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# SFC Publishes Guidance On Takeovers Code

The Securities and Finance Commission of Hong Kong (the **SFC**) has launched a series of newsletters aimed at providing guidance and interpretation on matters relating to takeovers in Hong Kong. The first Takeovers Bulletin was published in May 2007 and a second in September 2007.

The Bulletin contains articles relating to takeovers, mergers, and share repurchases in Hong Kong, and Practice Notes on relevant issues under the Codes on Takeovers and Mergers and Share Repurchases (the **Codes**). The Practice Notes are intended to provide informal guidance on the interpretation and application of the Codes' provisions by the Executive Director of the Corporate Finance Division of the SFC (the **Executive**). However, the Executive must be consulted for the application of the Codes to a particular case. In case of doubt regarding a proposed course of conduct under the Codes, parties or their advisers are advised to consult the Executive in advance.

Below is a summary of the Practice Notes given in the first two issues of the Takeovers Bulletin.

## 1. Practice Note 1 - Partial Offers

A partial offer is an offer made by a non-shareholder to shareholders of a company to buy a specified number/percentage (but not all) of shares with voting rights. A partial offer is specifically governed by Rule 28 of the Code in addition to its General Principles and Rules to ensure that shareholders are treated equally.

Partial offers can be made in the following two ways:

### A. Share register method

The Share register method is where the offer is made for a specific proportion of each shareholder's shares registered in his name on a record date. An accepting shareholder is assured that a minimum number of the shares held by him on the record date will be accepted by the offeror if the offer becomes unconditional. Most partial offers in Hong Kong are made using this method.

For example, if an offeror holding no shares offers to buy 30% of the offeree company's shares, an accepting shareholder holding 200 shares on the record date may tender 60 shares (i.e. 30% of his holding) or less and be assured that, if the offer completes, all of those shares will be taken up by the offeror. The shareholder is therefore free to hold on to or sell his remaining 140 shares. Some shareholders may offer more or all of their remaining shares. These are excess applications that the offeror may take up to reach his target of 30% if other shareholders do not accept his offer.

### B. Common pool method

Under this method the shares taken up by an offeror from each shareholder is determined by the total number of shares tendered for acceptance (the pool).

For example, if a non-shareholding offeror offers to buy 30% of the offeree company's shares and if the offeree company has 50 million issued shares, 30% would represent 15 million shares. If A holds 600 shares and offers all his shares and all the other shareholders also make a similar offer of all their shares, the offeror can take up only 30% of each shareholder's tendered shares, i.e. the offeror can take up only 180 shares from A.

However, if a total of 30 million shares are offered, 50% (i.e. 15 million ÷ 30 million) of the shares offered by each shareholder (300 shares from A presuming he offers all his shares) must be taken up by the offeror ensuring that all accepting shareholders share the offer on an equal basis. There is no record date and no reference to the share register; provision for excess applications is also not required.

Both types of offer mechanisms are acceptable under the Code as both methods ensure that shareholders are treated equally and full information regarding the mechanism and terms of the offer is available in both cases. However, in view of the drafting of Rule 28.8, the Executive may grant a waiver from strict compliance with that Rule in the case of common pool partial offers.

#### Odd lots

A partial offer often leaves the shareholders with odd lots of shares which are difficult to dispose of or must be sold below market price or involve greater transaction costs than board lots of shares. The Notes to Rule 28 require an offeror to arrange its acceptance procedure to minimise the number of existing and new odd lot shareholdings. A designated broker may be appointed to match sales and purchases of odd lot holdings.

To ensure that shareholders with odd lots are not treated differently from other shareholders and that General Principle 1 and Rule 28.3 are complied with, the designated broker may not itself make an offer to buy the odd lots from shareholders. Under Rule 28.3 the offeror, or persons acting in concert with him, cannot acquire voting rights during the offer period. If the designated broker were to make an offer for the odd lots, Rule 28.3 would be breached, as it is likely that the designated broker is acting in concert with the offeror.

#### Shareholder approval for partial offers for 30% or more

Under Rule 28.5 of the Code, a partial offer that results in the offeror holding 30% or more of the shares with voting rights of a company must normally be conditional on the approval of the offer, by independent shareholders holding over 50% of the shares (i.e. 50% of the total issued shares of the company not of shares held by shareholders attending the meeting). This ensures that over 50% of the independent shareholders approve the offeror's proposal to acquire 'control' by means of a partial offer (which can be regarded as an exception to the requirement to make a mandatory offer under Rule 26.1 of the Code).

A shareholder may approve the partial offer for more than 30% of the shares by ticking a separate box on the acceptance form and indicating the number of shares for which he gives his approval. The approval and the acceptance process are separate and a shareholder can accept a partial offer but not approve it or not accept the offer and yet approve it.

## 2. Practice Note 2 (PN2) - Treatment Of Profit Forecasts Required By Overseas Jurisdictions

Companies registered in overseas jurisdictions may be required by laws of those jurisdictions to include certain financial projections in documents sent to shareholders containing details of takeover transactions. Financial projections are usually regarded as profit forecasts under Rule 10 of the Code, which require reporting on by both the offeree company's financial advisers and its accountants or auditors. The Code requires that:

1. the financial advisers must satisfy themselves that the profit forecasts were prepared with due care and consideration by the directors of the company; and
2. the accountants or auditors must satisfy themselves that the profit forecasts, so far as accounting policies and calculations are concerned, were properly prepared on the basis of the assumptions made.

However, if the only reason for the publication of profit forecasts is the requirement under the laws and regulations of the overseas jurisdiction, the Executive may permit publication of the forecasts without full compliance with Rule 10. In such situations, the profit forecasts must have an appropriate warning stating that they do not comply with the standard required by Rule 10 and that shareholders and potential investors should assess the merits and demerits of the transaction on the basis of that warning.

## 3. Practice Note 3 (PN3) - Implementation Of Phase 1 Of The Electronic Disclosure Project And The Application Of Rule 19.1 Of The Takeovers Code

The Hong Kong Stock Exchange introduced the Electronic Disclosure Project on 25 June 2007. This deals with the electronic dissemination of regulatory information and contains some transitional arrangements. Under phase 1 of this project, listed companies no longer have to publish company announcements in newspapers if they have published the announcement on both their company website and the Stock Exchange's website. However, during the first six months of the new regime, companies are required to publish a notification in newspapers whenever they post an announcement on the Stock Exchange's and their own website.

Rule 19.1 of the Takeovers Code states that an announcement of results of an offer must be published on the Stock Exchange's website by 7.00 pm on the closing date. It is also a requirement that this notice must be "republished in accordance with Rule 12.2 on the next business day thereafter". Rule 12.2 of the Takeovers Code states that all "announcements in respect of listed companies must be made in accordance with the requirements of the Listing Rules". The Executive clarifies that for the purpose of Rule 19.1, it regards a publication in compliance with Phase 1 of the Electronic Disclosure Project as being satisfactory fulfilment of the Republication Requirement in Rule 12.2.

The Executive will issue further guidance on the Electronic Disclosure Project if and when it becomes necessary.

## 4. Practice Note 4 (PN4) - Can The Offer Price Be Increased After A "No Increase" Statement?

Parties to an offer, or possible offer, and their advisers must not issue statements that may mislead or create uncertainty, under Rule 18.1. An offeror must not state that it may improve its offer, without committing itself to doing so and specifying the improvement. This position regarding no increase statements is clarified in Rule 18.3:

"If statements in relation to the value or type of consideration such as "the offer will not be further increased" or "our offer remains at $x per share and it will not be raised" (no increase statements) are included in documents sent to offeree company shareholders, or are made by or on behalf of an offeror, its directors, officials or advisers, and not withdrawn immediately if incorrect, only in wholly exceptional circumstances will the offeror be allowed subsequently to amend the terms of its offer in any way even if the amendment would not result in an increase of the value of the offer (e.g. the introduction of a lower paper alternative) **except where the right to do so has been specifically reserved**." (emphasis added)

Similar provisions are also applied to no extension statements in Rule 18.2.

The rationale for Rule 18.3 reflects General Principle 6 of the Codes, which requires parties to make every effort to avoid the creation of a false market. The main concern is to prevent statements being made that may mislead shareholders or the market or create uncertainty. Offerors should also exercise caution when making statements during the offer period that may be taken as a statement of finality. Further guidance is provided in Note 1 to Rule 18.

An offeror is not under any obligation to make a no increase statement but when one is made it is usually in order to emphasise the finality of the terms of an offer. Shareholders should be able to be certain an offeror's statement is reliable and thus be able to reach an informed decision regarding the offer. An offeror may reserve the right to increase the offer at the same time as issuing a no increase statement, as long as the circumstances of such an increase are clearly given. Notes 2 and 3 to Rule 18 provide additional guidance if an offeror wishes to set aside a no increase statement in the event of a competing situation or recommendation by the board of the offeree company. Note 2 provides that if a competitive situation occurs, the offeror may choose not to be bound by the no increase statement only if:

1. it has specifically reserved the right to set the no increase statement aside should such circumstances occur; and
2. an announcement is issued that provides details of the revisions as soon as possible and within 4 business days after the announcement of the competing offer and a circular is sent to shareholders; and
3. any shareholders of the offeree company who accepted the offer after the date of the no extension or no increase statement are given a period of 8 days from the circular being sent, to withdraw.

Note 3 states that the offeror may choose not to be bound by a no increase statement, which would otherwise prevent the posting of an increased or improved offer recommended for acceptance by the board of the offeree company, only in the event that the offeror has reserved the right to do so.

Rule 18.3 allows for the revision of a no increase statement in "wholly exceptional circumstances" even if the offeror did not include the right to set aside the no increase statement. Detailed analysis of the situation would dictate whether it qualifies as a "wholly exceptional circumstance".

## 5. Practice Note 5 (PN5) - Executive's Commenting Process Does Not Give Immunity

The Executive recommended in the 2004/2005 Code review exercise that the commenting process in which the Executive comment on proposed draft announcements or documents, be shortened. There was concern that issuers and advisers were relying on the Executive's input rather than ensuring their draft was to a high standard before sending it for review. This meant that the Executive had to provide extensive comments and spend a greater amount of time on the commenting process. Since the review exercise, the Executive issues a confirmation that it has no further comments once substantive Code issues have been raised and dealt with. Other matters are left to the party issuing the announcement or document and its advisers to deal with.

The Executive is disappointed to announce that many parties still appear to remain overly reliant on the Executive's commenting process. The Executive reminds parties and their advisers involved in Code transactions that the Executive's role is no more than a consulting role whereby it will provide assistance in resolving any Code issues raised by it or identified by the parties. The parties and advisers should not be mistaken in thinking that when the Executive says that it has no further comments to make on a draft announcement or document, that it is confirming it to be fully compliant with the Codes. The party issuing the document or announcement is fully responsible for the information disclosed and for compliance with the requirements of the Codes.

Parties issuing Code related announcements and documents should be aware of possible criminal liability arising under Section 384 of the Securities & Futures Ordinance for any false or misleading information contained in such announcements or documents.

## 6. Executive Issues Statement On PCCW Takeovers Ruling

It is the policy of the Executive to publish important rulings together with the reasons for them, subject to confidentiality considerations.

The SFC has published a statement of the Takeovers Executive's ruling regarding the proposed sale of shares in PCCW Limited, a case of considerable significance. The issue involved the proposed sale of 22.65% of the shares of PCCW Limited (Stock Code 0008) (**PCCW**) by Pacific Century Regional Developments Ltd (**PCRD**) to Mr. Leung and a subsequent sale by him to Telefónica, Li Ka Shing Foundation (**HK Foundation**) and Li Ka Shing (Canada) Foundation (**Canada Foundation**).

The outcome of the application was important at the time it was made because, if the parties were found to be acting in concert, a number of proposed transactions (including the proposed sale of 22.65% of the issued share capital of PCCW to Mr. Leung) may have resulted in the enlarged concert group holding an aggregate of 30% or more of the voting rights of PCCW and in consequence a general offer obligation would have been triggered under Rule 26.1 of the Code.

Mr. Leung sought the Executive's ruling under the Code as to the status of the parties. The Executive held that at the time of the ruling there was insufficient evidence to conclude that Mr. Leung and/or Fiorlatte and/or Mr. Li Ka Shing (**Mr. KS Li**) and/or the HK Foundation and/or the Canada Foundation on the one hand and Telefónica and/or CNC on the other, were parties acting in concert as defined in the Codes.

However, the ruling also clarified that the Executive considered Mr. Leung, Mr. KS Li and the Foundations to be acting in concert in respect of PCCW and that the Executive would monitor the developments in the case. The Executive required reporting of any material change to the information or representations made to retain the validity of its ruling.

## 7. Takeovers Panel Decisions In Relation To Pacific Challenge Holdings Limited

The Panel met to consider disciplinary proceedings brought by the Takeovers Executive in respect of whether certain parties were acting in concert in relation to certain transactions in shares of Pacific Challenge Holdings Limited under the Takeovers Code. The Takeovers Panel dismissed the disciplinary proceedings on the basis that there was insufficient evidence to conclude that the alleged concert party relationship existed. The SFC published this decision, along with a series of related decisions, on 16 July 2007.

## 8. Takeovers Panel Decisions In Relation To Sanmenxia Tianyuan Aluminium Company Limited

The Panel's decision on the comparable offer price for the "H" shares of Sanmenxia Tianyuan Aluminium Company Limited was published on 6 August 2007. The Executive had referred this to the Panel as it related to a particularly novel, important or difficult point. The Panel decided that, as required in Rule 14 of the Takeovers Code, the offer price for the "H" shares should be at the same price paid for its Domestic Shares, which was the Hong Kong dollar equivalent of RMB0.1577 per share calculated by reference to the rate prevailing on the date the mandatory offer was triggered.

The purpose of this note is to provide a summary only of the Takeovers Bulletin.

## Texts And Feedback:

A copy of the Takeovers Bulletin can be found on the [SFC's website](http://www.sfc.hk/web/EN/regulatory-functions/listings-and-takeovers/takeovers-and-mergers/takeovers-bulletin-%28publication%29.html). The SFC invites suggestions or comments in relation to the bulletin.

A copy of the [Executive's Statement](http://www.sfc.hk/sfc/doc/EN/cfd/mergers/panel/executive_statement_ruling_20070517.pdf) ([see archive](executive_statement_ruling_20070517.pdf)) on the PCCW ruling

A copy of the [Takeovers Panel's decisions](http://www.sfc.hk/sfc/doc/EN/cfd/mergers/panel/executive_statement_ruling_20070717.pdf) ([see archive](executive_statement_ruling_20070717.pdf)) in relation to Pacific Challenge Holdings Limited

A copy of the [Takeovers Panel's decisions](http://www.sfc.hk/sfc/doc/EN/cfd/mergers/panel/panel_decision_20070803.pdf) ([see archive](panel_decision_20070803.pdf)) in relation to Sanmenxia Tianyuan Aluminium Company Limited

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