



# RETHINKING DIVIDENDS

April 2020

## It's that time of the (abnormal) year

As companies listed in Hong Kong enter the annual cycle of results announcements, reporting and annual general meetings, the market has seen a number of companies announcing no dividends or a cancellation of dividends previously declared. The perennial question of apportioning profits between distribution and retention bears an acute significance this year.

Company directors are facing a challenging task. The desire to meet shareholders' expectations and reassure the market about their company's financial strength is weighed against future cash flow concerns.

The following reasons have been cited:

- A heightened expectation of a business downturn causing a decrease in income
- The need to preserve extra cash to cope with an unexpected financing shortfall or an increase in costs
- Pressure from regulators in home countries, as in the case of financial institutions

- The need to show discipline to lenders in anticipation of re-financing and covenants negotiations
- To project an image of responsible management to employees and other stakeholders

## Hard to say no (especially if you have said yes before)

The board of directors is expected to appraise the impact of the COVID-19 pandemic on the company as it evolves. A decision made to pay a dividend can be (and has been) reversed.

Final dividends of companies incorporated in common law jurisdictions, and all dividends of companies incorporated in the PRC, are recommended by the board of directors and approved by shareholders in a general meeting. As such, they can be cancelled by the board withdrawing its recommendation before the shareholders' meeting.<sup>1</sup>

The articles of association of companies incorporated in common law jurisdictions generally permit interim dividends to be decided by the board of directors. So long as a payment date is specified, the dividends will not become owed by the company to the

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<sup>1</sup> Articles of association of companies incorporated in common law jurisdictions typically contain a provision that no dividend can exceed the amount recommended by the directors. Although this is not as commonly spelt

out in their articles, it is generally followed by PRC companies as a matter of practise.

shareholders until the specified date, and are susceptible to a cancellation by the board of directors.<sup>2</sup>

As difficult a decision it may be, there is a procedural basis under company law which enables directors to cancel a dividend with justification after it has been announced.

### But how about the market...

Company law considerations aside, directors of companies listed in Hong Kong should also have regard to the following:

- The size and timing of a dividend, or a decision not to declare a dividend if the market expects one, is generally regarded as inside information and needs to be promptly announced by listed companies. A decision to cancel an announced dividend is also going to be inside information that must be announced immediately.<sup>3</sup>
- Under the current T+2 settlement system, shares are generally traded ex-dividend one business day before the record date or, if there is a book closure, the last registration date. Before trading starts on the ex-dividend date, the HKEX normally adjusts the Previous Closing Price of the

shares and displays it on the trading system (OTP-C) for market reference.<sup>4</sup> Index-tracking investors and dividend arbitrageurs may execute trades around the ex-dividend date. To minimise investor grievances, a company should announce any changes in interim dividends previously declared<sup>5</sup> ahead of the last trading date preceding the ex-dividend date, if possible.

- The HKEX recommends that<sup>6</sup> any condition which will lead to the cancellation of the entitlement distribution must be clearly spelt out in the issuer's announcement. Whilst such conditions have been taken to mean events like shareholders' approval or consummation of corporate transactions, company directors should now consider stating suitable caveats in the announcement (and the directors' report) when there are reasons to believe the dividend being announced may be changed.
- As seen in other markets, companies finding it too difficult to make a determination on dividends now may announce a deferral of decision.

A question would still arise even if the decision to cancel a dividend is well-justified and

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<sup>2</sup> There is UK case law which establishes that shareholders do not have a right to enforce payment of a dividend from the company until the date on which it becomes payable, which serves as persuasive precedents in common law jurisdictions. See *Lagunas Nitrate Co Ltd v Schroeder & Co and Schmidt* (1901) 85 LT 22 and *Potel v IRC* [1971] 2 All ER 5. Meticulously drafted articles of some companies (for example, HSBC) contain express provisions as to when the debt would arise, which further clarifies the position.

<sup>3</sup> In addition to being inside information in its own right, a cancellation of a dividend would be a change in a matter which was the subject of a previous announcement which would require immediate disclosure. See

paragraph 35 in the Securities and Futures Commission's *Guidelines on Disclosure of Inside Information*.

<sup>4</sup> *HKEX Guidelines on Adjustments to the Previous Closing Price of a Security*

<sup>5</sup> For final dividends, the ex-dividend date is typically later than the AGM date. Since any decision to withdraw a final dividend should be made and announced before the AGM date, this issue would not arise with final dividends.

<sup>6</sup> *HKEX Guide on Distribution of Dividends and Other Entitlements*, paragraph 3.4

conducted in a way which does not contravene company law. Could investors claim that they have relied on the dividend announcement in making decisions to trade or not to trade, and try to seek remedies based on market misconduct or estoppel? Although there would be significant hurdles to bringing such claims successfully, as directors have an obligation to take into account the long-term health of the company, directors should consider this risk in the particular context of their company, and seek legal advice as needed.

### ... and the other stakeholders?

At such times of heightened austerity, directors will of course also pay attention to

the interests and concerns of lenders, employees, suppliers, pension trustees, regulators and the government, who may have demands on the company which conflict with those of shareholders. Decisions on dividends may give rise to perceptions and reactions colouring discussions on financing arrangements, prudential management, job protection and wages, regulatory policies and subsidies.

Notwithstanding that it is perfectly proper for directors to have regard to the interests of all these stakeholders, their main duty is to promote the long-term success of their company.



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If you would like further information about the impact of COVID-19 on your business, please speak to your usual Slaughter and May contact.