

TOPIC 3 - OVERVIEW

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1. INTRODUCTION

- The Codes have been **issued by the SFC** in consultation with the Takeovers Panel
- **Primary purposes of the Codes** are to ensure:
 - **Fair and equal treatment** of shareholders in takeovers, mergers and share buy-backs
 - A **fair and informed market** with timely and adequate information
 - Shareholders can make **informed decisions** on the merits of an offer
 - An **orderly framework** for takeovers, mergers and share buy-backs
- **Financial/commercial merits** of any takeover/merger/share buy-back are issues for the offeror, target company and respective shareholders – not covered by the Codes
- The **Listing Rules** require compliance with the Codes. That is, to enjoy the facilities of the Hong Kong markets, the Codes must be complied with
- **Day-to-day administration** of the Codes is the responsibility of the Executive Director (Executive) of the Corporate Finance Division of the SFC, supported by Division staff
- **Prompt disclosure of all relevant information**, including updates and corrections, should be made to the Executive

1.1 Non-statutory Nature of the Codes

- The Codes represent a **consensus of opinion** of participants in Hong Kong's financial markets and are not considered statutory
- Panel rulings can be judicially reviewed, i.e. the Court of first Instance can determine whether a decision of the Panel is lawful and valid
- The Codes are supplemented by **Practice Notes, Executive Statements and Panel Statements** providing details of how the Codes might be interpreted by the Panel and the Executive
- A **breach of the Codes** will be a breach of the Listing Rules

2. PURPOSE AND BASIC REQUIREMENTS OF THE CODES

- The Codes apply to takeovers, mergers and share buy-backs for the following:
 - **Public companies** in Hong Kong
 - Companies with a **primary listing** in Hong Kong
 - **REITS** with a primary listing of their units in Hong Kong
 - The Executive will normally grant a waiver from the requirements of the Codes to companies with a primary listing outside Hong Kong
- The following factors will be considered when determining whether a company is a **public company in Hong Kong**:
 - Number of Hong Kong shareholders
 - Extent of share trading in Hong Kong
 - Head office location and place of central management
 - Location of business and assets
 - Protection available to Hong Kong shareholders
- Companies that have a centre of gravity in China, are listed on NYSE, Nasdaq or LSE and have a secondary listing in Hong Kong, will not be regarded as public companies in Hong Kong
- Takeovers Code does not apply to offers for non-voting, non-equity capital
- Share buy-backs by general offer will be considered offers with both the Takeovers Code and the Share Buy-backs Codes applying

2.1 General Principles of the Codes

- The Codes are based on 10 general principles which are considered to reflect good standards of conduct for persons engaged in takeovers, mergers and repurchases. The principles include provision for:
 - equal treatment of shareholders, the provision of accurate and sufficient information and advice to them;
 - the making of general offers to be made if control of a company changes, is acquired or is consolidated;
 - full and prompt disclosure of information by persons concerned with offers;
 - offerors to ensure when making an offer that they will be able to meet their obligations;
 - rights of control to be exercised in good faith and without oppressing minority and non-controlling shareholders;
 - directors of offeror and offeree companies to provide disinterested advice to their shareholders; and
 - the board of an offeree company in an offer situation not to take any action likely to frustrate the offer without the approval of the shareholders in general meeting

3. ROLES AND RESPONSIBILITIES

3.1 Role of the Board

- Under general law, company directors have a **fiduciary duty to act in the best interests of the shareholders** of their respective companies, however the general principles behind the Codes can affect the freedom of their actions
- Each director is responsible to ensure that the Codes are complied with
- **Directors may delegate** day-to-day responsibility for the conduct of an offer to a board committee

3.2 Role of the Financial Adviser

- Financial advisers should ensure that their clients understand and comply with the requirements of the Codes
- Financial advisers **must respond to enquiries** from the Executive, the Takeovers Panel and the Takeovers Appeal Committee
- Financial advisers should ensure that **suitable resources are engaged** to address Code requirements
- A financial adviser to an offeror is required to confirm in the offeror's offer announcement that **the offeror's financial resources are sufficient** to complete the offer if successful
- Although financial advisers are required to advise/warn clients about communicating with the media, **any person interviewed is responsible for what they say**
- Financial advisers **should not comment on certain matters**, such as future profits and prospects, asset values and the likelihood of an offer revision

3.3 Verification Process

- Offer documents must be to prospectus standard, with the information in the documents being **verified by the directors and financial advisers**, ensuring that:
 - All facts stated are verifiable
 - All material facts have been stated
 - All opinions expressed are on reasonable grounds
 - Directors have properly accepted responsibility for the documents
- **Verification procedures** that can be adopted include:
 - Distributing a memo to all directors setting out their legal and regulatory obligations in relation to a takeover and their potential liabilities
 - Preparation of detailed minutes outlining degree of responsibility accepted by directors
 - Verification notes supporting the facts stated in the documents
 - Due diligence programme involving financial, accounting and legal advisers that identifies material facts to be disclosed
- Primary responsibility for verification lies with the **financial adviser**. While **legal advisers** can assist, their primary role is to provide legal advice or opinions

3.4 Requirement for Independent Advice, Independent Committees and Shareholder Approval

3.4.1 Board of the Offeree Company

- After being approached or receiving an offer, the board of the offeree company must **establish an independent committee of the board** to make a recommendation as to:
 - Whether the offer is fair and reasonable; and
 - Acceptance of or voting on the offer
- As soon as practicable, a **competent independent financial adviser must be engaged** to advise the independent committee in writing on the offer
- The independent committee must approve the appointment of any independent financial adviser before the appointment is made
- The board must issue a **circular to shareholders** with details of the advice of the independent financial adviser and the recommendations of the independent committee
- The independent financial adviser's appointment must be announced by the board as soon as possible after the appointment

3.4.2 Board of the Offeror Company

- When offering a **reverse takeover**, or when the directors have a **conflict of interest**, the board of the offeror must seek competent independent advice before announcing the offer or any revised offer. Shareholders must have access to the substance of the advice
- The board of the offeror may seek **oral advice prior to the announcement** of the offer and then obtain full advice as soon as possible
- The full advice must be circulated to the offeror's shareholders as soon as practicable
- **If a general meeting is to be convened** to approve the proposed offer, the full advice must be sent to shareholders at least 14 days in advance

3.4.3 Independence Requirements

- The following persons would **not** be regarded as independent:
 - Anyone who is a **member of the same group as the financial adviser** or other professional adviser to either party of the proposed transaction
 - **Anyone who has a significant connection**, financial or otherwise, with either party of the proposed transaction, or the controlling shareholder(s) of either of them (Chinese walls are not entertained)
- An independent committee of the board of directors should be made up of non-executive directors of the company who have no direct or indirect interest in any offer or possible offer

3.4.4 Shareholder Approval where Withdrawal of Listing Sought

- If a **proposed offer includes the intention to withdraw the listing of the shares of the offeree company**, neither the offeror, nor any persons acting in concert with the offeror, may vote at any shareholders' meeting of the offeree company convened under the Listing Rules
- The resolution to **approve the delisting must be subject to the following conditions:**
 - Shareholders of at least 75% of disinterested shares must approve the delisting by voting in person or by proxy
 - Shareholders voting against the delisting must not exceed 10% of disinterested shares
 - Offeror is entitled to exercise rights of compulsory acquisition

3.4.5 Schemes of Arrangement and Capital Reorganisations

- Where an offeror seeks to take over an offeree company by way of a scheme of arrangement or capital reorganisation, shareholders of the offeree company will need to approve a resolution, subject to the following:
 - Shareholders of at least 75% of disinterested shares must approve the delisting by voting in person or by proxy
 - Shareholders voting against the delisting must not exceed 10% of disinterested shares
- Normally, the costs of a scheme of arrangement to privatize a company would be **borne by the company itself**
- When an offeror intends to use a scheme to privatize an offeree company, then **costs will be borne by the offeror if:**
 - Either independent committee or independent financial adviser does not recommend the offer as fair and reasonable; and
 - Scheme is not approved by shareholders

3.5 Restrictions on Action During Bid Period

- Once the board of an offeree company has received an offer, it **cannot take any action to frustrate the offer** unless approved by shareholders in general meeting. In particular, without shareholder approval, the board cannot:
 - Issue any shares
 - Issue/grant any convertible securities/options/warrants in respect of shares of the offeree company
 - Sell/dispose/acquire assets of a material amount
 - Enter into any contracts outside the ordinary course of business
 - Purchase/redeem any shares in the offeree company, or provide any financial assistance for such purchases/redemptions
- In certain circumstances, the Executive may grant a waiver from the need to obtain shareholders' approval to frustrate an offer

- Where the **offeree company intends to grant options** over shares consistent with normal practice under an established scheme, the Executive will normally give its consent
- The offeree company and its advisers must consult the Executive **before declaring and paying an interim dividend** outside the normal course of business during an offer period

4. MANDATORY AND VOLUNTARY OFFERS

4.1 Introduction

- There are two types of offers that can be made for the shares of a company:
 - Mandatory offers
 - Voluntary offers
- In both cases, the offer will be conditional upon the offeror and persons acting in concert holding more than 50% of the offeree company's voting rights as a result of the offer

4.2 Mandatory Offers

- The general principle underlying a mandatory offer is that if the control of a company changes or is acquired or consolidated, a general offer to all other shareholders is normally required
- A **mandatory offer** is required to be made when:
 - any person (or two or more persons acting in concert*) acquires, whether by a series of transactions over a period of time or not, 30% or more of the voting rights of a company (**trigger**); or
 - any person (or two or more persons acting in concert*) who owns between 30% to 50% (inclusive) of the voting rights of a company, acquires more than 2% of the voting rights within a 12 month period (**creeper**)
- * Persons are acting in concert if they, pursuant to an agreement or understanding, actively co-operate to obtain or consolidate control of a company through the acquisition by them of voting rights of the company
- All mandatory offers must include a cash component and must be at a price not less than the highest price paid by the offeror, or any person acting in concert, within **6 months** prior to the start of the offer period
- **The chain principle:** When acquiring statutory control of a company, the acquirer may acquire indirect control of a second company, subject to the Takeovers Code. This may result from the shareholding structure of the companies or the aggregation of the shareholdings of the acquired company and that of the acquirer. Normally, the Executive will not require a mandatory offer to be made
- The acquisition of **convertible securities, warrants or options** will not normally give rise to a mandatory offer, however the exercise of these instruments may activate the trigger or creeper provisions
- **Inadvertent mistake:** a mandatory offer obligation triggered by an inadvertent mistake can be avoided if sufficient voting rights are disposed to unconnected persons
- **Whitewash:** The Executive can waive the mandatory offer obligation if at least 75% of the independent shareholders vote at a shareholders' meeting to approve the waiver and more than 50% vote to approve the relevant transaction. **Independent shareholders** are those who are not involved, nor interested, in the transaction in question

- **Acting in Concert:** The Takeovers Code outlines nine classes of persons who are presumed to be acting in concert with others in the same class:
 1. A company and any companies in the same group
 2. A company with any of its directors or those of its parent
 3. A company with any of its pension funds, provident funds and employee share schemes
 4. A fund manager, any investment company, mutual fund, unit trust or other person whose investments the fund manager manages on a discretionary
 5. A financial adviser and its client
 6. Directors of a company and their close relatives where the company is subject to an offer or the directors believe an offer is imminent
 7. Partners
 8. An individual and close relatives who all control related trusts and companies
 9. A person, other than an Authorised Financial Institution lending money in the ordinary course of business, providing finance or financial assistance relating to an acquisition of voting rights

4.3 Voluntary Offers

- A voluntary offer is any offer that is not a mandatory offer, but the offeror is still bound by the Takeovers Code
- A voluntary offer does not need a cash component, however **an offer in cash will be required** when the offeror (or concert parties) purchased shares for cash during the offer period and the previous 6 months, which together represent 10% or more of the class voting rights
- The price must not be less than the highest price paid within **3 months** prior to the start of the offer period
- **“Lowball” offers:** Unrealistically low offers can be used as a tactic to frustrate the business of the offeree company, with there being no intention to acquire the target. The Codes state that a voluntary offer at a discount of more than 50% to the market price will not normally be allowed to proceed. The Executive should always be consulted in the event of such an offer

4.4 Comparable Offers

- Where a company has more than one class of equity share capital, a comparable offer must be made for each class, whether or not the capital carries voting rights

4.5 Setting a Timetable

- Takeovers Code outlines the timetable within which documentation must be sent by the offeror and by the offeree company to shareholders of the offeree company

Posting Date

- An offer document should normally be posted:
 - **Within 21 days** of the offer announcement when it is a **cash offer**
 - **Within 35 days** of the offer announcement when it is a **securities exchange offer**
- Offer document must not be dated more than 3 days prior to despatch
- Where the **offeree's response is not sent to shareholders at the same time as the offer**, the offeree company must **send its response** to its shareholders **within 14 days** of the of the posting date of the offer

Other Critical Dates

- **Minimum offer period** when offer is open for acceptance from posting date:
 - **21 days**: offer and response documents are sent out on the same day
 - **28 days**: response document is sent after the dispatch of the offer document
- **Announcement by offeree company**
 - Offeree company **should not announce trading results**, profit or dividend forecasts, asset valuations or major transactions **after 39 days** from posting date of offer document
- **Revision of offer**
 - **No revision** of offer can be made in the **14 days before** the offer becomes unconditional
- **Unconditional offer**
 - If an offer is declared unconditional by the offeror, it must **remain open for a further 14 days**

5. OTHER LAWS AND RULES

5.1 Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited

- MBLR continue to apply in the takeover context. Either offeror/offeree company may trigger one of the following **notifiable transactions**:
 - Share transaction
 - Discloseable transaction
 - Major transaction
 - Very substantial disposal
 - Very substantial acquisition
 - Reverse takeover
 - Connected transaction
- A takeover may trigger the requirement for a **suspension in dealings** of either the offeror or offeree company

5.2 Securities and Futures Ordinance

- Corporate finance advisers must take care in takeover situations to ensure that all **inside information is kept confidential** until released to the market, in accordance with the Takeovers Code and Listing Rules. Such information would include:
 - Offer price
 - Details of the bid
 - Details of the parties; and
 - The fact that meetings have been taking place between the parties
- Dealings in securities of either company while in possession of inside information could be considered **insider dealing**
- Corporate finance advisers must ensure that their clients comply with Disclosure of Interests legislation

5.3 Companies Ordinance (CO)

- CO provisions will apply when a takeover involves a scheme of arrangement or other corporate events (eg reduction of capital)

5.4 Other Ordinances

- Examples of other ordinances that may affect a takeover situation in particular industries include:
 - Banking
 - Telecommunications
 - Utilities
 - Shipping

6. SHARE BUY-BACKS

- Share Buy-backs Code applies to **public companies** in Hong Kong and companies with a **primary listing** of their equity in Hong Kong
- A share buy-back is an offer to buy-back, redeem or acquire shares of the offeror which is made by the offeror itself
- It can include a **privatization, scheme of arrangement** or other forms or reorganization
- The Code extends to **all classes of shares**, including warrants and convertible bonds
- A company can only carry out a share buy-back by one of the following means:
 - An on-market share buy-back
 - An off-market share buy-back
 - An exempt share buy-back
 - A share buy-back by general offer
- A general offer must be made on the same terms to all shareholders of each class of shares

6.1 On-market Share Buy-backs

- The most commonly used method, buy-backs are carried out through the Stock Exchange of Hong Kong
- The most attractive method of buybacks for listed issuers, as they can be carried out at any time
- Company will instruct its broker to enter the market when the directors think the company's share price is weak

6.2 Off-market Share Buy-backs

- Buy-back is made from an identified party and will need approval from the Executive beforehand
- Executive approval will normally be conditional upon approval of at least 75% of independent shareholders

6.3 Exempt Share Buy-backs

- An exempt share buy-back is one of the following:
 - Employee share buy-back
 - Buy-back in accordance with terms of the shares being bought back
 - Buy-back made at the shareholders' instigation in accordance with the terms of the shares being bought back
 - Share buy-back required by law

7. DECISION-MAKING PROCESS

7.1 The Executive Director of the Corporate Finance Division of the SFC

- The **Codes are administered by the Executive**, who also undertakes any investigation of takeovers, mergers and share buy-backs
- If there is any doubt about the application or any action required by the Codes, the Executive should be **consulted in advance**
- **Consultations** with the Executive are usual **verbal discussions** and do not result in any formal rulings
- Executive will not normally answer hypothetical questions or give provisional rulings

Rulings

- Rulings are given after a **consideration of all relevant information** and a more thorough analysis than that permissible under a consultation
- **Applications to the Executive** for a ruling under either the Takeovers Code or Share Buy-backs Code should contain all relevant information, including:
 - A **summary of the ruling being sought** and the issues for consideration, details of the relevant sections of the Codes
 - **All parties** with a material interest in the submission, with details of their financial and legal advisers
 - **All material facts** relevant to the application
- If someone wants to **contest a ruling** of the Executive, the Panel can be asked to review the matter
- **Executive may refer a matter** to the Panel when he considers the issue is novel, important or difficult
- Executive also has **the power to issue a compliance** ruling to restrain a person(s) from breaching the Codes

7.2 The Takeovers and Mergers Panel

- The Panel is a **committee of the SFC**, hearing disciplinary matters and reviewing Executive rulings, when requested
- Consists of **up to 40 members** drawn from the financial and investment community, at least one of whom must be an SFC non-executive director
- No executive director or staff of the SFC may be Panel members
- **Quorum of the Panel is five**, including the Chairman
- Panel meetings often involve confidential, price-sensitive information and are therefore **informal and held in private** (may not be the case for disciplinary proceedings – see below)
- A party may present its own case to the Panel or have its financial/legal advisers present the case to the Panel
- Panel **rulings are normally published**, subject to confidentiality considerations

7.3 Disciplinary Proceedings

- The Executive may institute disciplinary proceedings before the Panel when it considers that there has been a breach of the Takeovers Code or Share Buy-backs Code
- Proceedings are **normally held in public**, except where confidential issues are to be covered
- If the **Takeovers Panel** finds there has been a breach of one of the Codes or of a ruling, it **may impose any of the following sanctions**:
 - issuance of a public statement which involves criticism;
 - public censure;
 - requiring intermediaries (dealers and advisers) not to act or continue to act for a stated period in any (or a stated) capacity for the guilty person;
 - banning advisers from appearing before the Executive or the Panel for a stated period; and/or
 - requiring further action to be taken as the Panel thinks fit
- Where there has been no finding of a breach of the Codes, either the Executive or the Panel may report a person to other regulatory authorities or professional bodies if they have reasonable grounds to believe that the person may have breached any applicable rules/regulations/codes of conduct
- Failure to comply with the Codes may lead to revocation or suspension of SFC license or registration

7.4 Takeovers Appeal Committee (TAC)

- A committee of the SFC that **reviews disciplinary rulings of the Panel**, when requested to do so
- TAC consists of a Chairman and other members of the Panel – none of whom can have been involved in the original decision
- If there is no appeal to the decision, **publication of decision** will be immediate, otherwise publication will be after the appeal decision is made
- Panel and TAC rulings are published on the SFC's website