Hong Kong Code on Takeovers and Mergers (the Takeovers Code) and Mandatory Takeovers

If a company (the "Offeror") acquires a controlling interest of at least 30% of the issued shares of a company (the "Offeree"), the unwary Offeror may be mandatorily required to make an offer to all the shareholders of the Offeree under the Takeovers Code, unless a waiver is granted by the Executive Director of the Corporate Finance Division of the Securities and Future Commission ("SFC") or any delegate of the Executive Director (the "Executive") who administers the Takeovers Code. If the Offeree is a primarily listed in Hong Kong or a public company, the Takeovers Code shall apply. In order to determine whether a company is a public company in Hong Kong the Executive will consider all the circumstances and will apply an economic or commercial test, taking into account primarily the number of Hong Kong shareholders and the extent of share trading in Hong Kong and other factors such as the location of its head office and place of central management; (b) the location of its business and assets, including such factors as registration under companies legislation and tax status; and (c) the existence or absence of protection available to Hong Kong shareholders given by any statute or code regulating takeovers and mergers outside Hong Kong.

Even though the Takeovers Code is a voluntary code, anyone in breach of the Takeovers Code may be subject to the private reprimand and/or public censure. The Securities and Futures Commission may also issue a public statement involving criticism, disciplinary action or even suspension. A person who has breached certain provisions of the Takeovers Code may also be ordered to pay compensation to shareholders who suffered loss as a result of the breach. It is therefore important for the Offeror, the Offeree and their directors to understand the Takeovers Code and to seek advice from lawyers and independent financial advisers at the outset and every step along the way for the intended acquisition.

General Principles

Under the Takeovers Code, any acquisition of a company under its legal ambit shall be based on the following 10 principles:

1. all shareholders are to be treated equally;
2. if control of an Offeree changes, a general offer to all other shareholders is normally required
3. during the course of an offer or when an offer is in contemplation, information made available to some shareholders must be made available to all shareholders;
4. an offer should only be made after careful and responsible consideration;
5. shareholders should be given sufficient information, advice and time regarding the offer;
6. all persons concerned with takeovers and mergers should make full and prompt disclosure of all relevant information and take every precaution to avoid the creation of a false market and making statements which may mislead shareholders or the market;
7. rights of control should be exercised in good faith and the oppression of minority shareholders is unacceptable;
8. directors should have regard to the interests of the shareholders as a whole;
9. the board of the Offeree must not take actions to frustrate a proposed bona fide offer or deny the shareholders the opportunity to decide on its merits; and
10. all parties concerned with takeovers and mergers should co-operate to the fullest extent with the Executive, the Takeovers and Mergers Panel ("Panel") and the Takeovers Appeal Committee.

Mandatory Offer under Rule 26

Other than the 10 general principles above, the Takeovers Code contains 36 rules which implement such principles. Rule 26 relating to the making of a mandatory offer and is considered one of the most important rules.

Rule 26 of the Takeovers Code requires a mandatory offer to be made to all the shareholders of the Offeree by the Offeror in the following circumstances, unless a waiver is granted by the Executive:

- when any person (or two or more persons acting in concert) acquires, whether by a series of transactions over a period of time or not, 30% or more of the voting rights of a company; and

- when any person (or two or more persons acting in concert) holding not less than 30% and not more than 50% of the voting rights of a company, acquires additional voting rights that increase his or their holding of voting rights by more than 2% from the lowest percentage holding by that person (or the concert group) in the preceding 12 month period. This is commonly referred to as the 'creeper' provision.

In other words, mandatory takeover may be triggered by the 30% rule or by the creeper provision. Except with the consent of the Executive, a mandatory offer made under Rule 26 is subject to the following:

- it must be made conditional only upon the Offeror having received acceptances in respect of voting rights which, together with voting rights acquired or agreed to be acquired before or during the offer, will result in the Offeror and any person acting in concert with it holding more than 50% of the voting rights, normally referred to as the "acceptance condition". However, where the Offeror holds more than 50% of the voting rights before the offer is made, an offer made under this rule should normally be unconditional;

- no acquisition of voting rights which would trigger the obligation to make a mandatory offer under Rule 26 must be made if the making or implementation of the mandatory offer would be subject to the passing of any resolution by shareholders of the Offeror, or any other conditions, consents, arrangements or regulatory approvals. Any regulatory approval required for a mandatory offer must be obtained before the general offer obligation is triggered.

What is a mandatory offer: If the Offeror acquires 30% or more of the voting shares of the Offeree, it must make an offer to all other shareholders for the remaining interest in cash or accompanied by a cash alternative at not less than the highest price paid by the Offeror, or any person acting in concert with it, for shares of the same class in the Offeree during the offer period (see below for the definition of an offer period) and within 6 months prior to its commencement. The cash offer or the cash alternative must remain open after the offer has become or is declared unconditional for not less than 14 days thereafter.

An "offer period" commences when an announcement is made of a possible offer (Rule 3.7 – talks announcement) or a proposed offer (Rule 3.5 - announcement of a firm intention to make an offer) and extends until the later of: (i) the date when the offer closes for acceptances; (ii) the date the offer lapses; (iii) an announcement that a possible offer will not proceed; (iv) the date of an announcement of the withdrawal of a proposed offer; and (v) where the offer contains a possibility to elect for alternative forms of consideration, the latest date for making such election.

Mandatory offer can be waived (i) with the whitewash procedure (see below), (ii) if the acquisition is a rescue operation, (iii) if it is an inadvertent mistake or (iv) if a placing and top-up transactions are involved.

Whitewash Procedure

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 mandatory offer under this Rule 26, the Executive will normally waive the obligation if the whitewash waiver and the underlying transaction(s) are separately approved by at least 75% and more than 50% respectively of the independent vote that are cast either in person or by proxy at a shareholders' meeting (effective on 13 July 2018).

For this purpose "independent vote" means a vote by shareholders who are not involved in, or interested in, the transaction in question. The requirement for a mandatory offer will also normally be waived, provided there has been an independent vote of shareholders, in cases involving the underwriting of an issue of shares.

The Announcements

A Offeror Announcement

Rule 3.1 provides that before the board of the Offeree is approached, the responsibility for making an announcement normally lies with the Offeror or potential Offeror. An announcement must be made by the Offeror or potential Offeror in the following 3 situations:

1. when, before an approach has been made, the Offeree is the subject of rumour or speculation about a possible offer or there is undue movement in its share price or in the volume of share turnover, and there are reasonable grounds for concluding that it is the actions of the potential Offeror or persons acting in concert with it (whether through inadequate security, purchasing of Offeree shares or otherwise) which have led to the situation;

2. when negotiations or discussions are about to be extended to include more than a very restricted number of people (outside those who need to know in the companies concerned and their immediate advisers); and

3. immediately when the Offeror triggers a mandatory offer obligation under Rule 26.

B Offeree Announcements

Following an approach to the board of the Offeree, which may or may not lead to an offer, the primary responsibility for making an announcement will normally rest with the board of the Offeree, which accordingly must keep a close watch on its share price and volume. Rule 3.2 requires an announcement to be made by the board of the Offeree in 4 situations:

1. when a firm intention to make an offer is notified to the board of the Offeree from a serious source, irrespective of the attitude of the board to the offer;
2. when, following an approach to the Offeree, the Offeree is the subject of rumour or speculation about a possible offer or there is undue movement in its share price or in the volume of share turnover, whether or not there is a firm intention to make an offer;
3. when negotiations or discussions are about to be extended to include more than a very restricted number of people (outside those who need to know in the companies concerned and their immediate advisers); and
4. when the board of the Offeree is aware that there are negotiations or discussions between a potential Offeror and the controlling shareholder(s) (i.e. the holder or holders of shares carrying 30% or more of the voting rights of the company) or when the board of the Offeree is seeking potential Offerors, and

a. the Offeree is the subject of rumour or speculation about a possible offer or there is undue movement in its share price or in the volume of share turnover; or
b. the number of potential purchasers or offerors approached is about to be increased to include more than a very restricted number of people.

C Vendors announcements and other announcements

A potential vendor is to make an announcement when there are negotiations or discussions between a potential Offeror and the controlling shareholder(s), and the Offeree is the subject of rumour or speculation about a possible offer or there is undue movement in its share price or in the volume of share turnover, and there are reasonable grounds for concluding that it is the potential vendor's actions (whether through inadequate security or otherwise) which have led to the situation.

Under either a possible offer under Rule 3.7 or a proposed offer under Rule 3.5, announcements should also be made. In the former case, there should also be a monthly update setting out the progress of the talks or the consideration of a possible offer until a proposed offer is made under Rule 3.5.

Once a possible or a proposed offer has been made, both the Offeree and Offeror/potential Offeror also need to make an announcement of all classes of its "relevant securities" and the number of such securities in issue (Rule 3.8). "Relevant securities", for these purposes, include shares, convertible securities, warrants, options and derivatives in respect of such securities. The Offeror/ potential Offeror also needs to disclose the securities of the company which are to be offered as consideration for the offer (if relevant).

In the announcement, the Offeree, the Offeror or potential Offeror should remind their respective associates to disclose their dealings in any relevant securities of the Offeree. In a securities exchange offer, the Offeree, the Offeror/ potential Offeror should also remind their respective associates to disclose their dealings in any relevant securities of the Offeror/potential Offeror (or of the company the securities of which are to be offered as consideration for the offer, as the case may be). The announcements of such details are to allow shareholders of the Offeror to determine whether they are "associates" of the Offeror and the Offeree to determine whether they are "associates" of the Offeree by holding 5% or more of its relevant securities respectively and therefore are subject to Rule 22 dealing disclosure requirements.

The Offer

When there is an offer, the Offeror shall post a formal offer document to the shareholders of the Offeree. The formal offer document will be accompanied by a form of acceptance, which shareholders who wish to accept the offer should sign and return to the Offeror. The offer document will set out the conditions of the offer and other financial information such as information on how the offer is to be financed. The offer will be made to acquire all the issued shares of the Offeree other than those currently owned by the Offeror and persons acting in concert with it.

The Offeree is required to send a circular to its shareholders setting out the views of its board or independent committee on the offer and the written advice of the independent financial adviser. In an agreed offer, the Offeror and Offeree normally combine the offer document and offeree board circular in a composite document.

The offer must be open for a minimum period of 21 days. In addition, unless it is wholly unconditional from the outset, it must be open for a further 14 days after the first closing date on which it becomes or is declared unconditional as to acceptances. This is so that the Offeree's shareholders who have not accepted the offer by such date have a second chance to accept the offer. The maximum period for which an offer may be open before it becomes or is declared unconditional as to acceptances is 60 days.

Professional advisers to a takeover

Financial Advisers

Both the Offeror and the Offeree need a financial adviser. The principal role of the financial advisers to the Offeror is to provide advice on financial issues of the offer and to opine whether or not it is fair and reasonable. The Takeovers Code requires that an independent committee of board of directors of the Offeree must obtain competent independent financial advice and based on that to advice the shareholders of the Offeree.

Other than negotiating the terms of the offer, the financial advisers ensure the offer is conducted properly. Together with the legal advisers, they set out the timetable, prepare documentation and liaise with the Executive and the Panel.

Legal Advisers

The legal advisers for both the Offeror and the Offeree will be primarily responsible for advising the legal issues of the offer. Together with the financial advisers, they are involved in negotiations, set out documentation and liaise with the Executive and the Panel.

Stockbrokers

Some financial advisers are stockbrokers and if they are not, the Offeror or the Offeree's stockbrokers are responsible for market analysis of the offer, and liaise with major shareholders and The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

Auditors

The Offeror or the Offeree's auditors are mainly involved in the preparation of financial information required to be disclosed for the offer.

Public Relations Consultants

The Offeror or the Offeree may employ financial public relations consultants to assist in such matters as drafting and distribution of press releases, liaising with the press and major shareholders.

Directors of the Offeror and the Offerees

The Takeovers Code requires each director of a company involved in an offer to ensure, so far as he reasonably can, that the Takeovers Code is complied with while conducting an offer. Each of them has to take responsibility for any document or announcement approved by the board or a committee of the board of which he has not expressed disapproval.

As a general rule, directors of the Offeror and the Offeree and anyone involved in the offer should not deal in the securities of the Offeree or of the Offeror (including options) unless and until they have obtained professional advice on the specific deal in question. During the period of negotiations and throughout the offer when price sensitive matters are being discussed, confidentiality should be kept at all cost. If there is any information leak giving rise to speculation or a rise in share price of the Offeree, the Executive may require a clarifying announcement and possibly to allegations of insider dealing.

Restrictions Following Offers

Where an offer has been withdrawn or has lapsed, neither the Offeror nor any person who acted in concert with the Offeror nor any person who subsequently acts in concert with any of them, may within 12 months from the date of withdrawal or lapse of such offer do either of the following, without the consent of the Executive:

- make an offer for the Offeree; or
- acquire any shares of the Offeree resulting in an obligation to make a mandatory offer under Rule 26.

Compulsory Purchase Requirements under the Companies Ordinance

Purchase of the minority's Shareholding

Section 693 of the Companies Ordinance (Cap. 622) enables an Offeror who has acquired (or contracted unconditionally to acquire) at least 90% in number of the shares to which the offer relates within 4 months of posting the initial offer document, to give notice to the remaining shareholders that it desires to acquire their shares ("squeeze out notice"). The Offeror must give this notice before the earlier of: (i) three months after the end of the offer period of the takeover offer; and (ii) 6 months from the date of the takeover offer (section 694(1) Companies Ordinance).

Within 2 months of receiving such notice, a shareholder can apply to court for an order that the Offeror is not entitled to acquire the shares or for an order varying the terms of the acquisition. If there is no such application, the Offeror is bound to acquire the shares on the terms of the takeover offer and must, within two months from the date of compulsory acquisition notice, send a copy of the compulsory acquisition notice to the Offeree together with the necessary instruments of transfer and the consideration; the Offeree must then register the Offeror as holder of those shares.

Where an Offeror is unable to achieve the 90% threshold for giving squeeze-out notices due to it being unable to trace one or more shareholders related to the offer, it can apply to court for authorisation to give squeeze out notices (section 693(4) and (5)). The court will need to be satisfied that the Offeror made reasonable enquiries in its efforts to trace relevant shareholders and that the consideration offered was fair and reasonable. The court will grant authorisation only if it considers it just and equitable to do so, having regard, in particular, to the number of shareholders who have been traced but not accepted the takeover offer.

The Minority's Right to be Bought Out

On the other hand, a shareholder of the Offeree to which the offer relates may require the Offeror to acquire their shares. Section 700 of the Companies Ordinance provides that if the Offeror has acquired or contractually agreed to acquire at least 90% in number of the shares in the Offeree before the end of the offer period, a holder of shares who has not accepted the offer may, by letter, require the Offeror to acquire his shares.

If shareholders are entitled to require the Offeror to acquire their shares under section 700, the Offeror must give notice to relevant shareholders explaining their rights under that section and the period during which those rights are exerciseable, unless it has given notice that it intends to acquire the shares under section 693 (section 701 Companies Ordinance). That notice must be given within one month of the section 700 rights arising. A shareholder must exercise his right to require the Offeror to purchase his shares within 3 months after the later of: (i) the end of the offer period; and (ii) the date of the Offeror's notice.

If the shareholder exercises his right to be bought out, the Offeror is entitled and bound to acquire the shares on the terms of the offer or on such terms as it may agree with the shareholder.

Delisting following a general offer

For both Main Board and GEM listed companies, the Offeror should ensure that a specified percentage of listed company's shares has to be in public hand and that percentage is 25% unless the Stock Exchange agreed to a lower percentage on initial listing.

If an Offeree proposes to be delisted following a general offer, the resolution to approve the delisting must be approved by 75% of the votes of disinterested shareholders and the number of shares voted against the resolution must not exceed 10%of the votes of all disinterested shareholders. A further condition to a delisting from the Stock Exchange is that the Offeror must be entitled to exercise, and must exercise, its rights of compulsory acquisition. (Rule 2.2) The purpose of the latter condition is to ensure that passive minority shareholders are not left holding illiquid shares in an unlisted company.

If companies incorporated in jurisdictions that do not afford compulsory acquisition rights to an Offeror (such as the PRC) seek delisting following a general offer, the Executive will require the Offeror to put in place arrangements to protect minority shareholders in order to obtain a waiver from the compulsory acquisition rights condition. The arrangements are intended to provide shareholders with every possible opportunity to exit their investment and require that:

i. when the offer becomes or is declared unconditional in all respects, the offer must remain open for a longer period than normally required by Rule 15.3 (i.e. 14 days after unconditional);

ii. shareholders who have not yet accepted the offer must be notified in writing of the extended closing date and the implications if they choose not to accept the offer; and

iii. the resolution to approve the delisting must be subject to the Offeror receiving valid acceptances amounting to 90% of the disinterested shares.