Charltons - Hong Kong Law Newsletter - 29 August 2013

[online version](http://www.charltonslaw.com/sfc-issues-takeovers-bulletin-on-disqualifying-transactions-under-the-whitewash-guidance-note-and-application-of-rule-201b-to-share-repurchases-by-partial-offer/)

# SFC Issues Takeovers Bulletin On (1) “Disqualifying Transactions” Under The Whitewash Guidance Note And (2) Application Of Rule 20.1(B) To Share Repurchases By Partial Offer

## Introduction

The Securities and Futures Commission (**SFC**) has published, in its latest issue of the Takeovers Bulletin (Issue No.25) in June 2013, clarification of:

* the meaning of “disqualifying transactions” under paragraph 3 of the Whitewash Guidance Note; and
* the application of Rule 20.1(b) of the Code on Takeovers and Mergers and Share Repurchases (Takeovers Code) to a listed company which repurchases its shares by a partial offer.

The purpose of this note is to provide a summary of the issues raised in the [Takeovers Bulletin](http://www.sfc.hk/web/EN/files/CF/pdf/Takeovers%20Bulletin/TB_Eng_Jun%202013.pdf) ([see archive](#nldir#/takeovers_bulletin.pdf)).

## Whitewash waiver and “disqualifying transactions”

Under Rule 26 of the Takeovers Code, a party is required to make a general offer for the shares of a target company in certain circumstances, such as where a party has acquired the voting rights of the target company and such acquisition increases that party's holding to 30% or more of the target's voting rights.

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 SFC will usually waive the obligation if there is an independent vote at a shareholders’ meeting (which is commonly known as the ‘whitewash’ procedure) [[1]](#footnote-26). This waiver is called the “whitewash waiver”.

In order for a whitewash waiver to be granted, the requirements stated under the Whitewash Guidance Note [[2]](#footnote-27) must be met. One of the requirements under the Whitewash Guidance Note is that there must be “*no disqualifying transactions by the person or group seeking the waiver in the period from the date 6 months prior to the announcement of the proposals and up to and including the date of the shareholders' meeting*.” [[3]](#footnote-28)

The requirement of “no disqualifying transactions” is set out in detail in paragraph 3 of the Whitewash Guidance Note. In summary, a whitewash waiver will not be granted if:

* the party to be issued with new securities in the target company (or any person acting in concert with that party) has acquired voting rights in the target company in the six months prior to the announcement of the whitewash proposal; and
* that party has acquired or disposed of voting rights in the target company in the period between the announcement of the whitewash proposal and the completion of the subscription of shares in the target.

These prohibitions aim to ensure equal treatment of shareholders so that the whitewash applicant and its concert parties may not provide an exit to some shareholders which is not available to others. Moreover, if the whitewash applicant who is proposing to increase its shareholding interest in the company through a whitewash transaction is allowed to dispose the voting rights before the completion of the whitewash proposal, that would be contrary to the intended effect of the proposal.

One issue arises: does it constitute a “disqualifying transaction” if the holders of convertible securities who are independent of the whitewash applicant exercise their conversion rights during the period between the announcement of the whitewash proposal and the completion of the share subscription? In the circumstances, the shareholding interest of the whitewash applicant (together with its concert parties) in the target company will be diluted as a result.

The SFC clarifies that such conversion would not constitute a "disqualifying transaction" since the resultant decrease in the shareholding interest of the whitewash applicant and its concert parties would not have been caused by an actual disposal of voting rights by the whitewash applicant and/or its concert parties.

## Application of Rule 20.1(b) of the Takeovers Code to share repurchases by partial offer

Rule 20.1(b) of the Takeovers Code provides that:

“*shares represented by acceptances in a partial offer shall not be acquired by the offeror before the close of the partial offer. Such shares must be paid for by the offeror as soon as possible but in any event within 7 business days following the close of the partial offer.*”

The SFC has recently been consulted as to whether Rule 20.1(b) of the Takeovers Code is applicable in cases where a listed company repurchases its shares by a partial offer. The SFC explains that a proposal by a listed company to repurchase its shares by a partial offer is essentially an offer to shareholders to buy a specified number (but not all) of the shares which carry voting rights of a company and is therefore in substance a “partial offer”. That means Rule 20.1(b) of the Takeovers Code applies to all partial offers which include share repurchases by partial offer.

In terms of the timing, the SFC reminds the practitioners to read Rule 20.1(b) in conjunction with Rule 28.4 of the Takeovers Code and note that for partial offers, once acceptances exceed the number of shares stated and the offeror declares the partial offer unconditional, the final closing date must be the 14th day thereafter and cannot be further extended.

[Practice Note 1](http://www.sfc.hk/web/EN/files/CF/pdf/Practice_Notes/Practice%20Note%2001_EN%20_revised%2013_06_28_.pdf) ([see archive](practice_note_21.pdf)) on partial offers has been revised to reflect the above.

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**Charltons - Hong Kong Law Newsletter - Issue 200 - 29 August 2013**

1. Note 1 on dispensations from Rule 26 of the Takeovers Code. [↑](#footnote-ref-26)
2. The Whitewash Guidance Note is set out at Schedule VI of the Takeovers Code. [↑](#footnote-ref-27)
3. Paragraph 2(a) of the Whitewash Guidance Note [↑](#footnote-ref-28)