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# Amendments To The Codes On Takeovers, Mergers And Share Repurchases Effective 1 October 2005

## Introduction

The Securities and Futures Commission (the "SFC") has published its Consultation Conclusions on the changes to the Hong Kong Codes on Takeovers, Mergers and Share Repurchases (the "Codes") proposed in its November 2004 Consultation Paper and announced that the amendments to the Codes will come into effect on 1 October 2005. A marked-up copy of the amended Codes is included at Appendix 2 of the Consultation Conclusions which are available on the [SFC website](http://www.sfc.hk).

The changes which will come into effect on 1 October are not as significant as the amendments made in 2001 which included the "trigger" for a mandatory takeover offer being reduced from 35% to 30% and a reduction in the "creeper" from 5% to 2%. The current amendments largely reflect recent changes to the London Takeovers Code and issues identified by the SFC and market practitioners.

## 1. Class 2 Of The Definition Of "Acting In Concert

A company is presumed to act in concert with the directors (together with their close relatives, related trusts and companies controlled by the directors, their close relatives or related trusts) of all group companies. Experience has shown the presumption to be unnecessarily wide.

The Class 2 presumption has therefore been amended to apply only to a company, its directors (and their associates and controlled companies) and those of its parent companies.

The question of whether any directors of subsidiaries or fellow subsidiaries are acting in concert will revert to being a question of fact rather than a presumption. It is expected that this amendment should eliminate in most cases the need to apply for waivers from the Class 2 presumption.

## 2. "Low-Ball" Or "One Cent" Offers

As the name implies, such offers are offers made at an extremely low price.

General principle 9 and Rule 4 provide that once a bona-fide offer has been communicated to the board of the offeree or the board of the offeree has reason to believe that a bona-fide offer may be imminent, no action that could effectively result in an offer being frustrated, or in the offeree's shareholders being denied the opportunity to decide on its merits, may be taken by the offeree's board in relation to the affairs of the company without the approval of shareholders in general meeting. In particular, the following "frustrating actions" listed in Rule 4 are prohibited without prior shareholders' approval:

1. the issue of shares;
2. creating, issuing or granting any convertible securities, options or warrants in respect of the offeree company's shares;
3. the sale, disposal or acquisition of assets of a material amount;
4. entering into contracts, including service contracts, other than in the ordinary course of business; and
5. causing the offeree company or any subsidiary or associated company to purchase or redeem any shares in the offeree company or provide financial assistance for any such purchase.

In order to prevent "low-ball" offers being used to frustrate the target's business (by virtue of the operation of Rule 4) where there is no genuine intention to seek control, a new Note to the definition of "offer" provides that a voluntary offer may not normally be made at a price that is at a discount of more than 50% to the offeree company shares' market price (being the lesser of the closing price of the shares on the day before the Rule 3.5 announcement and the 5 day average closing price prior to such day).

## 3. Frustrating Actions

Concerns have been raised as to the risks for shareholders of an incumbent board taking deliberate but lawful action (eg. issuing new shares or taking other action to reduce the overall value of the company) to frustrate the exercise of board control by a successful offeror.

Under a new Rule 31.5 therefore, once an offeror requisitions a general meeting after its offer has become unconditional in all respects, the offeree board must:

1. cooperate fully and convene the meeting as soon as possible; and
2. not take any frustrating action (as listed in Rule 4) without shareholder approval or the offeror's consent from the end of the offer period until the conclusion of the general meeting.

## 4. Vetting Process

Given the international trend away from pre-vetting in favour of enforcement, the SFC's commenting process will be shortened. The SFC may give confirmation that it has no further comments once any substantive Code issues have been raised and, if appropriate, dealt with. Other matters, including drafting which do not involve Code matters will be left to a company and its advisers to deal with.

References to SFC "clearance" of documents have been deleted due to the apparent safeguards the term was wrongly perceived to provide. The Code now also explicitly states that compliance is the sole responsibility of the issuer of the document (and its directors and advisers).

## 5. Telecom Mergers (New note 3 to Rule 15.5)

The Telecommunications (Amendment) Ordinance 2003 applies to a "change" (including an acquisition of 15%, 30% or 50% of the voting shares in the licensee or its controller) in relation to a carrier licensee in the Hong Kong telecommunications market. The Telecommunications Authority (the "TA") can commence an investigation where there has been an adverse effect on competition in relation to a "change".

A new Note 3 to Rule 15.5 extends "Day 39" (the latest date for announcement of new information by the offeree company) following any final decision of the Telecommunications Authority. If any such extension exceeds 3 months after posting of the offer document, the Executive should be consulted to determine whether the offer should lapse and, if so, which provisions of the Code continue to apply.

In addition, a new Note 4 to Rule 26.2 provides that no acquisition of voting rights which could give rise to a general offer obligation under Rule may be made if such acquisition or offer could result in a "change" in relation to a carrier licence within the meaning of section 7P(16) of the Telecommunications Ordinance.

## 6. Use Of Comparables (New Note 7 to Rule 9.1)

A new note 7 to Rule 9.1 requires comparables to be a fair and representative sample and the bases for compiling comparables to be clearly stated.

## 7. On Market Share Repurchases And Whitewash Waivers (Rule 32.1 Of The Takeovers Code And Rule 6 Of The Share Repurchases Code)

The Code only allows whitewash waivers of general offer obligations triggered by off-market share repurchases or share repurchases by general offer. The Consultation Paper considered allowing whitewash waivers for general offer obligations triggered by on-market share repurchases which are allowed in the UK.

The Consultation Paper considered allowing whitewash waivers for general offer obligations triggered by on-market share repurchases. Such waivers are allowed in the UK. It was suggested that corporate governance concerns could be addressed by the introduction of stringent requirements in the Codes.

The SFC has decided that it is not in the best interests of minority shareholders to make this amendment.

## 8. Competitive Situations (New Rule 16.5)

A new Rule 16.5 provides that where a competitive situation exists in the late stages of an offer period, the Executive will normally require revised offers to be published in accordance with an auction procedure (the terms of which will be determined by the Executive). This will normally require final revisions to competing offers to be announced by the 46th day after the posting of the competing offer document but will allow an offeror to revise its offer within a set period in response to any revision announced by a competing offeror on or after the 46th day.

If a competing offer is announced, both offerors will be bound by the timetable set by the posting of the competing offer document. The Executive will also extend "Day 60" for the purposes of any auction procedure under Rule 16.5 (new Note 2 to Rule 15.5).

A new Rule 31.4 further prevents a competing offeror whose offer has lapsed or any person acting in concert with such offeror from acquiring shares in the offeree company on terms better than those made available under its lapsed offer until each of the competing offers has either been declared unconditional in all respects or has lapsed.

## Other Amendments

For information on the other amendments to the Codes, please click [here](/newsletters/hklaw/en/2005/26/nl-hklaw-20050907-26.html).

*The purpose of this note is to provide a summary only of the principal amendments to the Codes on Takeovers, Mergers and Share Repurchases. Specific advice should be sought in relation to any particular situation.*

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