ISSUE NO. 54
September 2020

SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Takeovers Bulletin

Highlights

- Reminder about exclusivity agreements
- Implications of enforcement of security
- New online DoD submission platform launched
- Revisions to Practice Note 20
- Disciplinary proceedings against Ngai Lai Ha for alleged breach of Takeovers Code
- Quarterly update on the activities of the Takeovers Team

Reminder to offeree companies about exclusivity agreements

During negotiations which may lead to the making of a general offer (including a take private transaction), it is not uncommon for the potential offeror to request potential vendors or existing controlling shareholders of an offeree company to enter into an exclusivity agreement with the potential offeror or a person acting in concert with it for the purpose of restricting, usually for a stated period of time, the ability of the potential vendors or the existing controlling shareholders to discuss or negotiate with other potential offerors. It is generally acceptable for shareholders of an offeree company (ie, the potential vendors or the existing controlling shareholders) to enter into such exclusivity agreements, although parties need to be mindful that some terms contained in such agreements may give rise to implications under the Takeovers Code such as special deal concerns under Rule 25.

On the other hand, it is normally not acceptable for an offeree company itself to enter into an exclusivity agreement that may have the effect of restricting its ability to discuss or negotiate with other potential offerors. This is because the board of directors of an offeree company must not do anything that may prohibit the directors from carrying out their fiduciary duties, which in this case would be to advise the offeree company's shareholders of all possible bids. This is consistent with General Principles 8 and 9 of the Takeovers Code:

1. General Principle 8 provides that "*[d]irectors of the offeree company should give careful consideration before they enter into any commitment with an offeror (or anyone else) which would restrict their freedom to advise their shareholders. Such commitments may give rise to conflicts of interest or result in a breach of the directors' fiduciary duties*"; and

2. General Principle 9 also provides that "*[a]t no time after a bona fide offer has been communicated to the board of the offeree company, or after the board of the offeree company has reason to believe that a bona fide offer might be imminent, may the board of the offeree company take any action in relation to the affairs of the company, without the approval of shareholders in general meeting, which could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits*".

The above practice is consistent with Rule 21.2 of The City Code on Takeovers and Mergers in the

UK. Under this rule, except with the consent of the London Panel on Takeovers and Mergers, the offeree company may not enter into any offer-related arrangements with either the offeror or any persons acting in concert with it during an offer period or when an offer is reasonably in contemplation which may have the effect of, amongst others, restricting an offeree company board's freedom of action in responding to an offer.

The Executive should be consulted at the earliest opportunity if there is any doubt that any agreements, arrangements or commitments proposed to be entered into by an offeree company may not comply with General Principle 8 or General Principle 9.

Implications of enforcement of security

Since the publication of issue No. 52 of the *Takeovers Bulletin* in March 2020 on Dispensation Note 2 from Rule 26, the Executive continues to note an increase in the number of cases where offer periods are triggered by the enforcement actions of creditors, such as the appointment of a receiver or liquidator over a controlling block of shares. The Executive would like to remind market practitioners once again that all persons are expected to observe the letter as well as the spirit of the Takeovers Code. Parties should not expect the Executive to grant waivers or make exceptions under the Codes to facilitate debt recovery.

However, as explained in issue No. 52, the Executive may in appropriate circumstances waive the general offer obligation of a bank or a lending institution resulting from enforcement of security in accordance with Dispensation Note 2 from Rule 26.

In circumstances where a lender decides to take action in addition to the appointment of a receiver or liquidator to enforce its security, it should be aware of possible implications under the Takeovers Code. For instance, if a lender chooses to launch a voluntary general offer for the shares in a company at the same time as it appoints a receiver or liquidator over a substantial stake in the same company, any proposed settlement arrangement or agreement between the lender (as the offeror) and the borrower (being a shareholder of that company) may constitute a special deal under Rule 25 of the Takeovers Code.

It should also be noted that the offer timetable under Rule 15 of the Takeovers Code will be strictly enforced with no allowance made for settlement talks. Subject to the provisions of the Takeovers Code, an offeror will not be allowed to withdraw an offer, lapse an offer or vary conditions to an offer after a firm intention announcement has been made.

The Codes are designed to provide a fair and orderly framework within which takeovers, mergers and share buy-backs are to be conducted. The takeovers regime is not designed to act as a tool for debt recovery or to apply pressure to parties to commence or continue settlement discussions.

The Executive would like to remind potential offerors and market practitioners that offers should only be made after careful consideration. Parties and their advisers are encouraged to consult the Executive at the earliest opportunity if they are unsure of the application of the Takeovers Code to a proposed course of action.

New platform for e-submission of documents on display

The Executive has announced that from 5 October 2020, documents required to be put on display (DoDs) under Note 1 to Rule 8 of the Takeovers Code are to be submitted electronically using WINGS[1], the SFC's online portal. DoDs will no longer be submitted to the Executive using a recordable CD or DVD. The change will streamline the DoD submission and publication processes and increase efficiency.

The procedures for preparing DoDs, DoD Submission Forms and the requisite confirmations remain largely the same. Around the time the Executive is ready to confirm that it has no further comments on a Code document, a notification email will be sent to the issuer of the Code document or its professional advisers. The email will contain a unique hyperlink which directs the recipient to a designated submission interface on WINGS. Follow the instructions set out on the interface page to upload the:

(i) DoDs;
(ii) DoD Submission Form (in Excel format);
(iii) duly signed copy of the DoD Submission Form (in PDF format); and
(iv) the requisite confirmation[2].

Once the online submission is complete, an acknowledgement with a submission reference number will be shown on screen. The Executive will arrange for the publication of the DoDs on the SFC website when all is in order. The unique hyperlink will expire after a limited period of time.

If a party foresees any practical difficulties in submitting requisite DoDs electronically, the Executive should be consulted as soon as possible.

Parties are reminded that in addition to posting the DoDs on the SFC website, issuers should also arrange for them to be displayed on the website of the issuer of the Code document (which may be a transaction-specific website), from the time of the publication of the Code document until the end of the offer period or the date of the relevant shareholders meeting.

The DoD Submission Form and the revised "Documents on Display (DoD) Submission Form-How to Use Guide" can be downloaded in the "Takeovers and mergers – Forms" section of the SFC website. Further information on DoDs can also be found under paragraph 31 of Practice Note 20.

Revisions to Practice Note 20

In March 2014, the Executive introduced Practice Note 20 to provide guidance on announcements and documents issued under the Codes. The Practice Note contains useful reminders about various Codes provisions and requests parties to provide the Executive with certain information. It is intended to reduce the cost and burden of compliance as well as promote self-discipline amongst parties and market practitioners to ensure they comply with the Codes and related administrative procedures.

1 Web-based INteGrated Service.

2 Please refer to paragraph 31 of Practice Note 20.

The Executive would like to remind all parties to make good use of and be conversant with Practice Note 20 from the beginning of a Codes transaction. This will help ensure that confirmations and information required by the Executive are submitted in an accurate and timely manner and, where appropriate, all relevant disclosure requirements are met. Failure to comply with Practice Note 20 may lengthen the Executive's vetting process and in appropriate circumstances the Executive may suspend vetting until documents complying with Practice Note 20 have been submitted.

Paragraph 30 of Practice Note 20 requires parties to submit both hard and soft copies of revised draft documents to the Executive for vetting. To enhance efficiency, a soft copy of the revised pages should also be submitted as part of the revised draft documents. All new insertions should be shown as mark-ups and all deletions must be shown in strikethroughs. It is not satisfactory to merely denote the deletions with a symbol without showing the deleted text. Material changes to the draft document which may have Codes implications should also be highlighted to the Executive.

As always, when there is any doubt as to whether a proposed course of action is in accordance with the Codes, parties or their advisers should consult the Executive in advance.

The above requirement is reflected in the revised Practice Note 20. Other housekeeping changes have also been made. A marked-up version and a clean version can be found in the "Regulatory functions – Corporates – Takeovers and mergers – Practice notes" section of the SFC website.

Disciplinary proceedings against Ngai Lai Ha for alleged breach of Takeovers Code

On 16 September 2020, the Executive commenced disciplinary proceedings before the Takeovers and Mergers Panel against Ngai Lai Ha, the chairperson of International Housewares Retail Company Limited, over a breach of the Takeovers Code.

The Executive identified 13 separate instances during the period from March to May 2019 where following share acquisitions by Ngai, her concert group's voting rights in the company increased in aggregate more than 2% from their lowest collective percentage interest in the preceding 12 months without making a mandatory general offer. This breached Rule 26.1(d) of the Takeovers Code.

The disciplinary proceedings before the Takeovers Panel will be held in public. Details of the proceedings can be found in the "Regulatory functions – Corporates – Takeovers and mergers – Current disciplinary proceedings before the Takeovers Panel" section of the SFC website.

Quarterly update on the activities of the Takeovers Team

In the three months ended 30 June 2020, we received 11 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer share buy-backs), eight whitewashes and 92 ruling applications.

Useful links

- The Codes on Takeovers and Mergers and Share Buy-backs
- Practice notes
- Decisions and statements
- Previous Takeovers Bulletins

All issues of the *Takeovers Bulletin* are available under 'Published resources – Newsletters – Takeovers Bulletin' on the SFC website at www.sfc.hk.

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

If you want to receive the *Takeovers Bulletin* by email, simply click Subscriptions at www.sfc.hk and select Takeovers Bulletin.

Securities and Futures Commission
54/F, One Island East,
18 Westlands Road,
Quarry Bay, Hong Kong

Hong Kong

(852) 2231 1222
enquiry@sfc.hk
www.sfc.hk