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[online version](http://www.charltonslaw.com/sfc-publishes-consultation-paper-on-proposed-takeovers-code-amendments/)

# SFC Publishes Consultation Paper On Proposed Takeovers Code Amendments

## Introduction

On 24 August, 2011, the SFC announced a one-month consultation to request public comments on their proposed amendments to the Codes on Takeover and Mergers and Share Repurchases (the **Takeovers Code**). The principal proposals made by the SFC in a three-part paper are to amend:

* Rule 11.1(f) of the Takeovers Code in relation to the requirements for property valuation (Part 1);
* Note 7 on dispensations from Rule 26 of the Takeovers Code relating to confirmations of independence in placing and top-up transactions (Part 2); and
* the 10-day payment period for the settlement of consideration set out in Rule 20.1 of the Takeovers Code (Part 3).

Interested parties should submit comments and questions to the SFC by 26 September, 2011. Comments may be submitted online via the SFC website ([www.sfc.hk](http://www.sfc.hk/)), by email to [cfdconsult@sfc.hk](mailto:cfdconsult@sfc.hk), by post, or by fax to 2810 5385.

## Proposed Amendments

### Property Valuation Requirements: Part 1

#### Current Requirements

Rule 11.1(f) requires a valuation of properties in the case of an offer for a company with significant property interests, or in the case of a securities exchange offer, where the offeror company has significant property interests. The Executive has recently explored whether it might be appropriate to amend this requirement so that it only applies to offers where the offeror is a related party or which involve a special deal that requires shareholder approval under Rule 25 of the Takeovers Code.

The significance of Rule 11 is that it embodies one of the fundamental principles of the Code: that shareholders should have access to sufficient information to enable them to reach an informed decision on an offer. It sets out detailed requirements for asset valuations and aims to ensure that, when given in connection with an offer, such asset valuations are supported by the opinion of a named independent valuer. The reason for this is that, depending on the nature of a company’s business, the value attributed to particular assets may be vitally important to determining whether an offer is fair and reasonable and thus to a shareholder’s decision on the advantages and disadvantages of an offer. Rule 11 applies to land, buildings and process plant and machinery as well as other tangible and intangible assets.

Currently, Rule 11.1(f) is mandatory and is unique to Hong Kong. There are no equivalent rules in other jurisdictions such as the UK, Australia, New Zealand, Singapore, South Africa and Malaysia even though the takeover regulations of these countries are similar to those of Hong Kong. The rule has been in place since the first major revision of the Takeovers Code in 1992.

In recent years, some market practitioners have expressed their concern that the obligations imposed by Rule 11.1(f) are unduly burdensome or inappropriate. This is partly because of the change in weighting of the property sector in the Hang Seng Index since Rule 11.1(f) was first put in place. In 1992, property companies constituted almost a quarter of the sector weighting of the Hang Seng Index, whereas today their sector weighting is significantly lower. In addition, it has been argued that the fact that Rule 11.1(f) is compulsory may cause practical difficulties particularly with regard to the offer timetable. In the case of an unsolicited offer in particular, an offeree company might encounter difficulties in completing valuations of all its properties before the despatch deadline, perhaps due to the large number and/or diverse geographical locations of its properties.

The Executive has already begun to relax its approach to the strict application of Rule 11.1(f) in some cases. Concerned practitioners have suggested that it is not appropriate to include certain assets (e.g. properties used by a mining company for smelting or storage purposes or infrastructure such as roads) as property assets for the purpose of calculating the 15% threshold, despite the fact that they may be listed on a company’s balance sheet as “buildings” or “plant and buildings”. The Executive agrees that there are some circumstances under which the strict application of Rule 11.1(f) may be unduly burdensome. It therefore currently decides such matters on a case-by-case basis.

#### The Proposed Change

The Executive proposes to amend Rule 11.1(f) so that it will apply only to: (i) an offer (mandatory or voluntary, including a privatisation offer or proposal) where the offeror is a related party; (ii) a whitewash transaction where the whitewash waiver applicant is a related party; or (iii) an offer or whitewash transaction which involves a special deal that requires shareholder approval pursuant to Rule 25 of the Takeovers Code. In this context a related party would refer to: (a) a party which holds, alone or together with parties acting with it, 30% or more of the voting rights of the offeree company; (b) a director of the offeree company; or (c) a party acting or presumed to be acting in concert with any person falling within category (a) or (b).

The proposed amendment acknowledges that the continued full application of Rule 11.1(f) may be unduly burdensome for the relevant company in cost and time in some circumstances, and aims to reduce the costs and time incurred by an offeree company in obtaining an independent valuation in cases when the need for such valuation arises from the action of an unrelated party. This proposal would retain the more stringent requirements of Rule 11.1(f) both for transactions where the offeror is a related party and transactions which involve a special deal that requires shareholder approval pursuant to Rule 25.

Rule 11 reflects one of the Takeovers Code’s fundamental principles – that shareholders should receive sufficient information to enable them to reach an informed decision (General Principle 5) and that no relevant information should be withheld (see also Rule 8.1).

It should be noted that a valuation of property interests or assets will still be required under General Principle 5, even where the proposed transaction does not involve a related party or shareholder approval under Rule 25, in cases where the valuation is relevant information necessary to enable shareholders to reach a properly informed decision on an offer.

### Confirmations of Independence in Placing and Top-Up Transactions: Part 2

#### Current Requirements

Note 6 on dispensations from the mandatory general offer obligation in Rule 26 of the Takeovers Code relates to the grant of a waiver from the general offer obligation where a shareholder, who together with his concert parties holds no more than 50% of a company’s voting rights, places part of his holding with independent person(s) and subsequently subscribes for new shares up to the number of shares placed at a price substantially equivalent to the placing price.

Note 7 on dispensations from Rule 26 of the Takeovers Code relates to the verification of placees’ independence in placing and top-up transactions. It provides that the Executive will normally require confirmation from the financial adviser, placement agent or acquirer of the voting rights that the purchaser is independent of the vendor of the voting rights. As set out in the December 2009 issue of the Takeovers Bulletin, the Executive expects a financial adviser and/or placing agent to take all appropriate and reasonable steps to verify that the places they procure are independent of the vendor of the voting rights and to provide confirmation thereof to the Executive. A key question will always be whether the vendor of the voting rights was involved in the selection or identification of places.

Note 6 provides that the placing shareholder may only subscribe for new shares up to the number of shares placed; this is to ensure that all shareholders are diluted equally and are therefore treated equally. The verification of independence required by Note 7 is meant to ensure that the placing shareholder does not use the placing to consolidate control. Where the placees are existing clients of the placing agent, the Executive considers that the placing agent is best placed to confirm placees’ independence.

In practice, however, financial advisers and/or placing agents unfailingly confirm that the placees procured by them are independent of (and are not acting in league with) the vendor of the voting rights, and that the vendor of the voting rights was not involved in the selection or identification of the placees.

#### The Proposed Change

In order to aid the vendor of voting rights to top-up as soon as practicable, the Executive aims to process placing and top-up waiver applications promptly. In some situations, however, evidence may be demanded to substantiate the confirmations made. As explained above, in such cases the relevant financial advisers and/or placing agents must be able to explain all relevant matters to the Executive, including the provision of details of each step taken to ensure the independence of the placees. Ultimately, it is the responsibility of the relevant financial advisers and placing agents to verify the independence of the placees; the Executive may only provide guidance if consulted.

Therefore, in recognition of the fact that it is the responsibility of the financial advisor or placing agent to confirm the independence of placees, the Executive does not believe that it is appropriate for the Executive to be required “to satisfy itself of the acquirer’s independence” (Note 7). The Executive proposes to amend Note 7 to clarify that responsibility for ensuring and confirming the independence of placees lies with the financial advisers, placing agents and acquirers of the voting rights, and not with the Executive. Thus the proposed amended note provides, “The Executive would expect the relevant financial adviser, placing agent and acquirer of the voting rights to take all appropriate and reasonable steps to ascertain and verify whether the acquirer is independent of, and not acting in concert with, the vendor of the voting rights and then to provide appropriate confirmations to the Executive.”

In addition, the Executive proposes to clarify that it may make enquiries about the independence of the acquirer of the voting rights after the completion of the placing and top-up transaction. If the acquirer of the voting rights is found to have acted in collaboration with the vendor of such voting rights any waiver which has been granted would be invalidated and the Executive would take appropriate action including possibly requiring a general offer to be made in accordance with the requirements of Rule 26.

### Timing of Payment for Acceptances: Part 3

#### Current Requirements

The Executive has received a suggestion from the Federation of Share Registrars Limited regarding the 10-day payment period for shares by the offeror set out in Rule 20.1. This rule requires that acceptances of an offer which has become unconditional must be paid for by the offeror as soon as possible but in any case within 10 days. Currently, this 10-day payment period is measured in calendar days.

Share registrars or receiving agents do not have control over when an offer may become unconditional and when acceptances may be received. Processing of acceptances generally

The concern is that when any part of the 10-day payment period coincides with Hong Kong Public Holidays (in particular Chinese New Year, Easter and Christmas), the processing time before payment cheques must be despatched will be shortened significantly, thereby causing practical problems. The processing of acceptances involves stamp duty assessment and payment, transfers of share ownership to the offeror and release of funding by the offeror’s banker, and where non-cash consideration is payable (such as the issue of new shares by the offeror) additional working parties will need to be involved. A clear solution to this would be to specify the payment period in business days rather than calendar days, which should afford share registrars and receiving agents a more manageable timeframe in which to process payments without compromising the interests of accepting shareholders. A business day is defined as a day on which the Stock Exchange is open for the transaction of business.

#### The Proposed Change

The Executive therefore proposes to change the prescribed period for payment of acceptances from 10 days to seven business days in response to the point raised by the Federation of Share Registrars Limited. This should allow share registrars and receiving agents a more manageable and clear timeframe to process payments without compromising the interests of accepting shareholders. The amendment will replace all three references to “10 days” contained in Rule 20.1 with “7 business days”. The Executive will keep other references to “days” in the Codes under review, and will take into account market feedback in considering whether other amendments are appropriate.

### List of Consultation Questions

1. Do you agree that Rule 11.1(f) should be amended? If not, please give reasons.
2. If your answer to Question 1 is yes, do you agree with the proposal that Rule 11.1(f) should only apply if the offeror is a related party or if the transaction involves a special deal that requires shareholder approval pursuant to Rule 25? If not, please give reasons.
3. Do you agree with the proposed amendments to Rule 11.1(f)? If not, please give reasons.
4. Do you agree with the proposed amendment to Note 7 on dispensations from Rule 26? If not, please give reasons.
5. Do you agree with the proposed amendment to Rule 20.1? If not, please give reasons.

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