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# HKEx Publishes Listing Decision Regarding Restrictions On Disposal After A Change In Control Under Chapter 14 Of The Listing Rules

## Introduction

HKEx published in March 2011, a listing decision (HKEx-LD7-2011) on an attempt by a Main Board issuer ("**Company A**") to circumvent certain elements of the regulatory regime, set out in Chapter 14 of the Listing Rules, governing the conduct of reverse takeovers. This effort at circumvention applied particularly to Listing Rule 14.92, which prevents a listed issuer from disposing of its current business for a period of 24 months subsequent to a change in control. Company A sought a waiver from this Rule. However, HKEx refused to grant the waiver, principally on the grounds that Company A was attempting to defeat the policy goals of Rule 14.92. HKEx went on to state that if Company A persisted with the disposal, it would be treated as a new listing applicant under Rule 14.93.

This attempt to circumvent the relevant rules of Chapter 14 involved delaying the disposal of Company A's current business until after it had signed an agreement to acquire another business, in the hope of avoiding triggering the percentage ratio [[1]](#footnote-24) which constitutes a "very substantial acquisition" [[2]](#footnote-25) under Chapter 14. The classification of an acquisition as a very substantial acquisition leads to the triggering of the Rules on reverse takeovers. However, HKEx looked at the overall effect of the change in control, acquisition and disposal in this case and, having identified an attempt to undermine the policy goals of Rule 14.92, refused to grant the waiver.

## The Facts

Company A and its subsidiaries ("**the Group**") were engaged in the business of producing and selling chemical products, a business it conducted through another entity ("**the Disposal Target**"). The Disposal Target made up a huge proportion of the Group's overall assets and revenue, 70% and 100% respectively. The control in Company A had within the previous year become vested in another company ("**Company Z**").

Approximately one year subsequent to this change in control, Company A contracted with another party ("**the Vendor**") to purchase an entity ("**the Acquisition Target**") engaged in the creation and sale of lighting related products. The stated aim of this acquisition, which constituted a major transaction [[3]](#footnote-27) under Chapter 14 of the Listing Rules, was the expansion of the Company A's income base and the diversification of its business portfolio.

Within a very brief period of concluding the purchase of the Acquisition Target, Company A arranged to sell the Disposal Target to another party ("**the Purchaser**"), in a transaction amounting to a very substantial disposal [[4]](#footnote-28) under Chapter 14 of the Listing Rules. Among the terms of the disposal was an arrangement via which the Disposal Target would make what remained of the Group (after the sale of the Disposal Target) a non-exclusive distributor of its chemical products for a number of years. Company A submitted that it would continue its existing business by trading chemical products, despite the sale of the Disposal Target. The Disposal Target was profitable, but Company A submitted to HKEx that the sale was nevertheless in the interests of its shareholders, due principally to doubts over the Disposal Target’s viability as a business model going forward.

## The Regulatory Framework for Reverse Takeovers

Reverse takeovers are defined in Rule 14.06. The term, in summary, refers to an acquisition or sequence of acquisitions by an issuer, aimed at securing a listing of the assets acquired without going through the normal listing process for new applicants detailed in Chapter 8 of the Listing Rules. The two examples of reverse takeovers given in the Listing Rules are described as follows:

* Acquisition(s) of assets amounting to a very substantial acquisition [[5]](#footnote-30) where there is or will be a change in control (as defined in the Takeover Code) of the listed issuer as a result of the acquisition; or
* Acquisition(s) of assets from a person or group, under an arrangement entered into by the listed issuer, within 24 months of those persons taking control (in a manner not regarded as a reverse takeover at the time) of the listed issuer, where these acquisitions, either taken individually or aggregated, amount to a very substantial acquisition.

Rule 14.92 is the Rule most immediately relevant to this decision, for it is from this Rule that Company A sought a waiver from HKEx. As noted in the introduction, it prevents a listed issuer from disposing of its existing business for 24 months after a change in control. However, should the assets acquired from those gaining control (or their associates), and any other assets acquired by the listed issuer subsequent to the change in control, be capable of meeting the trading record requirement under Listing Rule 8.05, then the bar on disposal is lifted.

Rule 14.93 then goes on to state that any disposal by a listed issuer, which is within the 24 month period and does not fall within the carve out in Rule 14.92 for assets meeting the trading requirement, leads to that issuer being regarded as a new listing applicant and therefore subject to all the requirements for a new listing.

## HKEx's Examination of the Issues

The key point made by HKEx was that Rules 14.92 and 14.93 are designed to eliminate the possibility of companies circumventing the effect of Rule 14.06(6). Examples of the kind of circumvention which the Rules are meant to prevent include situations where the new controlling shareholder structures a reverse takeover as a series of transactions. The specific example given here by HKEx of such a transaction is where the new controller(s) inject assets into the listed issuer soon after assuming control, but defers the disposal of the issuer's existing business. This procedure permits the new controller(s) to avoid classifying the asset injection as a very substantial acquisition, as it ensures that the percentage ratios of the asset acquired will not reach 100% or more.

Despite highlighting the policy aim of the Rules, HKEx also emphasises that the wording of Rule 14.92 allows for a stricter reading of the section, one which prevents an issuer from selling any of its existing businesses within the 24 months subsequent to a change in control, even where there is no asset injection and the sale has a legitimate business rationale underlying it. However, HKEx stated in the decision that Rule 14.92 should be interpreted to meet the policy intent of obstructing the circumvention of Rule 14.06. With this in mind, HKEx noted that a waiver from Rule 14.92 may be granted to issuers so long as their situation is not the following:

* An injection of assets has been made by the new controlling shareholder into the listed issuer; and
* After factoring in the disposal(s) of the existing business of the listed issuer, this asset injection (or injections), made in the lead up to and subsequent to the change in control, would have constituted a very substantial acquisition on the part of the listed issuer.

## Conclusion

It was held that Rule 14.92 applied as Company A would sell its existing business within a 24 month period of its controlling stake changing hands and, furthermore, the requirements of the Rule had not been satisfied. HKEx stated no waiver could be granted, noting the following in support of its decision:

* **The Size of the Disposal Target relative to the Group:**  
  As noted above, the Disposal Target's revenue and total assets represented 100% and 70% of the Group's revenue and total assets. By selling the Disposal Target, Company A was effectively selling almost all of the Group's existing business.
* **The Change to the Group's Business Purpose**    
  Prior to the disposal, the Group was engaged in the business of producing and selling chemical products. Subsequent to the disposal,Company A would engage in the business of trading chemical products, which it claimed would represent a continuation of its existing business. However this is not the same as producing chemicals, which was the primary business of the Group. The Group would, subsequent to the disposal, be involved in the manufacture and sale of lighting related products, due to the purchase of the Acquisition Target, and the aforementioned trading of chemical products. Its current business would come to an end.
* **The Timing of the Disposal and the Acquisition**  
  If the acquisition was made subsequent to the disposal, it would represent a very substantial acquisition on the part of Company A. It would also, in terms of scale be significant to the Group and represent the vast majority of the Groups business. HKEx noted that the acquisition would constitute a method of accomplishing the listing of the Acquisition Target.
* **The Non Applicability of Rule 8.05**  
  As discussed above, should the assets acquired from the new controllers or their associates, or any other assets acquired by the listed issuer subsequent to the change in control be capable of meeting the trading record requirement under Listing Rule 8.05, then the bar on disposal is lifted. However, in this case, neither the Acquisition Target nor the restructured Group could satisfy these requirements.

After highlighting these factors, HKEx stated that "*the change in control, the acquisition and the disposal were a series of arrangements to circumvent the reverse takeover Rules*". As a result, HKEx concluded that Company A was in violation of the policy intent of the Rules and the waiver could not be granted, and if it continued with the disposal, it would be treated as a new listing applicant under Rule 14.93.

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1. Under Rule 14.07 the percentage ratios are the figures, expressed as percentages, which are the result of various calculations designed to relate the scale of a transaction to the scale of a listed issuer engaged in a transaction. For example, the total assets which are the subject of the transaction divided by the total assets of the listed issuer will give one the assets ratio of the transaction. [↑](#footnote-ref-24)
2. Rule 14.06 (5) defines a very substantial acquisition as an acquisition or a series of acquisitions (aggregated under rules 14.22 and 14.23) of assets by a listed issuer where any percentage ratio is 100% or more. [↑](#footnote-ref-25)
3. Under Rule 14.06 (3) a major transaction is a transaction (or a series of transactions) by a listed issuer where any percentage ratio is 25% or more, but less than 100% for an acquisition or 75% for a disposal. [↑](#footnote-ref-27)
4. Under Rule 14.06 (4) a very substantial disposal is a disposal or a series of disposals (aggregated under rules 14.22 and 14.23) of assets (including deemed disposals referred to in rule 14.29) by a listed issuer where any percentage ratio is 75% or more. [↑](#footnote-ref-28)
5. Under Rule 14.06 (6) (b) when determining whether the acquisition(s) constitute(s) a very substantial acquisition, the lower of:

   1. the latest published ﬁgures of the asset value, revenue and proﬁts as shown in the listed issuer's accounts and the market value of the listed issuer at the time of the change in control, which must be adjusted in the manner set out in rules 14.16, 14.17, 14.18 and 14.19, as applicable, up to the time of the change in control; and
   2. the latest published ﬁgures of the asset value, revenue and proﬁts as shown in the listed issuer’s accounts and the market value of the listed issuer at the time of the acquisition(s), which must be adjusted in the manner set out in rules 14.16, 14.17, 14.18 and 14.19, as applicable, is to be used as the denominator of the percentage ratios.

   [↑](#footnote-ref-30)