

## Hong Kong Proposes to Give More Teeth to Independent Shareholders in Whitewash Transactions

The Hong Kong Securities and Futures Commission (SFC) recently launched a three-month consultation (the “**Consultation**”) on a wide range of proposed amendments to the Codes on Takeovers and Mergers and Share Buy-backs (the “**Codes**”), amongst which key proposals include:

- raising the independent shareholders’ voting approval threshold for all whitewash transactions from simple majority to 75 percent;
- imposing additional exit requirements for privatisation of Mainland China companies (or companies incorporated in any other jurisdiction that does not afford compulsory acquisition rights) listed in Hong Kong so that any such delisting resolution should be made subject to the offeror receiving 90 percent acceptances from independent shareholders; and
- empowering the Takeovers Panel (the “**Panel**”) to require compensation to be paid to shareholders who have suffered as a result of a breach of the Codes.

### Meeting 75 percent Voting Approval for Whitewash Transactions

Under the existing requirements of the Codes, SFC may waive an obligation to make a general offer (known as a “whitewash waiver”) if a change of control is achieved as a result of the issue of new shares, subject to a number of conditions including the approval of the transaction(s) and the whitewash waiver by independent shareholders.

It was yet noted that between 2015 and 2017 all of the transactions subject to whitewash waivers (usually referred to as “whitewash transactions”) that were voted on by independent shareholders (more than 90 cases) were approved and that the average shareholder turnout rate appears to be appreciably higher in general meetings with higher voting

thresholds such as privatisations and share buy-back transactions. SFC is therefore concerned that the independent shareholders voting requirement in whitewash transactions is not acting as the “gatekeeper” that it was intended to be and that may lead to abuse by whitewash applicants looking to obtain or consolidate control.

It is thus proposed in the Consultation that in a whitewash transaction:

1. the independent shareholders’ voting approval threshold should be raised from simple majority to 75 percent;
2. separate resolutions should be put to independent shareholders to approve the underlying transaction and the whitewash waiver; and
3. the new 75 percent voting threshold should be applied to both the underlying transaction and the whitewash waiver.

This means a whitewash applicant would be able to proceed to completion only if (i) the whitewash waiver is approved by 75 percent of independent shareholders; and (ii) the underlying transaction is also approved by the requisite 75 percent.

In the event that the underlying transaction was approved but the whitewash waiver was voted down, a whitewash applicant may proceed with the underlying transaction, coupled with a general offer, if the whitewash condition was waivable and was waived by the applicant.

Please note that the above proposal only applies to whitewash transactions, and so the thresholds for approving the partial offer (where applicable) will not be affected (i.e., approval by independent shareholders holding more than 50 percent of voting rights).

## More Exit Obligations for Privatisation of Companies with No Compulsory Acquisition Rights

Under the existing requirements of the Codes, in order to alleviate concerns about use of the threat of delisting as part of the tactics of privatisation by general offer, it is provided that the related delisting resolution must be made subject to at least 75 percent approval and not more than 10 percent disapproval by disinterested shareholders and that the offeror being entitled to exercise, and exercising, its rights of compulsory acquisition. However, there is no compulsory acquisition rights as such under the laws of certain other jurisdictions such as Mainland China.

It is thus proposed in the Consultation that an offeror who wishes to make an offer for the shares of a listed company incorporated in Mainland China (or in any other jurisdiction that does not afford compulsory acquisition rights) with the view to privatisation, it should put in place a mechanism to help ensure that shareholders are afforded the greatest opportunity to exit should they wish to do so. Such proposed measures include:

1. the offer should remain open for acceptance for a longer period after it becomes unconditional;
2. notices should be sent to all shareholders who have not yet accepted the offer to notify them of the closing date and the implications if they choose not to accept the offer; and
3. the delisting resolution is subject to the offeror receiving 90 percent acceptances from independent shareholders.

## Panel Empowered to Give Compensation Rulings

Though there were precedent cases in relation to the imposition of compensation orders by the Panel, such power is not expressly provided for under the Codes and there is ambiguity as to whether the Panel is precluded in disciplinary matters from issuing rulings (in addition or as an alternative to disciplinary sanctions) remedial in nature.

It is therefore proposed in the Consultation that:

1. the Panel should be given with explicit power to issue compensation rulings demanding compensation to be paid to shareholders who have suffered as a result of a breach of the Codes,

which is limited only to those rules relating to the obligation to make an offer on terms prescribed by the Codes (such as Rule 26 in relation to mandatory general offer, Rule 16 entitlement to revised consideration, etc.); and

2. amending the relevant section to allow the Panel to impose appropriate sanctions and/or remedial measures in all disciplinary matters.

As the Codes do not have the force of law, there may still be a potential issue on how to enforce the compensation rulings made by the Panel.

## Other proposed amendments

The other proposed amendments in the Consultation include:

### *Power to give Pre-emptive Compliance Rulings*

Clarifying SFC's and the Panel's existing power to make compliance rulings as pre-emptive measures restraining a person from acting (or continuing to act) a particular thing if the SFC or the Panel is satisfied that there is a breach or a reasonable likelihood of a breach of the Codes.

### *Cooperation*

Requiring persons dealing with SFC, the Panel and the Takeovers Appeal Committee in all Codes transactions to give prompt cooperation and assistance and the provision of true, accurate and complete information.

### *Clarifying the definition and the use of the term "associate"*

Eliminating the overlap (and the potential inconsistencies arising from such overlap) between the various classes of persons who are normally treated as associates of the offeror (or the offeree company) and the classes of presumption of acting in concert under the Codes.

### *Incorporation by reference*

Allowing historical financial statements of Hong Kong-listed companies to be incorporated by reference in the offer documents/offeree board circulars issued pursuant to the requirements under the Codes, instead of reproducing the same information.

The Consultation will last for three months until 19 April 2018.

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