ***breach of ,the Hong Kong Takeovers Code:*** the failure to disclose material regulatory approvals required for completing an offer could be held to be in breach of General Principle 5 of the Hong Kong Takeovers Code which stipulates that “*shareholders should be given sufficient information, advice and time to reach an informed decision on an offer*”. This may result in market confusion or a disorderly market, in particular where shareholders have dealt in the offeree company’s shares or voted or accepted the offer based on incomplete information. The shares of accepting shareholders will also be locked up for an extended period pending regulatory approvals

which may or may not be granted. Such breach of the Hong Kong Takeovers Code may result in sanctions being imposed on the offeror;

- ii) ***the offer may need to be made irrespective of any breach of material regulatory requirements:*** in the circumstances, the SFC may not allow the condition concerning obtaining relevant material regulatory approvals to be invoked to cause the offer to lapse under Note 2 to Rule 30.1 of the Hong Kong Takeovers Code. This means that the offeror might risk having to proceed with the offer notwithstanding breach of other legal or regulatory requirements for not obtaining the relevant regulatory approvals.

*Note: We note that the above SFC cautionary statement should be qualified in the sense that the SFC may not necessarily or effectively compel an offeror to proceed with an offer notwithstanding breach of other legal regulatory requirements. In the case of Television Broadcasts Ltd v. The Takeovers and Mergers and Another [2017] HKCFI 1748, the Court of First Instance allowed a judicial review of the ruling of the Takeovers and Mergers Panel of the SFC (“Takeovers Panel”) concerning the share buy-back announced by Television Broadcasts Limited in early 2017 and quashed the ruling of the Takeovers Panel as it was determined in that case that the Takeovers Panel ruling was ultra vires for seeking to undermine public policies of a statute (the Broadcasting Ordinance). The court also ruled that the Hong Kong Takeovers Code does not have the force of law (but represents a consensus of opinion of those who participate in financial markets and the SFC regarding standards of commercial conduct and behavior considered acceptable for takeovers), and acknowledged the supremacy of statutes in comparison. Please refer to Charltons news update: <https://www.charltonslaw.com/court-allows-judicial-review-of-tvb-hong-kong-takeovers-panel-ruling/> for further details.*

*However, the failure to properly disclose conditions concerning the obtaining of material regulatory approvals could in fact put the offeror in a difficult situation as the SFC may insist on an offer being made under the Hong Kong Takeovers Code, irrespective of any material consequences for failing to comply with applicable laws and regulations*

(i.e. the offeror may need to consider its options between breaching applicable laws and regulations or provisions of the Hong Kong Takeovers Code).

- iii) **the offer may be delayed in breach of timetable requirements under the Hong Kong Takeovers Code:** the offeror may have to request an extension of the offer period to obtain the necessary regulatory approval. Nonetheless, SFC may not consent to such a request, which could potentially lead to a breach of the timetable requirements under the Code.

Further, in the SFC Takeovers Bulletin 55, the SFC reminded offerors and their advisers to conduct thorough due diligence on regulatory approval requirements at the outset such that all relevant regulatory approvals required for completion of offers are identified early and disclosed appropriately, failing which unnecessary delays may be caused to the offer timetable. This is particularly relevant to professional advisers, who are in a better position to conduct such due diligence given their resources and expertise.

It is important to note that the above guidance contained in the SFC Takeovers Bulletin 55 should *not* be applicable to a mandatory general offer under Rule 26.1 of the Hong Kong Takeovers Code. This is because, pursuant to Note 4 to Rule 26.2 of the Hong Kong Takeovers Code, a potential offeror must seek the prior approval from the relevant regulatory body (in relation to merger control or otherwise) *before* the potential offeror triggers an obligation to make a mandatory general offer under Rule 26.1 (i.e. the offeror cannot make a mandatory general offer conditional upon any such regulatory approval).

## B. Additional Disclosure Requirements in connection with Delistings of Mainland Issuers under Rule 2.2 of the Hong Kong Takeovers Code

This guidance concerns disclosure requirements applicable to Mainland issuers (or other issuers incorporated in jurisdictions where compulsory acquisition rights do not exist (“**Relevant Issuers**”) which are seeking to delist from the HKEx.

Under Rule 2.2(c) of the Hong Kong Takeovers Code, any resolutions to approve the delisting of an offeree company following an offer for shares of the offeree company must be subject to the condition that the offeror must be entitled to exercise, and exercising, its rights of compulsory acquisition under applicable laws governing the offeree company

(hereinafter, the “**compulsory acquisition requirement**”). For example, under Hong Kong law, an offeror may have the right to require non-accepting shareholders to sell their shares on the same terms where it has obtained re acceptances in respect of 90% of the shares subject to the offer.

The challenge faced by Mainland-incorporated issuers is that they do not have statutory rights of compulsory acquisition under the laws of the People’s Republic of China. The same difficulty is faced by Relevant Issuers.

Consequently, the SFC amended Rule 2.2 in July 2018,<sup>5</sup> outlining certain arrangements which the offeror would typically be required to put in place in order for the SFC to consider granting a waiver to the compulsory acquisition requirement for Mainland issuers (and Relevant Issuers) seeking to delist. These arrangements include: (i) allowing the offer to remain open for acceptance for a longer period after the offer becomes or is declared unconditional in all respects; (ii) sending notices to shareholders who have not accepted the offer to notify them of the implications of not accepting the offer; and (iii) requiring the resolution to approve the delisting to be subject to the offeror receiving valid acceptances amounting to 90% of the disinterested shares.

These three conditions are in place to ensure that minority shareholders have ample time to exit and tender their shares under an offer. Moreover, shareholders will be more aware of the implications of being a private company’s shareholders. For details of the amendment to Rule 2.2, see Charlton’s August 2018 newsletter.<sup>6</sup>

The SFC noted that Mainland issuers seeking a delisting typically included the following standard warning in Rule 3.5 announcements and offer documents:

*“Independent shareholders should note that if they do not accept the H share offer and the offer subsequently becomes unconditional in all respects and the company delisted from the Stock Exchange, this will result in such shareholders holding securities that are not listed on the Stock Exchange and the liquidity of the H shares may be severely reduced. In addition, the company will no longer be subject to the requirements under the Listing Rules and may or may not continue to be subject to the Codes depending on whether it remains as a public company under the Codes.”*

<sup>5</sup> <https://apps.sfc.hk/edistributionWeb/api/consultation/conclusion?lang=EN&refNo=18CP1>

<sup>6</sup> <https://www.charltonslaw.com/hk-takeovers-code-amendments-13-july-2018/>

With a view to enhancing independent shareholders' awareness of their rights in a voluntary general offer in relation to Mainland issuers or Relevant Issuers, the SFC will now require the following statement to be included immediately after the above standard warning in both the summary box and the body of the Rule 3.5 firm intention announcement, as well as repeated in full in the offer document:

*"Independent shareholders should also note that if they do not agree to the terms of an offer, they can vote against the delisting proposal at the meetings. If more than 10% of the disinterested shares voted against the delisting proposal, the offer would not become unconditional and the company would remain listed on the Stock Exchange of Hong Kong."*

### **3. Quarterly Update on the Activities of the Takeovers Team of the SFC**

The SFC Takeovers Bulletin 55 also provided an update of the SFC's work in the fourth quarter of 2020, during which period the SFC received 22 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer share buybacks), 10 whitewashes and 82 ruling applications.

If you have questions regarding the above and the Hong Kong Takeovers Code, please do not hesitate to consult Charltons.

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