



Hong Kong

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HKEX PROVIDES FURTHER GUIDANCE ON SIGNIFICANT DISTRIBUTIONS OF UNLISTED ASSETS BY LISTED ISSUERS

The Hong Kong Stock Exchange (the **Exchange**) recently updated listing decision HKEx-LD75-4 on the issue of whether a distribution by a listed issuer (**Company A**) of shares in its subsidiary (**Subsidiary B**) to Company A's shareholders was a transaction for the purposes of the Notifiable Transactions or Connected Transactions rules under Chapters 14 and 14A of the Listing Rules.

The latest update provides that a listed issuer's disposal of assets which constitutes a very substantial disposal (based on the percentage ratio calculations) must comply with the Rule requirements applicable to a withdrawal of listing, in addition to the requirements of Chapter 14. The following provides a summary of the original Listing Decision as well as the latest update from November 2015.

Facts

Company A and its subsidiaries (the **Group**) were principally engaged in the businesses of hotel investment and operation. Company A's controlling shareholder (the **Parent Shareholder**) had entered into an agreement with an investor under which it would sell its entire shareholding in Company A to the investor (the **Parent Transaction**). To facilitate this, the Parent Shareholder requested Company A's board of directors to submit a proposal for distribution of all Subsidiary B's shares in specie to Company A's shareholders on a pro rata basis (the **Distribution**) for shareholders' consideration. The Parent Shareholder would then acquire all Subsidiary B's shares¹ through a voluntary unconditional cash offer under the

Codes on Takeovers and Mergers and Share Buy-backs (the **Takeovers Code**). This offer would provide a cash alternative for other shareholders of Company A to realise their holdings of the shares in Subsidiary B.

The Parent Transaction was primarily conditional upon the approval of the Distribution by Company A's shareholders. After completion of the Parent Transaction, the investor would acquire all the shares in Company A² through a mandatory unconditional cash offer (the **Company Offer**) under the Takeovers Code.

Under Chapter 14 of the Listing Rules, a disposal of Company A's entire shareholding in Subsidiary B would be a very substantial disposal based on the percentage ratio calculations. The issue was whether the proposed Distribution would be regarded as a transaction for Company A under Chapter 14 and/or Chapter 14A.

Analysis of HKEx

Chapter 14 deals with transactions which are outside the issuer's ordinary and usual course of business, predominantly acquisitions and disposals, while Chapter 14A deals with connected transactions and seeks to ensure that an issuer takes the interests of shareholders as a whole into consideration when it enters into transactions with connected persons. Chapter 14A safeguards against connected persons (such as the issuer's directors, chief executives or substantial shareholders, or their associates) taking advantage of their

¹ Other than those already held by the Parent Shareholder and parties acting in concert with it.

² Other than those already held by the investor and parties acting in concert with it.

positions to the detriment of minority shareholders. Although dividend distributions to shareholders are not explicitly mentioned in the definition of transactions in Chapter 14A, Rule 14A.92(1) stipulates that a connected person receiving a pro rata entitlement to securities in its capacity as shareholder is fully exempt from the connected transaction requirements. Following the same principle, the Exchange will normally consider a dividend distribution to fall outside Chapter 14A where a connected person receives a pro rata entitlement in its capacity as shareholder.

Listing Rule 2.04 allows the Exchange to impose additional requirements in appropriate circumstances. According to the listing decision, in the case of a distribution in specie, the Exchange may have concerns as to whether the distribution is fair to all shareholders and whether the persons proposing the distribution have an interest different from other shareholders, particularly where unlisted assets are being distributed and there will be no liquid market for minority shareholders to realise a value from the distribution. In determining whether to impose additional requirements to ensure compliance with the principles of Rule 2.03,³ the Exchange will need to take all facts and circumstances into account.

After the Distribution, two options were available to the minority shareholders of Company A, they could either sell their shares to the Parent Shareholder under the voluntary unconditional cash offer or hold the unlisted shares in Subsidiary B. Furthermore, considering the substantial impact of the Distribution on Company A and the Parent Shareholder's material interest in the Distribution and related arrangements, the Exchange considered that safeguards should be in place to protect minority shareholders from the Parent Shareholder abusing its power. The following measures were proposed by Company A:

- 1) the Parent Shareholder and its associates would abstain from voting on resolutions in respect of the Distribution and other related arrangements at a special general meeting of its shareholders. The investor and its associates did not hold any shares in Company A; and
- 2) to allow independent shareholders to make an informed decision on how to vote: (1) the disclosures in the circular relating to the Distribution would be comparable to those for a very substantial disposal circular; and (2) an independent

financial adviser was appointed and the circular would contain its opinion on the Distribution and related arrangements.

Decision

The Distribution would not constitute a transaction under Chapter 14 or Chapter 14A. and the Exchange did not impose additional requirements under Rule 2.04 given the measures proposed by Company A to protect the interests of its independent shareholders.

Further Developments and Guidance from November 2015

A number of cases reviewed by the Exchange in 2015 involved issuers distributing significant portions of their businesses in specie, as compared to the issuers' remaining operations. In addition to the concerns raised above, the Exchange regards such distributions as equivalent to delistings of the assets to be distributed. It therefore requires that the same level of protection available for a withdrawal of listing should be given to shareholders.⁴

Thus where an issuer's disposal of assets amounts to a very substantial disposal under the Listing Rules (based on the percentage ratio calculations), the proposed distribution would also be subject to the Listing Rules' requirements applicable to a withdrawal of listing, in addition to the measures proposed by Company A (as described above):

- 1) the issuer should obtain prior approval of the distribution by independent shareholders in a general meeting. Any controlling shareholders (or if there is no controlling shareholder, the directors (other than independent non-executive directors) and chief executive of the issuer) and their associates must abstain from voting in favour of the resolution. The resolution must be approved by 75% of shareholders voting at the meeting (in person or by proxy) and not more than 10% of the shareholders may vote against the resolution; and
- 2) the issuer's shareholders (excluding the chief executive, the directors (other than independent non-executive directors), and controlling shareholders) should be offered a reasonable cash alternative or other reasonable alternative for the distributed assets.

³ Rule 2.03 contains general principles that all shareholders must be treated fairly and equally and the listed issuer's directors must act in the interests of the shareholders as a whole.

⁴ Refer to Rules 6.12(1)-(4)

Finally, the Exchange advised that issuers who intend to conduct significant distributions of unlisted assets should comply with the additional guidance and consult the Exchange as early as possible. The Exchange will impose the additional requirements set out above on these distributions under Rule 2.04.

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