Charltons - Hong Kong Law Newsletter - 27 March 2012

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# Amendments to the Takeovers Code Take Effect On 23 March 2012

## Introduction

On 23 March 2012, the Securities and Futures Commission (**SFC**) released its consultation conclusions (**Conclusions**) on the amendments to the Codes on Takeovers and Mergers and Share Repurchases (the **Takeovers Code**) proposed in its August 2011 consultation paper (**Consultation**).

The three principal amendments to the Takeovers Code are:

* the property valuation requirements now apply only to offers where the offeror is an interested party;
* in placing and top-up transactions, the financial adviser, placing agent and acquirer of voting rights are responsible for confirming the independence of places; and
* the prescribed period for payment of acceptances of an offer is now seven business days instead of 10 days.

The amendments came into effect immediately, i.e. on 23 March 2012.

The marked up text of the amendments to the Takeovers Code is set out in Appendix 2 of the Conclusions, which are available on [the SFC’s website](http://www.sfc.hk/sfc/doc/EN/speeches/public/consult/CP_March_2012%28EN%29.pdf)

The purpose of this newsletter is to provide a summary of the amendments.

## Property Valuation Requirements

### Property valuation requirements limited to offers where the offeror is an interested party

Rule 11.1(f) requires a valuation of properties in the case of an offer for a company with significant property interests, or in the case of a securities exchange offer, where the offeror company has significant property interests.

As proposed in the Consultation, Rule 11(f) has been amended so that it applies only to:

1. an offer (mandatory or voluntary, including a privatisation offer or proposal) where the offeror is an interested party; or
2. whitewash transaction where the whitewash waiver applicant is an interested party.

The term “interested party” has replaced the term “related party” which was used in the Consultation. An “interested party” for these purposes refers to:

1. a party holding, alone or together with parties acting in concert with it, immediately before either the commencement of an offer period or an obligation arises to make a mandatory offer under Rule 26.1, 30% or more of the voting rights of the offeree company;
2. a director of the offeree company; or
3. a party acting in concert with any person falling within category (i) or (ii).

The amendment acknowledges that the continued full application of Rule 11.1(f) may be unduly burdensome in terms of time and cost in some circumstances.

### Proposal to Retain Property Valuation Requirement for Special Deals Dropped

The Consultation also proposed to retain the more stringent requirements of Rule 11.1(f) for transactions which involve a special deal that requires shareholder approval pursuant to Rule 25.

Rule 25 reflects the principle set out in General Principle 1 that all shareholders must be treated equally. It prohibits an offeror from making arrangements with favourable conditions that are not extended to all shareholders unless the Executive has given its consent. The notes to Rule 25 give examples of certain arrangements which may be permissible subject to various safeguards including the requirement that the special deal is approved by independent shareholders and that an independent financial adviser publicly states that in his opinion the terms of the special deal transaction are fair and reasonable.

According to the Conclusions, as a matter of practice, the Executive requires a valuation of assets being disposed of or acquired to be included in the circular to shareholders for a special deal. This is consistent with the principle set out in General Principle 5 that shareholders should be given sufficient information to enable them to reach an informed decision on an offer.

In view of the safeguards offered by Rule 25 and General Principle 5, the SFC has decided not to apply the property valuation requirements of Rule 11(f) to special deals as originally proposed.

The situations in which a property valuation is required under the amended Rule 11(f) are summarised in the following table:

Scenario

Is the Offeror an interested party of the Offeree?

Valuation report

of the Offeree

of the Offeror

(listed)

(unlisted)

1. Cash offers
* No
* X
* X
* X
	1. Cash offers
	+ Yes
	+ √
	+ X
	+ X
		1. Securities exchange offers
		- No
		- X
		- X
		- √\*
			1. Securities exchange offers
			* Yes
			* √
			* √
			* √\*
			* \* Paragraph 30 of Schedule 1 to the Takeovers Code requires disclosure in the offer document of an estimate of the value of unlisted securities. The Executive envisages that any estimation would inherently include an up-to-date valuation of the underlying properties.
			*

### Properties of Mining Companies

The Consultation noted that the Executive has already relaxed its approach to the strict application of Rule 11(f) in certain circumstances where strict application might be unduly burdensome. Practitioners had suggested that it is not appropriate to include certain assets (e.g. properties used by a mining company for smelting or storage purposes or infrastructure such as roads at the mining sites) for the purposes of calculating the 15% threshold even though they may be listed on a company’s balance sheet as “buildings” or “plant and buildings”. The Executive agrees that strict application of the property valuation requirements may be unduly burdensome and its approach has been to decide such matters on a case-by-case basis in accordance with Practice Note 7 (of December 2007) which is available on [its website](http://www.sfc.hk/sfc/doc/EN/cfd/mergers/practice_note/PN07_eng_29.12.08.pdf)

A respondent to the Consultation sought clarification as to how the Executive determines whether to exclude the properties of mining companies given that such properties are regarded as part and parcel of a mine or mining site. In response, the Conclusions note that, as set out in Practice Note 7, the Executive may request a list of the assets including a detailed description of their nature, location, size, book value and other relevant information. The Conclusions recommend consulting the Executive at the outset of the transaction if parties are uncertain whether particular assets should be included for the purpose of calculating the 15% threshold.

### Application of General Principle 5

As mentioned above, General Principle 5 contains the fundamental principle that shareholders must be given sufficient information to enable them to make an informed decision on an offer. Accordingly, a valuation of property interests or assets would still be required under General Principle 5 in cases where the valuation constituted relevant information to allow shareholders to make a properly informed decision, even though a valuation may not be required under Rule 11(f).

In response to suggestions that a note should be added to Rule 11(f) to clarify that the Executive has discretion to require property valuations in appropriate cases, the Conclusions noted that this was not necessary since it is already clear that it has such discretion. In reaching a decision, the Executive will take into account all relevant factors including (without limitation) the nature of the business and principal assets of the target company, the structure and terms of the proposed transaction including the basis upon which the consideration was determined and the relationship between the parties involved. The Executive may also seek the views of an independent financial adviser.

## Confirmations Of Independence In Placing And Top-Up Transactions

### Responsibility for verification and confirmation of placees’ independence

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

As proposed in the Consultation, Note 7 on dispensations from Rule 26, which relates to the verification of placees’ independence in placing and top-up transactions, has been amended to clarify that responsibility for ensuring and confirming placees’ independence lies with the financial advisers, placing agents and acquirers of the voting rights, and not with the Executive.

Thus the amended Note 7 provides that:

1. it is the responsibility of the relevant financial adviser, placing agent and acquirer of the voting rights to ensure and confirm that the acquirer is independent of, and not acting in concert with, the vendor of the voting rights; and
2. the Executive expects the relevant financial adviser, placing agent and acquirer of the voting rights to take all appropriate and reasonable steps to ascertain and verify whether the acquirer is independent of, and not acting in concert with, the vendor of the voting rights and then to provide appropriate confirmations to the Executive.

### Vendor prohibited from participation in the screening or selecting of placees

The amendments to Note 7 specify that the vendor of the voting rights must not make arrangements to dispose of or place the voting rights with persons acting in concert with him. Following the consultation process, a further amendment has been made to prohibit the vendor of voting rights being involved in screening or selecting placees unless such involvement is strictly limited to due diligence enquiries by the placing agents and financial advisers regarding placees’ independence.

### Executive’s right to raise enquiries as to independence

Note 7 has been amended to clarify that the Executive may make enquiries about the independence of the acquirer of the voting rights before granting a waiver and after the completion of the placing and top-up transaction. If an acquirer of voting rights is found to have acted in concert with the vendor of such voting rights, any waiver which has been granted will normally be invalidated: according to the Conclusions, such a waiver would only be allowed to remain valid if the circumstances were exceptional. If a previously granted waiver is invalidated, the Executive is entitled to take appropriate action including possibly requiring a general offer to be made in accordance with the requirements of Rule 26.

## Timing Of Payment For Acceptances

Rule 20.1 has been amended to provide that offerors must pay for shares for which offers have been accepted as follows:

* In the case of a general conditional offer, payment must be made as soon as possible but in any event within 7 business days following the later of:
	1. the date on which the offer becomes, or is declared, unconditional; and
	2. the date of receipt of a duly completed acceptance.
* In the case of a general offer which is unconditional from the outset, payment must be made within 7 business days following the receipt of duly completed acceptances.
* In the case of a partial offer, payment must be made as soon as possible, but in any event within 7 business days following the close of the partial offer.

A “business day” is defined in the Takeovers Code as a day on which the Stock Exchange is open for the transaction of business. Previously, payment was required within 10 days which in accordance with market practice was calculated in calendar days.

The amendments were made in response to the concern raised by the Federation of Share Registrars Limited that when any part of the previous 10-day payment period coincides with Hong Kong public holidays (in particular Chinese New Year, Easter and Christmas), the processing time before payment cheques must be despatched is shortened significantly which gave rise to practical problems.

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