

▶ The Hong Kong Code on Takeovers and Mergers



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Introduction – The Code on Takeovers and Mergers

- First introduced in 1975;
- A voluntary code which depends on the willingness of market participants to comply with it rather than the law to enforce it;
- Administered by the Executive of the Corporate Finance Division of the SFC;
- The Code operates principally to ensure fair and equal treatment of all shareholders in relation to takeovers;
- Anyone in breach of the Code may be subject to the SFC's private reprimand, public censure, issuance of a public statement which involves criticism, disciplinary action or suspension.

Jurisdiction

- ▶ The code applies to takeovers and mergers affecting public companies in HK **AND** companies with a primary listing of their equity securities in HK.

Factors the SFC considers when determining whether a company is a HK public company

- the number of HK shareholders
- the extent of share trading in HK
- the location of the head office
- the place of central management
- the location of the business and assets
- the existence or absence of protection for HK shareholders under any statute or code regulating takeovers and mergers outside HK

General Principles of the Code

Acceptable standards of commercial conduct in relation to takeovers and mergers:

- all shareholders are to be treated equally;
- if control of a company changes, a general offer to all other shareholders is normally required;
- during the course of an offer or when an offer is in contemplation, information made available to some shareholders must be made available to all shareholders (except for some information furnished in confidence to the potential offeror or vice versa);
- an offer should only be made after careful and responsible consideration;
- shareholders should be given sufficient information, advice and time to reach an informed decision;
- all persons concerned with offers should make full and prompt disclosure of all relevant information and take every precaution to avoid the creation or continuance of a false market and making statements which may mislead shareholders or the market;

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General Principles of the Code (Cont'd)

Acceptable standards of commercial conduct in relation to takeovers and mergers:

- rights of control should be exercised in good faith and oppression of minority shareholders is unacceptable;
- directors should have regard to the interests of the shareholders as a whole;
- the board of the offeree should not take actions to frustrate a proposed bona fide offer or deny the shareholders the opportunity to decide on its merits; and
- all parties concerned with takeovers and mergers are required to co-operate to the fullest extent with the Executive, the Takeovers and Mergers Panel ('Panel') and the Takeovers Appeal Committee.

Voluntary And Mandatory Offers

- ❖ Any person or company may make a voluntary offer provided the consequence of such an offer does not trigger a mandatory offer or the two per cent. 'creeper rule'.
- ❖ This would change the voluntary offer into a mandatory offer pursuant to Rule 26 of the Code.
- ❖ A general offer is an offer by the Offeror and persons acting in concert with him, open to all the shareholders of the Offeree, to purchase shares from those shareholders.

Voluntary And Mandatory Offers (cont'd)

Voluntary Offer

- A voluntary offer may incorporate any conditions except conditions which depend on the Offeror's own judgment or the fulfillment of which is in his control or at his discretion (Rule 30.1).
- The Offeror should not invoke any condition, other than the acceptance condition, that causes the offer to lapse unless the circumstances which give rise to the right to invoke the condition are of material significance to the Offeror in the context of the offer.
- Except with the consent of the Executive, all offers (except partial offers made under Rule 28) must be conditional upon the Offeror having received the acceptance of shareholders, whose shares, together with shares acquired or agreed to be acquired before or during the offer, will result in the Offeror and persons acting in concert with it holding more than 50 per cent. of the voting rights of the Offeree (Rule 30.2) (Commonly known as the “**acceptance condition**”)
- A voluntary offer may be made conditional upon an acceptance level of shares carrying a higher percentage of the voting rights (70 per cent for example).
- However, the Offeror is reminded to observe the requirement of the Listing Rules that a specified percentage of a listed company's securities must be in public hands (i.e. 25% unless the SEHK agreed to a lower percentage on listing).

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Voluntary And Mandatory Offers (cont'd)

Voluntary Offer – Consideration

- A voluntary offer may not normally be made at a price that is at a discount of **more than 50%** to the Offeree shares' market price.
- This provision was introduced to prevent so-called 'low-ball' or 'one cent' offers being used to frustrate the Offeree's business where there is no genuine intention to seek control.
- If an Offeror, or any person acting in concert with it, has purchased shares in the Offeree
- within **3 months before** the start of the offer period (or earlier in the case of purchases from directors or connected persons) or
- during the period between the start of the offer period and the announcement of a firm intention to make an offer under Rule 3.5
- the offer must be on no less favourable terms than those applying to that purchase (Rule 24.1(a))
- An offer period commences on the making of an announcement of a proposed or possible offer.

Voluntary And Mandatory Offers (cont'd)

Voluntary Offer – Consideration (Cont'd)

- If, after an announcement of a firm intention to make an offer and during the offer period, the Offeror (or any person acting in concert) purchases shares in the Offeree at above the offer price, the Offeror must increase the offer price to the highest price paid for such shares (Rule 24.1(b)).
- This will require the Offeror to make a revised offer which must be announced immediately after the purchase of shares at above the offer price (Rule 24.3).
- Persons who have accepted the original offer are entitled to receive the revised price (Rule 16.1).
- The consideration for a voluntary general offer may be cash or securities.
- However, if the Offeror (and any person acting in concert) has acquired for cash shares in the Offeree **carrying 10% or more** of the voting rights during the offer period and **within 6 months before** the start of the offer period, the general offer must be in cash, or accompanied by a cash alternative, at not less than the highest price paid for such shares (Rule 23.1).
- The Executive also has a discretion to require cash to be made available where **less than 10%** has been purchased **in the 6 months before** the start of the offer period from directors or other persons closely connected with the Offeror or Offeree.

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Voluntary And Mandatory Offers (cont'd)

Voluntary Offer – Consideration (Cont'd)

- Conversely, if the Offeror (and any person acting in concert) has acquired shares in the Offeree carrying **10% or more** of the voting rights in exchange for securities during the offer period and **within 3 months** before the start of the offer period, such securities are required to be offered to all other holders of shares of that class (Rule 23.2).
- Unless the vendor is required to hold the securities received until either the offer has lapsed or the offer consideration has been posted to accepting shareholders, the offeror will also be required to make an offer in cash or to provide a cash alternative under Rule 23.1.
- In the case of a purchase from directors or persons closely connected with the Offeror or Offeree, the Executive may require a full share offer where **less than 10%** has been purchased or where the purchase was made **more than 3 months** before the start of the offer period.

Voluntary And Mandatory Offers (cont'd)

Acceptance of voluntary offer

- An acceptance is counted towards fulfilling the acceptance condition when the Offeror's receiving agent, usually the Offeree's registrar, receives an acceptance on or before the deadline for acceptance set out in the Offeror's relevant documents or announcements and the receiving agent has recorded that the acceptance and any relevant materials required have been received.
- The acceptance form should be completed and accompanied by share certificates of the relevant shares from a registered holder or his personal representatives and certified by the Offeree's registrar or the SEHK.

Voluntary And Mandatory Offers (cont'd)

Mandatory Offer

Under Rule 26 of the Code, the SFC requires a mandatory offer to be made to all the shareholders of the Offeree by the Offeror in the following circumstances, unless a waiver is granted by the Executive:

- i. 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; and
- ii. when any person (or two or more persons acting in concert) holding **not less than 30% and not more than 50%** of the voting rights of a company, acquires additional voting rights that increase his or their holding of voting rights by **more than 2%** from the lowest percentage holding by that person (or the concert group) in the preceding 12 month period. This is commonly referred to as the **'creeper' provision**.

Voluntary And Mandatory Offers (cont'd)

Conditions of the Mandatory Offer

- Except with the consent of the Executive, a mandatory offer under Rule 26 must be made conditional only upon the Offeror having received acceptances in respect of voting rights which, together with voting rights acquired or agreed to be acquired before or during the offer, will result in the Offeror and any person acting in concert with it holding **more than 50%** of the voting rights (Rule 26.2).
- However, where the Offeror holds **more than 50%** of the voting rights before the offer is made, an offer made under this Rule must normally be unconditional.
- In particular, a mandatory offer may not be made conditional upon the passing of shareholders' resolutions of the Offeror.
- Only in exceptional circumstances would the Executive allow other conditions, in addition to the acceptance condition, to be imposed on a mandatory offer.
- **Rule 26** can therefore have significant consequences for an unwary offeror. In addition to the obligation to make a mandatory offer for all the company's shares, it will lose the right to include the other conditions on which the offer could have been made.

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Voluntary And Mandatory Offers (cont'd)

Offeree Shareholders Entitled to Accept the Offer

The mandatory offer required under Rule 26 is a general offer as it should be extended to:

- Holders of each class of equity share capital of the Offeree, whether the class carries voting rights or not; and
- Holders of any class of voting non-equity share capital in which the Offeror (or persons acting in concert) hold shares.

Offers for different classes of equity share capital must be comparable and the Executive should be consulted in advance in such cases (Rule 14).

Voluntary And Mandatory Offers (cont'd)

Waiver of Mandatory Offer by the Executive

Whitewash Procedure

When the issue of new securities as consideration for an acquisition, or a cash subscription, or the taking of a scrip dividend, would otherwise result in an obligation to make a general offer under Rule 26 of the Code, the Executive will usually waive the obligation if there is an independent vote, on a poll, at a shareholders' meeting (which is commonly known as the 'whitewash' procedure).

However, the Executive will not normally grant a waiver if:

- the person to whom the new securities are to be issued or any person acting in concert with him has acquired voting rights in the company **in the 6 months** prior to the announcement of the proposals but subsequent to negotiations or discussions with the directors of the company in relation to the proposed issue of new securities; or
- voting rights have been acquired or disposed of by such persons without the Executive's prior consent in the period between the announcement of the proposals and the completion of the subscription.

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Voluntary And Mandatory Offers (cont'd)

Waiver of Mandatory Offer by the Executive (Cont'd)

Rescue Operations

Where the company is in such a serious financial position that the only way it can be saved is by an urgent rescue operation which involves the issue of new securities without approval by a vote of independent shareholders or the acquisition of existing securities by the rescuer which would otherwise fall within Rule 26.

Inadvertent Mistake

If the obligation to make a general offer results from an inadvertent mistake, provided that the person disposes of sufficient voting rights within a limited period to unconnected persons.

Placing and Top-up Transactions

Where a shareholder, who together with persons acting in concert with him holds **50% or less** of the voting rights of a company, places some of his shares with an independent person and then, as soon as practicable, subscribes for new shares up to the number of shares placed at a price substantially equivalent to the placing price less expenses.

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Voluntary And Mandatory Offers (cont'd)

Consideration

- Offers made under Rule 26 must be in cash or be accompanied by a cash alternative at not less than the highest price paid by the Offeror, or any person acting in concert with it, for shares of that class during the offer period and **within 6 months** prior to its commencement (Rule 26.3(a)).
- Only with the Executive's consent would the highest price not be taken as the offer price.
- If the voting rights were acquired for a consideration other than cash, the offer price must be determined by independent valuation.

Concert Parties And Indemnities

- Many provisions of the Code apply not only to the Offeror and the Offeree themselves, but also to those 'acting in concert' with the Offeror, and to those who may have an indemnity or other arrangement with either party such as to induce them to deal or refrain from dealing.
- A person will be taken to be acting in concert with an offeror if, pursuant to an agreement or understanding, he is actively co-operating, through the acquisition of voting rights, to obtain or consolidate control of the Offeree.

Concert Parties And Indemnities (Cont'd)

Persons presumed to be acting in concert with others (unless the contrary is established)

- a company, its parent, its subsidiaries, its fellow subsidiaries, associated companies of any of the foregoing, and companies of which such companies are associated companies;
- a company with any directors (together with their close relatives, related trusts and companies controlled by any of the directors, their close relatives or related trusts) of it or of its parent;
- a company with any of its pension funds, provident funds and employee share schemes;
- a fund manager (including an exempt fund manager) with any investment company, mutual fund, unit trust or other person, whose investments such fund manager manages on a discretionary basis, in respect of the relevant investment accounts;
- a financial or other professional adviser (including a stockbroker) with its client in respect of the shareholdings of the adviser and persons controlling, controlled by or under the same control as the adviser (except in the capacity of an exempt principal trader);
- directors of a company (together with their close relatives, related trusts and companies controlled by such directors, their close relatives and related trusts) which is subject to an offer or where the directors have reason to believe a bona fide offer for their company may be imminent;

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Concert Parties And Indemnities (Cont'd)

Persons presumed to be acting in concert with others (unless the contrary is established)

- partners;
- an individual (including any person who is accustomed to act in accordance with the instructions of the individual) with his close relatives, related trusts and companies controlled by him, his close relatives or related trusts; and
- a person, other than an authorised institution within the meaning of the Banking Ordinance (Cap. 155) lending money in the ordinary course of business, providing finance or financial assistance (directly or indirectly) to any person (or a person acting in concert with such a person) in connection with an acquisition of voting rights (including any direct or indirect refinancing of the funding of the acquisition).

Concert Parties And Indemnities (Cont'd)

- The presumption that parties are acting in concert is a strong one and the Executive, who is responsible for the day-to-day management of the Code and the conduct of investigations, will draw the inference unless provided with clear rebutting evidence.
- Practically, this is one of the most contentious issues of the Code, particularly as the Executive is prepared to determine that a concert party exists where the evidence is primarily circumstantial.
- Anyone dealing pursuant to an indemnity is likely to be regarded as acting in concert. For this reason, no arrangements of this nature should be entered into without full discussion with professional advisers, and will usually require to be disclosed.
- Whether a person is acting in concert is of particular significance when determining whether **the 30% threshold** has been reached which will trigger a mandatory offer under Rule 26.
- It should be noted that where an Offeror acquires **just under 30%** of a company, it is the Offeror's responsibility to ensure that there are no concert party holdings which will trigger the mandatory offer obligation (Note 7A to Rule 26).

Advisers – Financial Advisers

- The principal role of the financial advisers to the Offeror will be to advise on the financial aspects of the offer.
- It is a requirement of the Code that an independent committee of directors of the Offeree must obtain competent independent financial advice which must be made known to the Offeree shareholders (Rule 2.1).
- The financial advisers will assist in negotiating the terms of the offer, and, if advising the Offeree, may be involved in negotiations with rival, possibly preferred, offerors.
- The appointment of the IFA must be announced in the initial announcement of the offer or possible offer or as soon as possible thereafter.
- The board of the Offeror is also required to obtain competent independent advice as to whether an offer is in the interests of the Offeror's shareholders where the offer being made is a reverse takeover or when the directors are faced with a conflict of interest, which must be made known to the Offeror's shareholders (Rule 2.4).
- Situations which will involve a conflict of interest include where there are significant cross-shareholdings between the Offeror and Offeree, when a number of directors are common to both companies and when a person is a substantial shareholder in both companies.
- The financial advisers may be responsible for the general conduct of the offer, the timetable, documentation and liaison with the Executive and the Panel, although these additional roles may also be performed, in whole or in part, by the legal advisers.

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Advisers – Other Advisers

Legal Advisers

- The legal advisers for both the Offeror and the Offeree will be primarily responsible for advising upon the legal aspects of the offer.
- In conjunction with the financial advisers, they will also be involved in negotiations, and be responsible for settling documentation and liaison with the Executive and the Panel.

Stockbrokers

- Where they are not appointed as the financial advisers, the Offeror or Offeree's stockbrokers will need to be consulted. They will be responsible for advising upon such matters as the market perception of the offer, and liaison with major shareholders and the SEHK.

Auditors

- The Offeror or Offeree's auditors will be involved in the preparation of financial and other information required to be disclosed in the documentation issued during the course of the offer.

Press Consultants

- The Offeror or Offeree may also wish to employ a specialist firm of press or financial public relations consultants to assist in such matters as the drafting and distribution of press releases, liaison with the press and major shareholders.

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The Negotiations

Matters to be discussed

Once an approach has been made, and negotiations for a possible recommended offer commenced, the Offeror and Offeree boards will attempt to finalise the terms of the offer. This will include agreeing on the price of the offer, and a timetable, and settling plans for the future of the Offeree, its management and employees.

Information

The Offeror is likely to ask for financial information on the Offeree, much of which may be confidential. The Offeror may therefore be required to give a formal undertaking to keep the information confidential.

However, under the Code, any information given to an offeror must, on request, be given to any bona fide competing offeror (but usually on the same terms as to confidentiality) (Rule 6). This requirement may affect the extent to which the Offeree is prepared to release information, even to a friendly offeror.

The Negotiations (Cont'd)

Irrevocables

- In order to ensure the success of its offer, the Offeror may require that certain shareholders undertake irrevocably to accept the offer once it is made.
- Commitments of this form are known as 'irrevocables' or, where they effectively prevent a competing offer from succeeding, 'shut-outs'.
- The Executive must be consulted before any approach is made to obtain an irrevocable commitment.
- The exception to this is where a very restricted number of sophisticated shareholders who have a controlling shareholding are approached.
- It will be a matter for negotiation as to whether these irrevocables commit the shareholders concerned to accept the offer in any event, or whether they are allowed to accept an alternative, higher offer from a competing offeror.

The Negotiations (Cont'd)

Special deals

- The Code prohibits an Offeror from entering into arrangements with shareholders of the Offeree with favourable conditions which are not available to all shareholders (Rule 25).

Secrecy

- During the period of negotiations and throughout the offer when price sensitive matters are being discussed, the need for absolute secrecy is vital.
- Any 'leak' may give rise to speculation or a rise in share price of the Offeree, which in turn may lead to the Executive requiring a clarifying announcement (which could prejudice the successful outcome of the negotiations) and possibly to allegations of insider dealing.

Announcements

- Announcements in respect of listed companies must be published on the websites of the Exchange and the listed company in accordance with the Listing Rules.
- Announcements in respect of unlisted offeree companies must be published in a leading daily English language and Chinese language newspaper in Hong Kong. All documents published in respect of unlisted offeree companies must also be delivered in electronic form for publication on the SFC website.

Announcements

Announcement Requirements – Offeror Announcements

Before the board of the Offeree is approached, the responsibility for making an announcement normally lies with the Offeror or potential Offeror.

Rule 3.1 stipulates that an announcement must be made by the Offeror or potential Offeror in the following 3 situations:

- A. when, before an approach has been made, the Offeree is the subject of rumour or speculation about a possible offer or there is undue movement in its share price or in the volume of share turnover, and there are reasonable grounds for concluding that it is the actions of the potential Offeror or persons acting in concert with it (whether through inadequate security, purchasing of Offeree shares or otherwise) which have led to the situation;
- B. when negotiations or discussions are about to be extended to include more than a very restricted number of people (outside those who need to know in the companies concerned and their immediate advisers); and
- C. immediately when the Offeror triggers a mandatory offer obligation under Rule 26.

Announcements (Cont'd)

Announcement Requirements – Offeree Announcements

Following an approach to the board of the Offeree, which may or may not lead to an offer, the primary responsibility for making an announcement will normally rest with the board of the Offeree, which accordingly must keep a close watch on its share price and volume.

Rule 3.2 requires an announcement to be made by the board of the Offeree in 4 situations:

- A. when a firm intention to make an offer is notified to the board of the Offeree from a serious source, irrespective of the attitude of the board to the offer;
- B. when, following an approach to the Offeree, the Offeree is the subject of rumour or speculation about a possible offer or there is undue movement in its share price or in the volume of share turnover, whether or not there is a firm intention to make an offer;

Announcements (Cont'd)

Announcement Requirements – Offeree Announcements (Cont'd)

Rule 3.2 requires an announcement to be made by the board of the Offeree in 4 situations:

- C. when negotiations or discussions are about to be extended to include more than a very restricted number of people (outside those who need to know in the companies concerned and their immediate advisers); and
- D. when the board of the Offeree is aware that there are negotiations or discussions between a potential Offeror and the controlling shareholder(s) (i.e. the holder or holders of shares carrying 30% or more of the voting rights of the company) or when the Board of the Offeree is seeking potential Offerors, and
 - i. the Offeree is the subject of rumour or speculation about a possible offer or there is undue movement in its share price or in the volume of share turnover; or
 - ii. the number of potential purchasers or offerors approached is about to be increased to include more than a very restricted number of people.

Announcements (Cont'd)

Vendor Announcements

- Rule 3.3 requires a potential vendor to make an announcement when there are negotiations or discussions between a potential Offeror and the controlling shareholder(s) and the Offeree is the subject of rumour or speculation about a possible offer or there is undue movement in its share price or in the volume of share turnover, and there are reasonable grounds for concluding that it is the potential vendor's actions (whether through inadequate security or otherwise) which have led to the situation.

Announcement of a Possible Offer ('talks announcement')

- Until a firm intention to make an offer has been notified, a brief announcement that talks are taking place or that a potential offeror is considering making an offer will satisfy the obligation to make an announcement under Rules 3.1 and 3.2.
- After the announcement of a possible offer, announcements must be made monthly as to the progress of the talks or the consideration of a possible offer until an announcement of a firm intention to make an offer or of a decision not to proceed with an offer.
- If a potential offeror announces that it has no present intention to make an offer, it will normally be prohibited from bidding for the Offeree for a period of 6 months (Rule 31.1(b)).

Announcements (Cont'd)

Announcement of a Firm Intention to Make an Offer

- Once the formal terms of the offer have been agreed, any necessary irrevocables secured, and any required finance put in place, the Offeror will make an announcement of a firm intention to make an offer under Rule 3.5. This announcement does not constitute the offer itself, but, under the Code, must contain all of its terms.
- The announcement must include confirmation by the financial adviser (or other appropriate 3rd party) that the Offeror has the resources to satisfy the offer in full.
- Once an announcement of a firm intention to make an offer has been made, the Offeror must, except with the consent of the Executive, proceed with the offer unless the offer is subject to the fulfilment of a specific condition which has not been satisfied (Rule 5).

Announcements (Cont'd)

Announcement of Numbers of Relevant Securities in Issue

- Once an announcement of a proposed or possible offer has been made, the Offeree must publish an announcement giving details of all classes of its 'relevant securities' and the number of such securities in issue (Rule 3.8).
- 'Relevant securities', for these purposes, include shares, convertible securities, warrants, options and derivatives in respect of such securities.
- An offeror or potential offeror must announce details of its relevant securities following any announcement identifying it as an offeror or potential offeror, except in the case of a cash only offer.
- Any such announcement must include a reminder of the requirement for associates to disclose their dealings in any securities of the Offeree or, in the case of a securities exchange offer, in securities of the same class as those being offered as consideration.

Announcements (Cont'd)

Announcement of the Results of an Offer

- An Offeror is required to publish an announcement on SEHK's website by 7.00 p.m. on a closing date stating whether the offer has been revised or extended, has expired or has become or been declared unconditional (and whether as to acceptances or in all respects) (Rule 19.1).
- A draft of the announcement must be submitted to the Executive and SEHK by 6.00 p.m. for comment.

Disclosure under SFO

- Part XV of the Securities and Futures Ordinance (the 'SFO') requires an acquisition of an interest of 5% or more of the voting shares of a Hong Kong listed company to be disclosed to the SEHK and the company **within 3 business days**.
- An 'interest' in shares includes an interest in the underlying shares of equity derivatives.
- Disclosure is also required if a notifiable interest increases or decreases **across a percentage level** (e.g. from 6.9% to 7.1%).
- Once the **5% threshold** is reached, the acquisition or disposal of a short position of **1% or more** in the voting shares of a listed company and a change in the percentage level of a short position must also be disclosed.

Dealings (Cont'd)

Disclosure under the Code

- Once an announcement has been made of a proposed or possible offer, all dealings by parties to an offer and their associates in relevant securities of the Offeree (and, if certain securities are being issued as consideration by the Offeror, in the Offeror) must be disclosed by 10.00 a.m. on the business day following the date of the transaction (Rule 22).
- The disclosure obligation relates to all dealings during the offer period which extends until the later of the date when the offer closes for acceptances, the offer lapses, it is announced that a possible offer will not proceed, the announcement of the withdrawal of a proposed offer or, where the offer contains a possibility to elect for alternative forms of consideration, the latest date for making such election.
- Disclosure must be made in writing to all Offerors and the Offeree or their respective financial advisers and in electronic form to the Executive and, in the case of listed securities, to the SEHK.

Dealings (Cont'd)

Disclosure under the Code (Cont'd)

Associates include persons 'acting in concert' and all persons who directly or indirectly own or deal in relevant securities and have (in addition to their normal interests as shareholders) an interest or potential interest, whether commercial, financial or personal, in the outcome of the offer.

- i. an Offeror's or the Offeree's parent, subsidiaries and fellow subsidiaries, and their associated companies, and companies of which such companies are associated companies;
- ii. any bank, financial and other professional adviser (including a stockbroker) to an Offeror, the Offeree or any company in class (i) and persons controlling, controlled by or under the same control as such banks, financial and other professional advisers (a holding of 30% or more of the voting rights of a company is the normal test of 'control');
- iii. the directors (together with their close relatives, related trusts and companies controlled by any of the directors, their close relatives and related trusts) of an Offeror, the Offeree or any company in class (i);
- iv. the pension funds, provident funds and employee share schemes of an Offeror, the Offeree or any company in class (i);

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Dealings (Cont'd)

Disclosure under the Code (Cont'd)

Associates include persons 'acting in concert' and all persons who directly or indirectly own or deal in relevant securities and have (in addition to their normal interests as shareholders) an interest or potential interest, whether commercial, financial or personal, in the outcome of the offer.

- v. any investment company, unit trust or other person whose investments an associate manages on a discretionary basis, in respect of the relevant investment accounts;
- vi. a person who, or who as a result of a transaction, owns or controls 5% or more of the relevant securities of an Offeror or the Offeree; and
- vii. a company having a material trading arrangement with an Offeror or the Offeree.

Dealings (Cont'd)

Code consequences

Some dealings by the Offeror or those acting in concert with it may affect the terms of the offer itself.

- If the Offeror or any person acting in concert acquires shares at above the price of the offer, the offer itself must be increased to that price (Rule 24.1);
- If the Offeror and any concert parties acquire in excess of 10% of the Offeree for cash during the offer period and within the 6 months prior to its commencement, it must increase the level of any cash alternative to meet the best price paid within that period, even if its share alternative is in fact worth more (Rule 23.1(a)).
- A full share offer will be required if the Offeror (and its concert parties) acquire Offeree shares carrying more than 10% of the voting right in exchange for securities during the offer period and within 3 months before the start of the offer period (Rule 23.2).
- If the Offeror acquires shares carrying 30% or more of the voting rights of the Offeree, it must make a mandatory offer to all other shareholders in cash or accompanied by a cash alternative at not less than the highest price paid within the preceding 6 months (Rule 26).

Dealings (Cont'd)

Prohibited dealings under the SFO

- The SFO renders an individual who is knowingly in possession of price-sensitive information liable to sanction if he deals, or procures someone else to deal, in the listed securities or the derivatives of a company he is connected with.
- Dealing in the listed securities or the derivatives of a company which is the subject of a takeover offer, or a contemplated takeover offer, may also constitute 'insider dealing' where the person so dealing has access to price-sensitive information.
- A person in possession of price-sensitive information in relation to such a company may also commit insider dealing if he discloses the information to another, knowing (or having reasonable cause to believe) that that person will use the information to deal, or procure someone else to deal, in the securities.
- Insider dealing is a criminal offence under Part XIV of the SFO and subject to a maximum of 10 years' imprisonment and fines of up to \$10 million. Alternatively, civil proceedings may be brought before the Market Misconduct Tribunal under Part XIII SFO and anyone identified as an insider dealer may be disqualified as a director, prohibited from dealing in securities for up to 5 years or required to repay any profit made from the insider dealing.

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Dealings (Cont'd)

Prohibited dealings under the Code

- There are provisions in the Code which restrict dealings in an Offeree's securities before and during the period of a general offer and, where a general offer does not proceed, after the termination of discussions until an announcement of the position.
- Rule 21.1 provides that no dealings of any kind may take place in securities of the Offeree by any person (other than the Offeror) who is privy to confidential price-sensitive information concerning an actual or contemplated offer or revised offer before the announcement of the approach, offer or revised offer.
- Such dealings in securities of the Offeror are also prohibited by Rule 21.1 unless the offer or proposed offer is not price-sensitive in relation to those securities.
- Where the consideration for an offer includes securities of the Offeror or a person acting in concert with it, neither the Offeror nor such person may propose or conduct any off-market share repurchase or share repurchase by general offer before the end of the offer period (Rule 21.3).

Dealings (Cont'd)

Summary: seek advice before any dealing

- In view of these issues, as a general rule, those involved in an offer (including the directors of the Offeror and the Offeree) should not deal in the securities of the Offeree or of the Offeror (including options etc.) except after taking professional advice on the specific deal in question.

The Offer Document

The offer document is usually posted as soon as practicable after the announcement of a firm intention to make an offer, and in any event is required by the Code to be posted **within 21 days** (or **35 days** in the case of a securities exchange offer) of the date of announcement of the offer terms (Rule 8.2).

The offer document is required to contain the information specified in Schedule I to the Code, together with any other relevant information to enable the Offeree's shareholders to reach a properly informed decision.

The Formal Offer

This will be set out in the form of a letter, usually from the Offeror's stockbroker or merchant bank. It will include the offer price, information on the business of the Offeror and of the Offeree, taxation advice and the procedure for acceptance.

A Letter from Offeror

There will be a letter from the board of directors of the Offeror explaining the reasons for the offer.

The Offer Document (Cont'd)

Terms and conditions

In practice the most important terms and conditions are likely to relate to the level of acceptances required, consents and other authorisations and material changes.

Acceptances

- Under the Code, an offer must usually be made conditional upon the Offeror receiving acceptances which, together with those shares already held or agreed to be acquired by it, represent **50%** of the voting rights in the Offeree.
- In a voluntary offer, a higher acceptance level may be specified but with the ability to be waived this if the offeror wishes.
- When the original (or reduced) level is achieved the offer is said to be unconditional as to acceptances.
- In practice, once an offer is declared unconditional as to acceptances other shareholders will usually accept the offer fairly swiftly, to avoid being left as a minority in the Offeree.
- All other conditions must be satisfied (or waived) within 21 days of the first closing date or of the date the offer becomes or is declared unconditional as to acceptances, whichever is the later (Rule 15.7).

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The Offer Document (Cont'd)

Terms and conditions (Cont'd)

Consents

- The offer will usually be expressed to be conditional upon obtaining various consents, some of which may be imposed by external requirements.
- The Offeror will usually have no choice but to secure such consents.
- The conditions may refer to a number of other general regulatory requirements which the Offeror may wish to be satisfied, but will usually reserve the right to waive.

• **Other conditions**

- The Offeror will usually wish to be able to withdraw its offer if there has been a material adverse change in the Offeree; again this condition is likely to be waivable by the Offeror.

The Offer Document (Cont'd)

Terms and conditions (Cont'd)

Other information

- The offer document will contain other detailed information and terms, mainly in compliance with the Code.
- This information will include information on the Offeror's intentions concerning the Offeree and its employees, financial information of the Offeree, including information on how the offer is to be financed, details of shareholders and dealings by the parties and their associates, verification of profit forecasts, etc.
- In the case of a securities exchange offer, the offer document will need to contain additional information in relation to the securities offered for exchange and details of the company whose shares are being offered for exchange.

The Offeree Board Circular

- The Offeree is required to send a circular to its shareholders setting out the views of its board or independent committee on the offer and the written advice of the independent financial adviser.
- In an agreed offer, the Offeror and Offeree are encouraged to combine the offer document and offeree board circular in a composite document.
- If, however, the offer is contested (or there is a competing offer), then the offeree board circular will be sent separately and must be posted within 14 days of the formal offer document (Rule 8.4).
- The offeree board circular should contain the information set out in Schedule II of the Code together with any other information needed for shareholders to reach a properly informed decision about the offer.

Timetable

Offer Period

- The offer must be open for a minimum of 21 days from the posting of the offer document where the offer document and offeree board circular are posted on the same day or combined in a composite document.
- Where the offeree board circular is posted after the offer document, the offer must remain open for a minimum of 28 days from the posting of the offer document (Rule 15.1).
- In addition, unless it is wholly unconditional from the outset, it must be open for a further 14 days after the first closing date on which it becomes or is declared unconditional (whether as to acceptances or in all respects)(Rule 15.3).
- The maximum period for which an offer may be open before it becomes or is declared unconditional as to acceptances is 60 days (Rule 15.5).
- In practice, a recommended offer is usually declared unconditional well within this timetable, although a hostile one may well be drawn out to the very end.

Timetable (Cont'd)

Offer Period (Cont'd)

- To ensure that shareholders are given enough time to consider the merits of an offer before it finally closes, the Code stipulates **the 39th day** after the posting of the initial offer document as the last time by which the Offeree can announce material new information (including trading results, profit or dividend forecasts, asset valuations or proposals for dividend payments or for any material acquisition or disposal or major transactions)(Rule 15.4).
- The Code also stipulates the last time by which the Offeror can increase its offer (**the 46th day**).
- If a competing offer is announced then, in general, any Code timing restrictions on the first Offeror are relaxed to correspond with those relating to the competing Offeror.
- Consideration cheques must be posted to accepting shareholders within 7 business days of the later of the date on which the offer becomes, or is declared, unconditional and the date of receipt of a duly completed acceptance (Rule 20.1).

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Timetable (Cont'd)

A typical outline timetable for a takeover offer :

Announcement	Offeror makes announcement of firm intention to make an offer under Rule 3.
Day 0	Posting of offer document (Rule 8.2) <ul style="list-style-type: none">•within 21 days of announcement (cash offer)•within 35 days of announcement (securities offer)
Day 14	Last day for posting of offeree board circular (Rule 8.4)
Day 21	First permitted closing date (for composite document) (Rule 15.1)
Day 28	First permitted closing date (separate offeree board circular)(Rule 15.1)
Day 39	Last day for offeree company to announce material new information (Rule 15.4)
Day 46	Last day for revision of offer
Day 60	Last day for offer to become or be declared unconditional as to acceptances (Rule 15.5)

Communication with Shareholder, the Press and the Public

Profit forecasts

- The Code sets out detailed requirements to ensure that profit forecasts and valuations made by either side during an offer are properly verified.
- These rules apply not only to the more usual form of forecasts and valuations set out in a document, but may also apply to any informal or unguarded statement, for example 'profits have grown this year'.
- Where such statements cannot be properly verified, the Executive will usually insist that they are withdrawn.

Other statements

- Those involved in an offer must take care not to issue statements which might mislead shareholders or the market or create uncertainty.
- Statements of this sort might include the Offeror stating that it might increase or extend its offer (without actually committing itself to do so), or statements by the Offeree relating to a given level of support.

Communication with Shareholder, the Press and the Public (Cont'd)

Meetings and telephone calls

- The Code restricts the extent to which parties to an offer may contact the Offeree shareholders to induce them to accept or reject the offer. Proposed meetings or telephone calls should therefore be carefully discussed in advance with professional advisers.

Statements to the Press

- The directors of the Offeror or the Offeree should exercise great care when having any conversations with journalists.
- Remarks may be misunderstood or misattributed, which may lead to a requirement to clarify or withdraw by the Executive.
- In particular, discussions relating to sensitive subjects, such as future profits, prospects, and asset values should be avoided.

Summary: seek advice

- Given the importance of the above issues, it is vital that the directors of the Offeror or Offeree consult their advisers before speaking to shareholders or to the press.

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Duties of the Board of the Offeror and Offeree

It is likely to be a term of the disposal that the existing directors of the Offeree resign on completion in which case the primary duty of the Offeree's existing board is to ensure that there is a binding contractual commitment on the Offeror to comply with the provisions of the Code after the completion of the disposal.

Legal responsibilities

- to act bona fide in the interests of the company (the interests of the company being a question on which the directors are generally free to decide);
- to act for proper, and not 'collateral' purposes;
- to avoid conflicts of interest with the company, not to make secret profits and to exercise skill and care in performance of their duties;
- a duty to be honest and not to mislead the shareholders of the company when giving advice.

Duties of the Board of the Offeror and Offeree (Cont'd)

General Code Responsibilities

- The Code requires each director of a company involved in an offer to ensure, so far as he is reasonably able, that the Code is complied with during the conduct of the offer.
- The Code recognises that a board of directors may delegate the day to day conduct of an offer to individual directors or to a committee of directors.
- However, the board as a whole must ensure that proper arrangements are in place to enable it to monitor the conduct of an offer so that each director fulfills his obligations under the Code. In particular, the board should ensure that:
 - A. It receives promptly:
 - copies of all documents issued by the company in relation to the offer;
 - details of all dealings in relevant securities by the company or its associates; and
 - details of any agreements, understandings, guarantees, expenditure (including fees) or other obligations involving the company and the offer other than routine administrative matters;
 - B. The directors with day-to-day responsibility for the offer are in a position to justify their actions to the board; and
 - C. The advisers' opinions are available to the board.
- In addition, board meetings should be held as and when necessary throughout the offer to ensure that all directors are kept up-to-date with events.

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Duties of the Board of the Offeror and Offeree (Cont'd)

Preparation of documentation

- Documents and advertisements issued in connection with an offer must be prepared with the highest standard of care and accuracy.
- Directors must take responsibility for the accuracy of the information in all documents and that each document must contain a statement to that effect (Rule 9.3).
- When detailed supervision of any document has been delegated to a committee of the board of the Offeror or Offeree, each of the remaining directors must reasonably believe that the persons to whom a supervisory role has been delegated are competent to carry it out and must have disclosed to the committee all relevant information not known by the committee.
- The directors should be satisfied that, where any employee or adviser has been instructed to check the accuracy of any part of the offer documentation, it is reasonable for that person to be given the task having regard to the nature of information concerned and to the extent to which it may require special knowledge of the company affairs.
- The person concerned must be given access to any necessary documents, and the opportunity to discuss any points that arise with any of the company officers and advisers.
- Although the company's financial and legal advisers will co-ordinate the preparation of the offer documentation, it is important that the directors should be aware of their responsibility to satisfy themselves that the procedure for ensuring the accuracy of the contents is correct and followed.

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Duties of the Board of the Offeror and Offeree (Cont'd)

Pre-vetting by the Executive

With the exception of certain documents on the SFC's Post-Vet List, all announcements and documents published by a party to a takeover offer must be filed with the Executive for comment prior to publication and must not be published until the Executive has confirmed that it has no further comments. A published version of documents on the Post-Vet List must be filed with the Executive immediately after publication. The Post-Vet List is available on the SFC website in the "Takeovers & Mergers" section.

Responsibility statements

- Each director will be asked to sign a form of responsibility statement addressed to the Offeror or the Offeree, as appropriate, and its financial advisers. Under this responsibility statement, the director will take responsibility, as required by the Code, for an 'approved document' that is, a document or announcement which has been approved by the board or a committee of the board and of which he has not expressed disapproval.

Duties of the Board of the Offeror and Offeree (Cont'd)

No Frustrating Action

- The Code and the relevant laws and regulations impose many duties and obligations on the Offeree once it receives an offer or believes that an offer is imminent.
- Once the board of a company is notified of an offer or has reason to believe that an offer is imminent, no action should be taken by the board which could frustrate the offer or deny the shareholders the opportunity to decide on the merits of the offer without the approval of the shareholders at a general meeting (Rule 4).
- In particular, the board must not, without such approval:
 - issue any shares;
 - create, issue or grant, or permit the creation, issue or grant of, any convertible securities, options or warrants in respect of shares of the company;
 - sell, dispose of or acquire assets of a material amount;
 - enter into contracts, including service contracts, other than in the ordinary course of business; or
 - cause the company or any subsidiary or associated company to purchase or redeem any shares in the company or provide financial assistance for any such purchase.

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Duties of the Board of the Offeror and Offeree (Cont'd)

No Frustrating Action (Cont'd)

- Where the company is under a prior contractual obligation to take any of the above-mentioned actions, or where there are special circumstances, the Executive must be consulted.
- The Executive may waive the requirement to obtain shareholder approval either in appropriate circumstances or when the offeror agrees to such waiver.

The Independent Committee of the Board

- A board which receives an offer, or is approached with a view to an offer being made, is required to appoint an independent committee of the board to make a recommendation as to whether the offer is fair and reasonable and as to acceptance and voting (Rule 2.1).
- Members of the independent committee should comprise all non-executive directors of the company who have no interest in the offer other than as a shareholder of the company (Rule 2.8).

Restrictions Following Offers and Possible Offers

- Where an offer has been withdrawn or has lapsed, neither the Offeror nor any person who acted in concert with the Offeror nor any person who subsequently acts in concert with any of them, may within 12 months from the date of withdrawal or lapse of such offer do either of the following, without the consent of the Executive (Rule 31.1(a)):
 - make an offer for the Offeree; or
 - acquire any shares of the Offeree resulting in an obligation to make a mandatory offer under Rule 26.

Acquisition of Minority Shares After Successful Takeover Offer

Purchase of the Minority's Shareholding

- Once the mandatory offer is made under the Code, the Offeror may rely on s.693 of the Companies Ordinance (Cap. 622) (“Ordinance”) to compulsorily acquire the remaining shares not already held by it.
- This enables an offeror who has within 4 months of posting the initial offer document acquired (or contracted unconditionally to acquire) at least 90% in number of the shares to which the offer relates, to give notice to the remaining shareholders that he desires to acquire those shares.
- The notice to the remaining shareholders must be given before whichever is the earlier of the following:
 - a) the end of the period of 3 months beginning on the day after the end of the offer period of the takeover offer;
 - b) the end of the period of 6 months beginning on the date of the takeover offer

Acquisition of Minority Shares After Successful Takeover Offer (Cont'd)

Purchase of the Minority's Shareholding (Cont'd)

- If the notice is given within the above time limit and in accordance with other requirements under s.694 of the Ordinance, the offeror is entitled and bound to acquire the shares on the terms of the takeover offer.
- Within 2 months of receiving such notice, an application may be made to the court for an order that the offeror is not entitled to the shares or for an order that the Offeror is entitled and bound to acquire the shares on the terms specified in the order.
- If there is no such application, two months from the date of notice, the Offeror must send a copy of the notice to the Offeree together with the necessary instruments of transfer and the consideration; the Offeree must then register the Offeror as holder of those shares.

Acquisition of Minority Shares After Successful Takeover Offer (Cont'd)

The Minority's Right to be Bought Out

- The holder of any shares to which the offer relates may require the Offeror to acquire their shares.
- Where the Offeror has acquired or contractually agreed to acquire at least 90% in number of the shares in the Offeree, a holder of shares who has not accepted the offer may by letter addressed to the Offeror require it to acquire his shares (Section 700 Companies Ordinance).
- The Offeror must give notice to shareholders of their rights under section 700 to require the Offeror to acquire their shares.
- The notice must be given to shareholders within one month after the first day on which their rights arise under section 700.
- A shareholder must exercise his right to require the Offeror to buy him out within 3 months after the later of:
 - the end of the offer period; and
 - the date of the Offeror's notice.

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Acquisition of Minority Shares After Successful Takeover Offer (Cont'd)

The Minority's Right to be Bought Out (Cont'd)

- The rights given to the minority shareholders to require an offeror to acquire their shares are only exercisable within 3 months after whichever is the later of the following:
 - a) the end of the offer period;
 - b) the date of the notice given to the minority shareholders
- Where the shareholder exercises his right to be bought out, the Offeror is entitled and bound to acquire the shares on the terms of the offer or on such terms as it may agree.

Q & A

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