SFC 證監會

# TAKEOVERS BULLETIN

A periodic newsletter to help participants in the Hong Kong's financial markets better understand the Codes on Takeovers and Mergers and Share Repurchases

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## Highlights



## Introduction

This is the second issue of the Takeovers Bulletin. We are encouraged that the first issue has generated a high download rate on our website.

If you wish to receive the Takeovers Bulletin by email, simply register for the SFC's Website Update Email Alert service on our homepage and select Takeovers and Mergers, or send a message to takeoversbulletin@sfc.hk

In addition to the two Practice Notes in the first issue, this issue contains three more Practice Notes to clarify the application of certain rules of the Codes and the role of the Takeovers Executive in the commenting process.

We would also like to draw your attention to our proposed amendments to the Codes, a summary of which can be found in this issue.

## Practice Note 3 (PN3) – Implementation of Phase 1 of the Electronic Disclosure Project and the application of Rule 19.1 of the Takeovers Code

On 25 June 2007 the Hong Kong Stock Exchange launched a new regime for electronic dissemination of regulatory information (the Electronic Disclosure Project). Certain transitional arrangements have been put in place. Under Phase 1 of these arrangements, listed company announcements no longer need to be published in newspapers so long as they are published on the company's own website as well as the Stock Exchange's website. However for a six month transitional period a company will be required to publish a notification in newspapers whenever it publishes an announcement on its own website and on the Stock Exchange's website.

Under Rule 19.1 of the Takeovers Code, the announcement of results of an offer must be published on the Stock Exchange's website by 7.00 pm on the closing date. Rule 19.1 also requires that such announcement "*must be republished in accordance with Rule 12.2 on the next business day thereafter*" (the Republication Requirement). Rule 12.2 of the Takeovers Code states that "*[a]ll announcements in respect of listed companies must be made in accordance with the requirements of the Listing Rules*".

For the avoidance of doubt, the Executive wishes to clarify that for the purpose of Rule 19.1 it would regard any publication which is in compliance with the requirements under Phase 1 of the Stock Exchange's Electronic Disclosure Project (which have been incorporated in the Listing Rules) as being satisfactory fulfilment of the Republication Requirement.

The Executive will continue to monitor the progress of the implementation of the Electronic Disclosure Project and will issue further guidance if and when necessary.

## Practice Note 4 (PN4) – Can the offer price be increased after a "no increase" statement?

Under Rule 18.1 parties to an offer or possible offer and their advisers must take care not to issue statements which, while not factually inaccurate, may mislead shareholders and the market or may create uncertainty. In particular, an offeror must not make a statement to the effect that it may improve its offer without committing itself to doing so and specifying the improvement. Rule 18.3 clarifies the position regarding no increase statements as follows:

"*If statements in relation to the value or type of consideration such as "the offer will not be further increased" or "our offer remains at $x per share and it will not be raised" ("no increase statements") are included in documents sent to offeree company shareholders, or are made by or on behalf of an offeror, its directors, officials or advisers, and not withdrawn immediately if incorrect, only in wholly exceptional circumstances will the offeror be allowed subsequently to amend the terms of its offer in any way even if the amendment would not result in an increase of the value of the offer (e.g. the introduction of a lower paper alternative)* ***except where the right to do so has been specifically reserved***." (emphasis added)

Similar provisions also apply to no "extension statements" (see Rule 18.2).

The main rationale for Rule 18.3 is to maintain an orderly framework for the conduct of takeovers and mergers and to ensure that statements made by offerors are accurate and not misleading. This rationale reflects General Principle 6 of the Codes which requires parties who are concerned with offers to make every effort to avoid the creation of a false market. The overriding concern is that statements are not made which may mislead shareholders or the market or create uncertainty. It follows that offerors should exercise caution when making statements during the offer period which might be construed as a statement of finality regarding the offer (Note 1 to Rule 18 provides further guidance on this point).

An offeror is under no obligation to make a no increase statement. However if one is made it is normally issued with a view to emphasising the finality of the terms of the offer. In these circumstances shareholders should be able to place the highest possible reliance on the offeror's (and its adviser's) statement and accordingly reach an informed decision in respect of the offer.

If an offeror decides to issue a no increase statement it may at the same time reserve the right to increase the offer so long as the circumstances in which the offer might be increased are clearly set out. If an offeror reserves its right in this way it may choose not to be bound by a no increase statement in the event that one of the specified circumstances occurs.

Offerors and their advisers should be aware that Notes 2 and 3 to Rule 18 provide additional guidance if an offeror wishes to set aside a no increase statement in the case of a competing situation or a recommendation by the board of the offeree company.

Note 2 provides that in the event of a competitive situation arising the offeror may choose not to be bound by its no increase statement only if:

(i) it has specifically reserved the right to set the no increase statement aside in such circumstances; and

(ii) an announcement is issued providing details of the revisions as soon as possible and in any event within 4 business days after the announcement of the competing offer and a circular is sent to shareholders at the earliest opportunity; and

(iii) any shareholders of the offeree company who accepted the offer **after** the date of the no extension or no increase statement are given a right of withdrawal for a period of 8 days following the date on which the circular is sent.

Note 3 clarifies that, again only in the event that the offeror has reserved the right to do so, the offeror may choose not to be bound by a no increase statement which would otherwise prevent the posting of an increased or improved offer recommended for acceptance by the board of the offeree company.

As already mentioned Rule 18.3 permits revision of a no increase statement in "**wholly exceptional circumstances**" even if the right to set the no increase statement aside has not been specifically reserved. The question of what might amount to "**wholly exceptional circumstances**" would depend on a detailed analysis of the circumstances of the particular case. If in doubt the Executive should be consulted at the earliest opportunity.

## Practice Note 5 (PN5) – Executive's commenting process does not give immunity

In the last Code review exercise in 2004/2005, the Executive recommended that where possible the commenting process (i.e. the process in which the Executive comment on Code related draft announcements or documents) should be shortened. At the time there was a concern that in some instances the commenting process appeared to encourage over-reliance by issuers and their advisers on the Executive's input and the apparent safeguards it is perceived to provide. The Executive noted that this resulted, in some cases, in poor work on the part of the advisers, resulting in the need for extensive comments by the Executive which in turn leads to a lengthier commenting process with inevitable effects. Since the review exercise the Executive normally issues a confirmation that it has no further comments on any draft announcement or document once substantive Code issues have been raised and, where considered appropriate, dealt with. Other matters including drafting points which do not involve Code issues are left to the party issuing the announcement or document and its advisers to deal with and finalise.

Since the adoption of this new practice, the Executive is disappointed to note that many parties and their advisers appear to remain overly reliant on the Executive's commenting process. In this regard, the Executive would like to take this opportunity to remind parties and their advisers who are involved in Code transactions that the Executive's role in the commenting process is no more than a consulting role where the Executive provides assistance in resolving any Code issues raised by the Executive or identified by the parties and their advisers. Most importantly, parties and their advisers should not be under the misconception that by expressing that it has no further comment on a draft announcement or document the Executive is confirming that the announcement or document fully complies with the Codes. In all cases, it is the party issuing the announcement or document who is ultimately responsible for the information disclosed as well as for compliance with the requirements of the Codes.

In addition, parties who issue Code related announcements and documents should be aware of possible criminal liability arising under Section 384 of the Securities and Futures Ordinance (Cap. 571) for any false or misleading information contained in such announcements and documents.

## Takeovers Panel decisions in relation to Pacific Challenge Holdings Limited and Sanmenxia Tianyuan Aluminum Company Limited

The Panel has had a busy summer. In a substantive hearing consisting of a series of meetings held between 3 and 12 July 2007 the Panel met to consider disciplinary proceedings brought by the Takeovers Executive in respect of whether certain parties were acting in concert in relation to certain transactions in shares of Pacific Challenge Holdings Limited under the Takeovers Code. The disciplinary proceedings were dismissed by the Takeovers Panel on the basis that there was insufficient evidence to conclude that the alleged concert party relationship existed. The Panel's substantive decision and a series of related decisions were published by the SFC on 16 July 2007.

On 6 August 2007, the SFC published the Panel's decision that the comparable offer price for the "H" shares of Sanmenxia Tianyuan Aluminum Company Limited as required by Rule 14 of the Takeovers Code should be at the same price paid for its Domestic Shares, being the Hong Kong dollar equivalent of RMB0.1577 per share calculated by reference to the exchange rate prevailing on the date the mandatory offer was triggered. The Executive referred the matter to the Panel as the matter related to a particularly novel, important or difficult point at issue. The Panel met on 1 August 2007 to consider this matter.

Section 16.3 of the Introduction to the Codes provides that, subject to confidentiality considerations, it is the policy of the Panel to publish its decisions and the reasons for those decisions, so that its activities may be understood by the public.

If you would like to know more about the Panel's decisions, please follow this link.

## Consultation Paper on proposed amendments to the Codes

On 19 September 2007 the SFC issued a Consultation Paper on proposed amendments to the Codes. The proposed amendments, formulated in close consultation with the Panel, aim to address issues that have arisen since the last amendments in 2005.

It is proposed to amend the Takeovers Code to address a potential loophole which arises if a company disposes of substantially all of its assets and withdraws its listing from the Stock Exchange under the Listing Rules. In this situation, once a company has disposed of substantially all of its assets (which only requires approval by a simple majority (i.e. 50%) of the independent votes under the Listing Rules), shareholders are left with little choice other than to approve any related delisting proposal. The only alternative for shareholders is to be left with a cash company which may not be regarded as suitable for continued listing and hence would be suspended for an indefinite period or become delisted. It is arguable that a transaction structured in this way enables a company to effectively privatise and delist in a manner which circumvents the voting thresholds and other provisions of the Takeovers Code. In order to address this loophole it is proposed that the Codes be amended to clarify that transactions involving asset disposals coupled with possible delistings may fall within the jurisdiction of the Codes. This should prevent shareholders from being coerced into approving a proposal they might otherwise wish to disapprove.

Various amendments are also proposed relating to securities borrowing and lending activity by persons connected to an offer. The proposals recognise that in securities borrowing and lending transactions the voting rights pass to the borrower along with the borrowed shares. This gives rise to concerns of potential abuse as the underlying purpose of the transaction may be to secure a tactical advantage or to manipulate the price or location of relevant securities. For example, a person connected to an offer may "lend" his shares to another person so that those shares may be voted in accordance with the lender's wish on a resolution which the lender was prohibited from voting on.

Finally, in response to requests by market practitioners, it is proposed to provide additional guidance in respect of dealings by discretionary fund managers and principal traders who are connected to an offer.

The consultation period will end on 9 November 2007 unless extended. A Consultation Conclusions Paper will be issued in due course.

Copies of the Consultation Paper are available at the SFC office.

You can also follow this link to the Consultatioin Paper.

The Takeovers Bulletin is available under 'Speeches, Publications & Consultations' – 'Publications' of the SFC website at http://www.sfc.hk.

Feedback and comments are welcome and can be sent to takeoversbulletin@sfc.hk

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