TAKEOVERS BULLETIN

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

Introduction

1. This issue of the Takeovers Bulletin contains a new Practice Note 18 in which the Executive clarifies that Rule 31.3 applies to general offers that are unconditional at the outset.
2. The Executive would like to remind market practitioners that in placing and top-up transactions it is the responsibility of the financial adviser or placing agent to verify and confirm the independence of placees.
3. Exempt fund managers and exempt principal traders are reminded to make timely submissions regarding their group holdings as at the date of commencement of an offer period as well as dealing disclosures.
4. The Executive reminds market practitioners of the importance of compliance with Code disclosure requirements, and in this regard Practice Note 5 has been revised.
5. The Executive also updates the market on the activities of the Takeovers Team in the six months ended 30 September 2009.
6. Last but not least, the Executive wishes all readers a Healthy and Happy New Year.

Highlights

- Practice Note 18 - Clarification on application of Rule 31.3
- Reminder on financial advisers' or placing agents' duty to verify and confirm placees' independence in placing and top-up transactions
- Reminder to exempt fund managers and exempt principal traders to make timely disclosures
- Revised Practice Note 5
- Update on the activities of the Takeovers Team

Practice Note 18 (PN18) - Rule 31.3 applies to general offers that are unconditional at the outset

Rule 31.3 of the Takeovers Code provides that *"[e]xcept with the consent of the Executive, if a person, together with any person acting in concert with him, holds more than 50% of the voting rights of a company, neither that person nor any person acting in concert with him may, within 6 months after the end of the offer period of any previous offer made by him to the shareholders of that company which* ***became or was declared unconditional****, make a second offer to, or acquire any shares from, any shareholder in that company at a higher price than that made available under the previous offer. For this purpose the value of a securities exchange offer shall be calculated as at the day the offer became, or was declared, unconditional."* (emphasis added)

Rule 31.3 prohibits an offeror and its concert parties from making a second offer or acquiring offeree company shares at a higher price than the previous offer price in the six-month period after the close of a successful offer.

The Executive believes that one of the main purposes of Rule 31.3 is to ensure equality of treatment of shareholders by preventing a successful offeror from acquiring shares from the remaining minority shareholders or making a further offer to acquire shares from them at a higher price than the previous offer.

This Rule is also an extension of one of the important disciplines imposed on an offeror under Rule 31.1 which, among other things, aims to encourage an offeror to put its best offer forward within a limited and specified time period after which, if the offer fails, the offeror is prohibited from making a new offer for the same company for a restricted period.

Rule 31.3 therefore provides assurance to an offeree shareholder in reaching a decision of whether or not to accept an offer that the offeror will not be offering a higher price shortly after the offer closes.

The Executive has been consulted on a number of occasions on whether Rule 31.3 applies only to offers that have become or been declared unconditional after the posting of the offer document and not to those which are unconditional at the time they are made.

The Executive wishes to clarify that it interprets Rule 31.3 to apply equally to offers that are unconditional at the outset. Given the primary purpose of the Codes is to afford fair treatment for shareholders who are affected by takeovers, mergers and share repurchases, the Executive believes that no distinction should be made between offers that commence as unconditional offers and those that become or are declared unconditional subsequently.

Responsibility of financial advisers or placing agents to verify and confirm independence of placees in placing and top-up transactions

The Executive wishes to remind market practitioners that financial advisers or placing agents, and not the Executive, are responsible for ensuring and confirming that placees procured under a placing and top-up transaction are independent of, and not acting in concert with, the vendor of the voting rights.

Note 7 on dispensations from Rule 26 provides that *"[w]hen compliance with a Rule or a waiver is dependent upon a disposition or placement of voting rights to independent persons the Executive will normally require the financial adviser, placement agent or acquirer of the voting rights to verify and/or confirm that the purchaser is independent of, and does not act in concert with, the vendor of the voting rights, and such verification or confirmation shall be provided in such manner as the Executive may reasonably require to satisfy itself of the acquirer's independence. In the case of a single placee the Executive will be particularly concerned with verifying the independence of the placee."*

In support of an application for a placing and top-up waiver (under Note 6 on dispensations from Rule 26), the Executive would expect the financial adviser and/or placing agent concerned to first take all appropriate and reasonable steps to ascertain and verify whether the placees procured by them are independent of, and not acting in concert with, the vendor of the voting rights and its concert parties and then to provide appropriate confirmations to the Executive.

Normally where the placing agents have procured their existing clients as placees, the Executive notes that the placing agents should be in the best position to provide the confirmation of independence. This is consistent with the "know-your-client" rule in paragraph 6.1 of the Corporate Finance Adviser Code of Conduct and paragraph 5.1 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission. Placees may also be introduced by other means. In both cases, a key question will be whether the vendor of the voting rights was involved in the selection or identification of the placees. Depending on the actual process of how placees are procured or introduced, financial advisers and/or placing agents should exercise their professional judgment in considering what steps are sufficient in ensuring the independence of the placees including for instance obtaining direct confirmations of independence from the placees concerned.

The Executive notes that in practice financial advisers and/or placing agents invariably confirm that the placees procured by them are independent of, and not acting in concert with, the vendor of the voting rights and its concert parties, and the vendor of the voting rights was not involved in the selection or identification of the placees.

With a view to facilitating the vendor of voting rights to top-up as soon as practicable, the Executive endeavours to process placing and top-up waiver applications promptly. Market practitioners should however bear in mind that certain circumstances may demand evidence to be produced to substantiate the confirmations made. As explained above, in such cases the relevant financial advisers and/or placing agents ought to be able to explain all relevant matters to the Executive including providing details of each step taken by them to ensure the independence of the placees. Whilst the Executive may provide guidance if consulted, it is the ultimate responsibility of the relevant financial advisers or placing agents to verify the independence of the placees.

Reminder to exempt fund managers (EFMs) and exempt principal traders (EPTs) to make timely disclosures

The Executive has noted on a number of occasions that EFMs and EPTs appear to have overlooked the requirement to submit details of their group holdings of relevant securities of the offeree company and, in the case of a securities exchange offer, of the offeror as well, as at the close of business on the day the offer period commences. The Executive wishes to remind EFMs and EPTs of this requirement which is expressly stated in the Executive's ruling letter granting exempt status. The relevant submission must be made to the Executive by 5:00 p.m. on the day after the offer period commences (see paragraph 7.3 of Practice Note 9 - Exempt fund manager and exempt principal trader status).

EFMs and EPTs should also note that the deadline for submitting dealing disclosures under Rule 22 of the Takeovers Code is 10.00 a.m. on the business day following the date of the transaction, unless dealings have taken place on stock exchanges in the time zones of the United States where the Executive has indicated that such disclosures may be made no later than 10.00 a.m. on the second business day following the date of the transaction (see Note 5 to Rule 22 and paragraphs 7.1 and 7.2 of Practice Note 9).

Repeated failure to comply with the above requirements may imply a deficiency in the compliance function on the part of the EFM or EPT which may jeopardize an entity's continued exempt status.

If EFMs and EPTs encounter difficulty in complying with the above requirements they should consult the Executive at the earliest opportunity.

Reminder to market practitioners to comply with Code disclosure requirements

The Executive has noted in a number of recent cases that parties and their advisers have, under Rule 12.1 of the Takeovers Code, submitted draft announcements and documents to the Executive for comment that fail to address the specific disclosure requirements in the Codes, e.g., the standard information required under Rule 19.

As stated in Note 2 to Rule 12.1 and Practice Note 5, the party issuing the announcement or document is ultimately responsible for the information disclosed and for compliance with the Codes. In this regard, the Executive would like to remind parties and their advisers who are involved in Code transactions that where the Rules prescribe specific disclosure to be made they are expected to exercise diligence in ensuring that the required information is fully disclosed in the first draft of the announcement or document submitted to the Executive for comment.

Practice Note 5 has been expanded to reflect the above and can be found on the Practice Notes page of the Takeovers and Mergers section of the SFC website.

Update on the activities of the Takeovers Team in the day-to-day administration of the Codes

Further to our update on the activities of the Takeovers Team in the June 2009 issue of the Takeovers Bulletin, in the six months ended 30 September 2009, the Executive dealt with 29 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer repurchases) and 23 whitewashes. The Executive also received 141 ruling applications.

The Executive referred one case to the Takeovers Panel for a ruling during this six-month period as particularly novel, important and difficult points were at issue.

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