



## Hong Kong SFC Consultation on Takeovers and Share Buy-backs Code Amendments

The Hong Kong Securities and Futures Commission (the **SFC**) is consulting on amendments to its Codes on Takeovers and Mergers and Share Buy-backs (the **Hong Kong Takeovers Code**) which are set out in its [Consultation Paper on the proposed amendments to the Codes on Takeovers and Mergers and Share Buy-backs](#) published on 19 May 2023. The proposed changes involve codifying various existing practices of the Takeovers Executive;<sup>1</sup> cutting the number of paper documents published under the codes and housekeeping amendments; and including amendments to:

- clarify various matters relating to shareholders' voting and acceptances;
- broaden the definition of "close relatives" that is relevant principally to the categories of persons deemed to be acting in concert;
- provide guidance on the chain principle;
- add a new Rule 3.09 giving the Executive the express power to issue "put up or shut up orders";
- in the context of independent shareholders' approvals of delistings following a general offer,<sup>2</sup> include an express provision that shares purchased by the offeror and its concert parties count towards meeting the acquisition of 90% of the disinterested shares threshold that is a condition for the Executive's waiver of the condition that the offeror exercises its compulsory acquisition rights,<sup>3</sup> in cases where the offeree's jurisdiction of incorporation lacks compulsory acquisition rights;
- streamline the requirements for collecting irrevocable commitments by:
  - only requiring offerors to consult the Executive if they intend to approach shareholders not having a material interest (5% of voting rights) in the offeree company; and
  - restricting offerors to approaching a maximum of six shareholders (whether they hold a material interest or not);
- align the requirements for the return of share certificates with those for the payment of consideration on the lapse or withdrawal of takeover offers;
- clarify the Code's timing requirements;
- remove the requirement for the Executive's consent for privatisations by scheme of arrangement where the Rule 15.7 timing requirement (i.e. that the scheme's effective date must occur within 21 days of the court meeting) cannot be met because of the court's timetable;

- prohibit the inclusion of indicative share prices in Rule 3.7 “talks announcements”;
- codify the effect of dividends and withholding tax on an offer price by providing that an offeror:
  - can only reduce the offer price by the amount of a dividend or other distribution paid or payable to the offeree’s shareholders if it has expressly reserved the right to do so in an announcement; and
  - can only deduct the gross amount of the dividend or distribution received or receivable by the offeree’s shareholders;
- clarify that, on partial offers:
  - an offeror’s extension of the closing date beyond the 14th day after the first closing date<sup>4</sup> is conditional only on satisfaction of the acceptance condition (but not the approval condition under Rule 28.5);
  - the first closing date can only be extended for 14 days (to the **final closing day**) meaning that the offer will lapse if the Rule 28.5 approval condition is not met by the final closing day; and
  - introduce a new Rule 28.10 to require that, on offers that could result in the offeror holding 30% or more of the offeree’s voting rights, the offeror must make Rule 13 offers or proposals to the holders of the offeree’s convertible securities, warrants, options or subscription rights;
- clarify that the “tick-box” approval condition under Rule 28.5 (i.e. the requirement that a partial offer which would result in the offeror acquiring 30% of the offeree’s voting rights must be conditional on majority approval by the offeree’s independent shareholders) does not apply to offerors and their concert parties who already hold more than 50% of the offeree’s voting rights;
- clarify that shares held by exempt principal traders cannot be voted in the context of partial offers;
- revise the definition of “on-market share buy-backs” to mean share buy-backs by HKEX-listed companies through the HKEX’s automatic order matching system and where the company buying back its shares and its directors are not involved in soliciting, selecting or identifying the sellers of the shares;
- codify the requirement for Rule 3.5 announcements of a firm intention to make an offer to disclose the details of any special deals or provide an appropriate negative statement;
- remove the Rule 3.8 requirement for offerors’ class (6) associates to disclose their dealings in the offeree’s relevant securities during a cash offer;
- revise Rule 4 on frustrating actions to clarify that:
  - the events listed are merely non-exhaustive examples of frustrating actions;
  - while prior contractual obligations announced by the offeree before the board has reason to believe that a bona fide offer is imminent will not generally be considered to be frustrating actions, any special circumstances must be brought to the Executive’s attention to make a determination as to the application of Rule 4. Special circumstances such as obligations that will only be triggered when a takeover offer is made for the offeree, e.g. a poison pill, will likely be deemed to be frustrating actions notwithstanding that they are prior contractual obligations; and
  - to streamline the operation of Note 1 to Rule 4 to provide that:
    - the approval of a frustrating action by the offeree shareholders is not required if the offeror consents to the action to be taken; and
    - if there are competing bids, the consent of all offerors is required to waive the requirement for shareholders’ approval.

The text of the proposed revisions to the codes is set out in Appendix 1 to the Consultation Paper.

The consultation will close on 23 June 2023 and comments on the proposals should be submitted on or before then via the SFC website ([www.sfc.hk](http://www.sfc.hk)) or by email to [takeoverscode\\_review@sfc.hk](mailto:takeoverscode_review@sfc.hk).

# 1. Clarification of Voting, Acceptance and Concert Party Requirements on Takeovers Code Transactions

## Hong Kong Takeovers Code: a Broader Definition of “close relatives”

The term “close relative” is principally relevant to Classes (2), (6) and (8) of the presumptions of acting in concert and Class (3) associates. The current definition covers a person’s spouse, de facto spouse, children, parents and siblings and is thought by the SFC to be too narrow, risking missing other relevant relationships. It is therefore proposing to revise the definition to codify its existing practice of including the following among those presumed to be acting in concert:

- a person’s grandparents and grandchildren;
- a person’s siblings, a sibling’s spouse or de facto spouse and their children; and
- the parents and siblings of a person’s spouse or de facto spouse.

The revised definition would also clarify that “children” include natural, adopted and step-children.

The SFC will continue to allow applications to rebut the presumption of acting in concert and, as at present, the burden of proof will fall on the applicant. However, the SFC notes in the Consultation Paper that it is unlikely to accept arguments that parties are not in regular contact, or have not seen each other for a period, as grounds for rebutting the presumption unless there is corroborative evidence (e.g. litigation between family members evidencing a breakdown of the family relationship).<sup>5</sup>

As the proposed expansion of the “close relatives” definition would also expand the scope of the waiver from a general offer obligation under Note 6 to Rule 26.1, the SFC considers that people within the amended definition should equally receive the benefits of a waiver under Note 6 to Rule 26.1.

## Hong Kong Takeovers Code: Revised Definition of “voting rights”

Fundamental to the Hong Kong Takeovers Code are the consequences of the acquisition of “control” of a Hong Kong-listed company (**HKEX-listed company**) (or other company to which the code applies<sup>6</sup>). “Control” is defined as holding 30% or more of a company’s voting rights which are defined as “voting rights *currently* exercisable at a general meeting of a company whether or not attributable to the share capital of the company” (*emphasis added*).

The question has arisen as to whether voting rights “are currently exercisable” if, in fact, the relevant shares are subject to voting restrictions.

The SFC proposes to amend the “voting rights” definition to clarify that voting rights are still regarded as exercisable at a general meeting despite the existence of restrictions on their exercise (e.g. by agreement between the parties, by operation of law and regulations, or under a court order). This is because it maintains that voting restrictions do not fundamentally alter the rights attached to the shares: voting rights are generally conferred by companies’ constitutional documents, and voting rights restrictions (e.g. injunctions or shareholders’ agreements) rarely remove them from the constitutional documents. Thus a person who acquires 30% of a company’s voting rights will have to make a mandatory general offer under Rule 26.1 of the Hong Kong Takeovers Code notwithstanding that the voting rights are subject to an injunction prohibiting that person from exercising them. An exception will be made for voting rights attached to treasury shares.

## Shareholders’ Approval and Acceptance: Note to Rule 2.2(c) of the Hong Kong Takeovers Code

Under Rule 2.2(c) of the Hong Kong Takeovers Code, a shareholders’ resolution approving an HKEX-listed company’s delisting after a proposed offer must be subject to the offeror being entitled to exercise, and exercising, rights to compulsorily acquire the remaining shares. If an offeree company is incorporated in a jurisdiction without compulsory acquisition rights, the SFC will waive the requirement provided the three conditions set out in the Note to Rule 2.2 are met. In particular, in addition to obtaining the requisite shareholders’ approval, the offeror must receive valid acceptances of 90% of the disinterested shares. However, condition (iii) to the Note to Rule 2.2 is silent as to whether purchases made by an offeror and its concert parties can be included when determining whether the 90% of disinterested shares threshold has been met.

The SFC is therefore proposing to revise condition (iii) of the Note to Rule 2.2 to expressly include purchases made by the offeror and persons acting in concert with it from the date of the announcement of a firm intention to make an offer, when determining whether the 90% of the disinterested shares threshold has been met.

## Rule 2.11 of the Hong Kong Takeovers Code

Rule 2.11 requires an offeror and its concert parties to have acquired 90% of the offeree company's disinterested shares before exercising its compulsory acquisition rights. The current language of Rule 2.11 only allows purchases made by an offeror and its concert parties during the period of 4 months after the posting of the initial offer document, together with acceptances, to count towards the 90% threshold.

In determining whether an acceptance condition has been met, the SFC considers the current language to be problematic because it differentiates between offers not involving a delisting (e.g. a conditional voluntary general offer where an offeror does not intend to exercise compulsory acquisition rights) and offers involving delisting (e.g. a voluntary general offer seeking to privatise by way of compulsory acquisition). The SFC considers the requirement of acquiring 90% of the disinterested shares under Rule 2.11 to be equivalent to an acceptance condition. The SFC also considers that acquisitions resulting from the acceptance of an offer and on-market acquisitions should be treated in the same manner.

Under the proposed amendment to Rule 2.11, purchases made by an offeror and its concert parties from the date of the announcement of a firm intention to make an offer until the end of 4 months after the posting of the initial offer document can count (with acceptances) towards the 90% of the offeree company's disinterested shares threshold for the purpose of the offeror's entitlement to exercise its compulsory acquisition rights.

## Rules 2.2 and 2.10 of the Hong Kong Takeovers Code

Under Rule 2.10 of the Hong Kong Takeovers Code, a privatisation by way of a scheme of arrangement can only be implemented if:

- the scheme is approved by at least 75% of the votes attached to the disinterested shares cast at a duly convened meeting of the holders of disinterested shares; and
- the number of votes cast against the resolution at such meeting does not exceed 10% of the votes attaching to all disinterested shares.

However, recent Hong Kong court judgments<sup>7</sup> have interpreted Rule 2.10 differently in terms of the required form of shareholders' meetings. The so-called "non-prohibition view" allows the offeror and its concert parties to vote at a shareholders' meeting held to consider a scheme of arrangement, but does not allow their votes to be counted for the purposes of Rule 2.10. The alternative "prohibition view" prohibits the offeror and its concert parties from voting.

Prior to these judgments, the Executive had considered the non-prohibition view to be the correct approach to interpreting Hong Kong Takeovers Code Rule 2.10, since it gives the Executive the flexibility necessary to achieve the Rule's underlying purpose - that is, that in determining whether the thresholds under Rule 2.10 are met, only votes cast by disinterested shareholders should count. The SFC maintains that the form of meeting should be governed by the relevant company's constitutional documents and the company law of its place of incorporation given that the Takeovers Code is non-statutory and cannot override the legal requirements in the jurisdiction of offeree companies which are typically incorporated outside Hong Kong. The same is true of Rule 2.2, which similarly refers to approval by disinterested shareholders at a meeting.

To clarify how Hong Kong Takeovers Code Rules 2.10 and 2.2 should be interpreted, the SFC proposes amendments to:

- refer to approval by at least 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy at a duly convened meeting of "shareholders" (rather than of "disinterested shareholders"); and
- add a new Note 8 to Rule 2 stating that a "*duly convened meeting of shareholders*", for the purposes of Hong Kong Takeovers Code Rules 2.10 and 2.2, "*refers to a shareholders' meeting duly convened in accordance with the offeree company's constitutional documents and the company law of its place of incorporation*".

## Hong Kong Takeovers Code: Irrevocable Commitments

The SFC generally permits offerors to obtain irrevocable commitments from shareholders as to acceptance (or non-acceptance) of an offer, or on voting on resolutions relating to an offer, provided that they follow Note 4 to the Takeovers Code's Rules 3.1, 3.2 and 3.3 and Practice Note 12 on gathering irrevocable commitments.

In light of the market's increased sophistication and the widespread use of irrevocable commitments, the SFC aims to streamline the process by:

- not requiring an offeror to consult the Executive when approaching a shareholder with a material interest (i.e. 5% or more of an offeree company's voting rights held directly or indirectly by the shareholder and their concert parties);
- only requiring an offeror to consult the Executive if it intends to approach other shareholders without a material interest in the offeree company; and
- limiting the offeror to approaches to no more than six shareholders (whether they hold a material interest or not).

## 2. Hong Kong Takeovers Code: the Chain Principle

The SFC is proposing to revise the Hong Kong Takeovers Code's chain principle which applies where a mandatory general offer obligation for a second company (a **chain principle offer**) arises following an acquisition of statutory control of a company (the **first company**) where a person or group of persons obtains or consolidates control over the second company because the first company controls the second company. Note 8 to Rule 26.1 of the Hong Kong Takeovers Code sets out the two key tests for determining whether a "chain principle offer" is required: the Substantiality Test and the Purpose Test. If either test is satisfied, the Executive will require the making of a chain principle offer.

The **Substantiality Test** compares the assets and profits of the second company with those of the first company to determine whether the holding in the second company is "significant". Relative values of 60% or more will generally be regarded as significant.

The **Purpose Test** looks at whether securing control of the second company was one of the main purposes of acquiring control of the first company.

The SFC identifies several issues in relation to the Substantiality Test:

- it is unclear which assets and profits line items should be compared (e.g. total or net assets, gross or net profit). The SFC notes that, in practice, it considers all these items and, if an anomalous result is obtained, it considers each case on its particular facts to determine how the Substantiality Test results should be interpreted;
- the Substantiality Test cannot be applied in situations where either the first or second company has net liabilities, a net loss or breaks even; and
- Note 8 to Rule 26.1 does not specify the applicable "look-back" periods for financial information under the Substantiality Test.

The SFC is proposing to:

- add market capitalisation as one of the parameters for comparison when determining the Substantiality Test in revised Note 8(a) to Hong Kong Takeovers Code Rule 26.1;
- codify the Executive's existing practice of looking at at least the three most recent financial periods when calculating whether the Substantiality Test produces an anomalous result; and
- update Practice Note 19 to provide further guidance on the Executive's approach to the Substantiality Test.

No amendments to the Purpose Test are proposed.

## 3. Hong Kong Takeovers Code Offer Period and Timetable

### Definition of "offer period"

Many of the Hong Kong Takeovers Code's obligations are triggered on the commencement of an offer period. The SFC notes that offeree companies experiencing financial difficulties and companies whose controlling stake is in receivership often find themselves in prolonged offer periods that render ongoing compliance with the relevant Takeovers Code requirements (e.g. the publication of monthly updates) unnecessarily burdensome. The fact that a company continues to be subject to an offer period also risks misleading the market into believing that there is the prospect of a takeover offer.

The SFC issued Practice Note 24 in November 2022 to provide guidance on when an offer period should start when receivers or liquidators are appointed. However, once commenced, an offer period will not end until one of the

situations under the definition of “offer period” is met (i.e. the offer closes for acceptances, lapses, is withdrawn, will not proceed or, if an offer allows alternative forms of consideration to be elected, the last date for making that election is reached). The definition does not give the Executive<sup>8</sup> explicit authority to end an offer period.

The SFC is proposing to give the Executive explicit power to terminate an offer period, but intends that this power will only be exercised in limited circumstances. When the Executive terminates an offer period, it will publish a statement on the SFC’s website under the section headed “Executive decisions and statements” and update the offer period table to include the reasons for ending the offer period.

## **Last Possible Day for Day 60 in Privatisations and Take-private Transactions under the Hong Kong Takeovers Code**

Under existing Rule 15.5(ii) of the Hong Kong Takeovers Code, the offeree board can consent to the final day for an offer to become unconditional as to acceptances being extended beyond the 60th day after the posting of the composite document.

In privatisations by a board-controlling controlling shareholder, Rule 15.5(ii) allows the offeror to decide whether, and for how long, Day 60 should be extended if the offer is not declared unconditional as to acceptances by the original deadline. Shareholders who accept the offer early (i.e. before the acceptance condition is met) are subject to an extended lock-up of their shares without any certainty as to when the offer will become unconditional, or when the shares tendered may be returned to them in the event the offer is unsuccessful (unless and until they exercise withdrawal rights under Rule 17, when available).

When the Executive has been asked to approve the extension of Day 60, it has done so subject to the condition that the extension will not exceed four months from the date of despatch of the offer document. The SFC considers this to achieve a fair balance between an offeror’s interest in extending the offer period to fulfil the acceptance condition and the interests of the offeree company’s shareholders. The SFC proposes to revise Rule 15.5 to codify this practice by adding: *“In any event, ‘Day 60’ shall not be extended beyond a date that is 4 months after the date of the offer document.”*

## **Put Up or Shut Up (PUSU) Orders**

A PUSU order is issued by the Executive, on application by an offeree company, and requires a potential offeror to either announce a firm intention to make an offer within a set time period (put up), or to announce that it will no longer proceed with an offer (shut up). However, there is no express provision in the Hong Kong Takeovers Code empowering the Executive to issue a PUSU Order. The Executive therefore relies on the spirit of Rule 31.1 (b) and Note 2 to Rules 31.1 and 31.2 as the basis for issuing PUSU orders. The SFC proposes to codify the existing practice and empower the Executive to impose PUSU orders in exceptional circumstances.

In deciding whether or not to impose a PUSU order, the Executive will consider the following factors:

- the current duration of the offer period;
- the reason(s) for the delay in the offeror issuing a firm intention announcement;
- the proposed offer timetable (if any);
- any adverse effects that the offer period has had on the offeree company; and
- the conduct of the parties to the offer.

The proposed new Rule 3.9 states:

*“At any time during an offer period following the announcement of a possible offer, but before the announcement of a firm intention to make an offer, the offeree company may request the Executive to impose a time limit for the potential offeror to clarify its intention with regard to the offeree company. The Executive may, in exceptional circumstances, impose such a time limit on the potential offeror if it considers it appropriate to do so, irrespective of whether a request has been made by the offeree company. If a time limit for clarification is imposed by the Executive, the potential offeror must, before the expiry of the time limit, announce either a firm intention to make an offer for the offeree company in accordance with Rule 3.5, or that it does not intend to make an offer for the offeree company, in which case the announcement will be treated as a statement to which Rule 31.1(c) applies.”*

The new Rule will be one of the Takeovers Code Rules that apply to share buy-back transactions and will therefore be included in the list set in Rule 5.1(c) of the Hong Kong Code on Share Buy-backs.

## Settlement of Consideration and Return of Share Certificates under the Hong Kong Takeovers Code

Rule 20.1 of the Hong Kong Takeovers Code requires the consideration for an offer to be paid within 7 business days following the later of:

- the date the offer becomes, or is declared, unconditional; and
- the date of receipt of a duly completed acceptance.

However, if an offer lapses, the share certificates must be returned within 10 days of the offer's withdrawal or lapse under Rule 20.2.

The SFC is proposing to align the timing requirement for the return of share certificates under Rule 20.2 with that for the payment of consideration under Rule 20.

### Share Certificate Return

#### Successful Offers

In successful offers, share certificates for untaken shares (i.e. shares that have been tendered for acceptance by a shareholder but not taken up by the offeror) and untendered shares (i.e. shares that are not tendered for acceptance represented in a share certificate which also represents shares that the shareholder tenders for acceptance) in an offer (including partial offers) or a share buy-back by way of general offer must be posted to, or be made ready for collection by the accepting shareholder, at the same time as the payment of consideration, and in any event no later than 7 business days after the later of:

- the date the offer becomes, or is declared, unconditional; and
- the date of receipt of a duly completed acceptance.

In the case of partial offers, the deadline for the return of share certificates will be 7 business days after the close of the partial offer.

#### Unsuccessful Offers

If an offer is withdrawn or lapses, the offeror must, as soon as possible but in any event no later than 7 business days after the offer is withdrawn or lapses, post the share certificates lodged with acceptance forms to, or make such share certificates available for collection by, those offeree company shareholders who accepted the offer.

The same timing will apply to an accepting shareholder who withdraws his acceptance after 21 days from the first closing date of the offer, if the offer has not become unconditional as to acceptances.

### Amendments to Hong Kong Takeovers Code's Timing Requirements

The SFC notes that the Code's existing timing requirements create confusion as to which day should count as Day 1. For example, Rule 8.2 uses "within 21 days of the date of the announcement", while Rule 20.1 uses "within 7 business days *following* the later of...". The SFC proposes a housekeeping amendment to clarify that the day of the event is excluded from counting. The complete set of changes to the Codes' timing requirements are set out in Appendix 2 to the Consultation Paper on Takeovers Code changes.

The SFC also aims to clarify the earliest time the director of the offeree company could resign under Rule 7. The proposed amendment states that directors of an offeree company should not resign until after the publication of the closing announcement on the first closing date of the offer, or the publication of the announcement that the offer has become or been declared unconditional, whichever is later. In the case of whitewash transactions, resignations should not take effect until after the publication of the results announcements of the shareholders' meeting to approve the waiver.

### Timing of Resignation of Offeree Directors under Rule 15.7 of the Hong Kong Takeovers Code

Currently, the offeree company's directors cannot resign, except with the Executive's consent, until the later of the offer's first closing date or the date the offer becomes or is declared unconditional (Rule 15.7). The SFC is proposing the following revisions to clarify that:

- the resignation of an offeree company director cannot take effect until:
  - after the publication of the closing announcement on the offer's first closing date; or
  - the publication of the announcement that the offer has become or been declared unconditional;
- on a takeover offer involving a whitewash waiver, the resignation of an offeree company director cannot take effect until after publication of the results announcement relating to the shareholders' meeting to approve the waiver under Note 1 on dispensations from Rule 26.

Under Rule 15.7 of the Hong Kong Takeovers Code, all conditions must be fulfilled or the offer will lapse within 21 days of the later of:

- the first closing date; or
- the date when the offer becomes or is declared unconditional.

In the context of privatisations by scheme of arrangement, this means that the period between the date of the court meeting (which is akin to the date when an offer is unconditional as to acceptances) and the effective date of the scheme may not exceed 21 days without the consent of the Executive. The Executive has granted waivers of this requirement to privatisation cases involving a scheme of arrangement where this timing cannot be met due to the court's timetable which is beyond the company's control.

The SFC is proposing to add a note to Rule 15.7 so that the Executive's consent will not be needed in cases where the delay between the court meeting and a scheme's effective date is the consequence of the court's timetable. The Rule amendment will also streamline the vetting and approval process for a privatisation by scheme of arrangement.

## 4. Offer Requirements

### Disclosure of Offer Price in Rule 3.7 Talks Announcements

Issue 37 (June 2016) of the Takeovers Bulletin advised parties to maintain confidentiality and take all necessary steps to prevent leakage of information prior to the announcement of a firm intention to make an offer. If confidentiality is maintained, the offeree need not issue a "talks announcement" under Rule 3.7. The Executive adopts a strict approach on the issue of "talks announcements" to prevent the announcement being used to condition the market and mitigate the risk of the offeree's trading price being impacted by the announcement of negotiations which may or may not proceed to an offer. Where the obligation to make a "talks announcement" arises under Rule 3.7, it is expected to be fairly short and to disclose only the fact that talks are taking place. This message has been conveyed and elaborated on in Takeovers Bulletin Issues [40 \(March 2017\)](#) and [53 \(June 2020\)](#). It will not normally be acceptable for talks announcements to disclose the indicative offer price or the form of consideration where these have been communicated to the offeree board, given that an offer will not necessarily materialise.

Market practitioners have sometimes contended that the Executive's practice is overly restrictive and have argued that parties should be allowed to disclose a price in a Rule 3.7 announcement if they wish, and that there could be situations where this would be desirable, e.g. where there are rumours that an offer will be made at a significantly higher price than the price being negotiated.

The SFC considers its existing approach appropriate and proposes to codify the current practice by adding a new note 3 to Rule 3.7 providing that the disclosure of an indicative offer price is not normally permitted before the announcement of a firm intention to make an offer, unless there are exceptional circumstances. The SFC says in the Consultation Paper that exceptional circumstances may include:

- the need to clarify an incorrect market rumour or incorrect statement in the media which may be creating a false market in the shares of the offeree company; or
- where an offeror or offeree company is required by overseas regulatory requirements to disclose an offer price prior to the announcement of a firm intention to make an offer.

In these cases, the disclosed offer price will serve as a floor price for any offer that subsequently materialises.

### Deduction of Dividends from Offer Price under the Hong Kong Takeovers Code

In the 2019 Dalian Port (PDA) Company Limited Takeovers and Mergers Panel decision,<sup>9</sup> the Panel ruled that



the offeror could not deduct the final dividend approved by shareholders of Dalian Port from its offer price in a possible mandatory general offer, if it had not reserved the right to do so. Where the deduction of dividends from the offer price is permitted, but the dividend payment is subject to withholding tax, the Executive will permit the offer price to be reduced by the gross amount of the dividend received by shareholder.

The SFC is proposing to amend Note 11 to Rule 23.1 and Note 3 to Rule 26.3 of the Hong Kong Takeovers Code to provide that:

- an offeror cannot deduct from the offer consideration the amount of a dividend (or other distribution) subsequently paid or payable to offeree company shareholders by the offeree company, unless it has specifically reserved its right to do so in an announcement; and
- where a dividend (or other distribution) is subject to withholding tax or other deductions, the offer consideration should be reduced by the gross amount received or receivable by the offeree company shareholders.

## 5. Partial Offers

### Offer Periods Relating to Partial Offers

Under General Principle 2 of the Hong Kong Takeovers Code, offerors are normally required to provide a full exit to shareholders on an acquisition, change or consolidation of control of a company. The circumstances in which a partial exit for shareholders will be allowed (e.g. on obtaining shareholders' approval of a whitewash waiver) are extremely limited. Partial offers involve shareholders accepting a concessionary offer for only part of their holdings which may nevertheless result in a change, acquisition or consolidation of control of the offeree company in circumstances where the offeror will normally be required to make a mandatory general offer under Rule 26.1 for all not part of shareholders' interests.

The requirements for partial offers under Rule 28 of the Hong Kong Takeovers Code are therefore intentionally more stringent than the Codes other rules. For instance, Rule 28.4 limits the extension of the closing date when the acceptance condition is met. The offeror can only declare an offer unconditional as to acceptance before the first closing date, or on the first closing date if the number of acceptances exceed the number of offer shares on such day. In both situations, the offeror can only extend the final closing day to a date not more than 14 days after the first closing date. An offeror need not extend the final closing day at all provided the offer has been open for at least 14 days following satisfaction of the acceptance condition. Partial offers are also subject to the Rule 28.5 approval condition which means that a partial offer must be conditional on obtaining approval of 50% of all independent shareholders if an offer may result in an offeror holding 30% or more of a company. Where partial offers are subject to the approval condition, the approval must be obtained on or prior to the final closing day, and there can be no further extension of the offer period after the approval condition has been satisfied.

The SFC notes that the current wording has confused market practitioners. Some have mistakenly treated the acceptance and approval conditions as one condition and concluded that an offer must be unconditional on both acceptances and approval before Rule 28.4 comes into play. While Rule 15.7 imposes a deadline by which all conditions for an offer must be met, the SFC notes that the effect of treating the acceptance and approval conditions as one condition, thus delaying the offeror's ability to extend the final closing day under Rule 28.4, would result in a prolonged offer period which is contrary to the rationale for Rule 28.4 and the tighter Rules that generally apply to partial offers.

The SFC is therefore proposing to amend Rule 28.4 to provide that:

- if, on a closing day, acceptances received equal or exceed the precise number of shares stated in the offer document under Rule 28.7, the offeror must declare the partial offer unconditional as to acceptances and extend the final closing day to the 14th day thereafter. The offeror cannot further extend the final closing day;
- If the acceptance condition is fulfilled before the first closing day, the offeror must declare a partial offer unconditional as to acceptances on the day the acceptance condition is met, and the offer must remain open for acceptances for at least a further 14 days; and
- If the acceptance condition is satisfied after the first closing day during an extended offer period, the offeror must declare a partial offer unconditional as to acceptances on the day the acceptance condition is met, and the final closing date cannot be extended beyond the 14th day thereafter.

### Comparable Offer for Convertible Securities, Warrants etc. under the Hong Kong Takeovers Code

The Codes currently lack explicit requirements for making appropriate Rule 13 offers for convertible securities, options, warrants etc. during a partial offer. This contrasts with the requirement to make Rule 14 comparable offers during a partial offer which is expressly provided for under Rule 28.9 of the Hong Kong Takeovers Code. One reason for this is that partial offers never result in the privatisation or delisting of an offeree company, unlike general offers. Accordingly, it is not necessary for holders of convertible securities to have a proportionate opportunity to exit the offeree company.

The SFC notes that some practitioners have contended that Rule 13 comparable offers are required for partial offers given that Rule 13 refers to “an offer being made” without specifying whether this refers to general or partial offers, or both. All partial offers made since 2011 have included comparable offers for options or convertible securities, with percentages typically matching the partial offer for shares. Given the market’s acceptance of appropriate Rule 13 offers applying to partial offers, the SFC is proposing to add a new Rule 28.10 to clarify this requirement.

Under the proposed Rule 28.10, when an offer could result in the offeror holding at least 30% of the voting rights and the offeree company has convertible securities, warrants, options, or subscription rights outstanding, the offeror is required to make an appropriate offer or proposal to the holders of these securities to which the Rule 13 requirements will apply.

## **Application of Tick-box Approval Requirement to Partial Offers**

Rule 28.5 imposes a “tick-box” approval condition requiring a partial offer to be conditional on (as well as acceptances) majority approval of the offeree’s independent shareholders which can be waived if an independent shareholder with over 50% of the independent voting rights has indicated approval of the partial offer. However, there is ambiguity as to whether this requirement can be waived when the offeror, together with its concert parties, already holds over 50% of the offeree company’s voting rights. The SFC considers that on a strict interpretation, the “tick-box” approval condition will apply to a partial offer in that situation.

The SFC is therefore proposing to amend Rule 28.5 to clarify that the “tick-box” approval condition does not apply to partial offers (i.e. offers within Rule 28.1(a) or (b)).

## **Acceptance and Approval of Partial Offers by Exempt Principal Traders**

Rule 35.4 prohibits exempt principal traders connected with an offeror or offeree company from voting in the context of an offer. However, the applicability of Rule 35.4 to partial offers is unclear. The SFC proposes to clarify that partial offers are subject to the application of both Rule 35.3 and Rule 35.4, which provides that shares held by exempt principal traders connected to an offeror must not be assented to an offer, until the offer becomes or is declared unconditional as to acceptances.

# **6. Green Initiatives**

## **Electronic Dissemination of Documents**

The Listing Rules of the Hong Kong Stock Exchange allow HKEX-listed companies to send corporate communications to their securities holders electronically if certain conditions are met.

The SFC proposes to add a new Rule 8.7, which provides the offeror and offeree company with the option of dispatching documents under the Codes electronically. However, the SFC also states that any document sent in breach of applicable laws and regulations and constitutional documents may not be treated as having been sent or dispatched under Rule 8.7.

## **Language Preference**

Rule 8.6 of the Codes currently requires that documents be printed and dispatched in both Chinese and English. The SFC proposes to introduce a new Note 2 to Rule 8.6, permitting issuers to send physical copies of documents in either English or Chinese, as long as arrangements are in place to ascertain the language preference of the recipient.

## **Publication of Announcements in Respect of Unlisted Offerees**

The SFC currently requires unlisted offeree companies who are public companies within section 4.2 of the Introduction to the Codes to publish their announcements in a leading English and a leading Chinese newspaper. The SFC proposes to remove this requirement from Rule 12.2.

## Submissions to the Executive

The SFC is proposing to require all submissions (including draft documents, ruling applications, financial resources confirmations, no material change confirmations and other reports, letters and confirmations required under the Codes and Practice Note 20) to be made electronically by email to [cfmailbox@sfc.hk](mailto:cfmailbox@sfc.hk), unless directed otherwise. It will continue to accept fees for document vetting and ruling applications by cheque or telegraphic transfer. The proposals will be effected by amendments to Rules 8.1 and 8.2 to the Introduction to the Codes, Rule 12.1 and Practice Note 20.

## 7. Other Hong Kong Takeovers Code Amendments

### Definition of On-Market Share Buy-backs

Off-market share buy-backs require the approval of 75% of the company's independent shareholders. The SFC proposes to clarify that, for HKEX-listed shares, an "on-market share buy-back" means a share buy-back made by an HKEX-listed company made through the facilities of the Hong Kong Stock Exchange's automatic order matching system in which the company buying back its shares and its directors are not involved in the selection or identification (directly or indirectly) of the sellers of the shares.

### Disclosure of Special Deals in Firm Intention Announcements

The Executive has routinely required vendor, offeror and offeree companies to disclose details of special deals or an appropriate negative statement in announcements of a firm intention to make an offer and shareholders' documents since publishing its [Issue 48](#) of the Takeovers Bulletin in March 2019. The SFC is therefore proposing to codify this requirement by including it as a prescribed disclosure under Rule 3.5, and Schedules 1 and II which will be revised to include provisions that where a firm intention to make an offer is made, the announcement must include:

- *"where an offer involves or otherwise relates to a sale (directly or indirectly by a vendor of shares in the offeree company:*
  - *details of any consideration, compensation or benefit in whatever form paid or to be paid by the offeror or any party acting in concert with it to the vendor of the sale shares or any party acting in concert with such vendor in connection with the sale and purchase of the sale shares; and*
  - *details of any understanding, arrangement, agreement or special deal between the offeror or any party acting in concert with it on the one hand, and the vendor of the shares and any party acting in concert with it on the other hand;*
- *details of any understanding, arrangement or agreement or special deal between any shareholder of the offeree company and:*
  - *the offeror and any party acting in concert with it, or*
  - *the offeree company, its subsidiaries or associated companies."*

### Disclosure of Offeror and Offeree Relevant Securities on Commencement of Offer Periods

Rule 22 of the Hong Kong Takeovers Code requires the disclosure of dealings in relevant securities by the offeror and offeree and their respective associates during the offer period. The definition of "relevant securities" includes:

- securities of the offeree which are being offered for or which carry voting rights;
- equity share capital of the offeree company; and
- in the case of a securities exchange offer, the securities or equity share capital of an offeror, or of a company the securities of which are to be offered as consideration for the offer.

The SFC is proposing to remove the requirement for class (6) associates of the offeror to disclose their dealings in relevant securities of the offeree during a cash offer.

### Frustrating Actions

Rule 4 of the Hong Kong Takeovers Code prohibits the board of the offeree from taking any action to frustrate an offer or which might result in the offeree's shareholders being denied an opportunity to decide on the merits of an offer, except with shareholders' approval. Note 1 to Rule 4 provides that if the offeror consents to a corporate action, the Executive may waive the requirement for it to be approved by shareholders.

#### Rule 4 list of frustrating actions is non-exhaustive

The SFC proposes to amend Rule 4 to clarify that the following frustrating actions listed in the Rule are merely examples of events that might constitute frustrating actions and are not a definitive or exhaustive list of the events that may be frustrating actions:

- share issues;
- the issue or grant of convertible securities, options or warrants for the offeree company's shares;
- the sale, disposal or acquisition of assets of a material amount;
- the entering into of contracts otherwise than in the ordinary course of business; and
- causing the offeree or its subsidiary or associated company to buy back, purchase or redeem any shares in the offeree or provide financial assistance for any such buy-back, purchase or redemption.

The over-arching principle to be considered in determining whether an action is "frustrating" is whether the action results in the offeree's position being materially different from when the offeror announced its intention to make an offer (or when the offeror approached the offeree with an offer).

#### Prior contractual obligations

Rule 4 provides that the Executive must be consulted at the earliest opportunity when the offeree has a prior contractual obligation to take an action and that such actions are not normally caught as frustrating actions, particularly where they are announced by the offeree company before the board has reason to believe that a bona fide offer may be imminent. However, if there are special circumstances, these should be brought to the Executive's attention as soon as possible to confirm whether Rule 4 applies. An example of special circumstance would be where obligations are put in place, but are not otherwise enforceable or triggered, unless and until a takeover offer is made for the offeree company, such as a poison pill. In these circumstances, the Executive is likely to consider these prior contractual obligations as frustrating actions under Rule 4.

#### Offeror's consent

Note 1 to Rule 4 provides that shareholders' approval is not required if the offeror consents to the corporate action being taken. To streamline the operation of Note 1, the SFC will amend it so that once the offeror has given its consent, it will not require a further waiver from the Executive. Where an announcement is made, it will be sufficient to include a statement confirming that the offeror's consent has been obtained. If no announcement will be made (for example, because the relevant corporate action is not a notifiable transaction under the HKEX Listing Rules), the offeror's consent to the corporate action will need to be lodged with the Executive. If there are competing bids, consents from all named offerors or potential offerors will need to be obtained before the shareholders' approval requirement can be dispensed with.

### **Disclosure of Market Prices of Offeree Company's and Offeror's Securities**

Paragraph 10 of Schedule I to the Hong Kong Takeovers Code sets out certain disclosure requirements relating to the closing price of the securities of the offeree company and the securities of the offeror (if the consideration for the offer involves the offeror's securities). Where the trading of shares is halted during a trading day, the SFC normally requires disclosure of, and comparison with:

- the closing price for the full trading day before such halt; and
- the last trading price immediately before the trading halt.

The SFC is proposing to codify this practice by adding a new note to paragraph 10 of Schedule I stating that where trading of securities is suspended during a trading day, disclosure is required of the closing price on the last full trading day and the trading price immediately before the suspension.

### **Application of Rule 31.1 in Whitewash Transactions**

Rule 31.1 prohibits an offeror and its concert parties from announcing a further offer for the offeree company or acquiring voting rights of the offeree where this would require the making of a mandatory offer under Rule 26, within 12 months of the withdrawal or lapse of a previous offer, except with the Executive's consent.

Note 4 to Rule 31.1 and 31.2 further provides that the restrictions under Rule 31.1(c) also apply to a person who announces a transaction that is conditional on no general offer being required, where the person does not reserve the right to waive the condition, or does reserve the right to waive but does not waive the condition.

The SFC is proposing to apply the restrictions under Rule 31.1 to whitewash transactions so that a transaction that is conditional on a whitewash waiver being granted will be treated in the same way as a transaction that is conditional upon no mandatory general offer being required. Accordingly, Rule 31.1 is proposed to be included in the list of Takeovers Code requirements applicable to whitewash transactions in paragraph 2(d) of Schedule VI. However, the revised Note 4 would not restrict back-to-back non-waivable whitewash transactions: it would allow a person to enter into non-waivable whitewash transactions repeatedly given that no subsequent offers can be made if the whitewash condition is voted down by shareholders.

## Application of Rule 3.8 to Share Buy-backs by way of General Offer

In a share buy-back by way of general offer, the most up-to-date position of the offeree company's relevant securities must be made known to assist investors in complying with the Hong Kong Takeovers Code's requirements, to determine whether they are class (6) associates who need to comply with Rule 22. The Rule 3.8 requirement for offerors and offerees to announce details of their relevant securities should therefore apply equally to share buy-backs by way of general offer.

The SFC is therefore proposing to amend Rule 5.1(c) of the Share Buy-backs Code to include Rule 3.8 as being one of the Takeovers Code Rules that apply to share buy-backs. The amendments will also include the new proposed Rule 3.9 in Rule 5.1(c) of the Share Buy-backs Code.

## 8. Housekeeping Amendments

Paragraph 2(a) of Schedule VI states there should be no disqualifying transactions from 6 months prior to the announcement of the whitewash proposals and up to the date of the shareholders' meeting. However, this is inconsistent with paragraph 3 which states that there should be no disqualifying transactions from 6 months prior to the announcement of the proposals and up to the completion of the subscription. The current operating rules regarding disqualifying transaction have been applied since their last amendment in 2005 and therefore paragraph 2(a) is a typographical error which will be amended and aligned with paragraph (3) as follows:

### "2. *Specific grant of waiver required*

*In each case, specific grant of a waiver from the Rule 26 obligation is required. Such grant will be subject to:*

*(a) there having been no disqualifying transactions (as set out in paragraph 3 of this Schedule VI) by the person or group seeking the waiver;"*.

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[1] The "Takeovers Executive" is the Executive Director of the SFC's Corporate Finance Division or his/her delegate

[2] Under Rule 2.2 of the Hong Kong Takeovers Code

[3] Under Rule 2.2(c) of the Hong Kong Takeovers Code

[4] Under Rule 28.4 of the Hong Kong Takeovers Code

[5] SFC. (2023). 'Consultation paper on proposed amendments to the Codes on Takeovers and Mergers and Share Buy-backs'. P. 9 at paragraph 6

[6] The Takeovers Code also applies to companies determined to be "public companies" according to the factors set out in 4.2 of the Introduction to the Code

[7] Re. Cosmos Machinery Enterprises Ltd (HCMO 601/2021, [2021] HKCFI 2088) and Re. Chong Hing Bank Limited (HCMP 968/2021, [2021] HKCFI 3091

[8] The Executive refers to the Executive Director of the Corporate Finance Division of the SFC or any delegate of the Executive Director.

[9] See the Takeovers and Mergers Panel Decision at <https://www.sfc.hk/-/media/EN/files/CF/pdf/Takeovers-and-Mergers-Panel---Panel-Decision/Dalian-Port---Decision-paper---2-Oct-2019-FINAL.pdf?rev=9219e0fc281f4c5fa165929faa3a05b1&hash=DBAC0C67D460CF6E3DF48C398B66434C>

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