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Takeovers Bulletin

Highlights

- Schemes of arrangement and Rule 2.10 of the Takeovers Code
- Application of the Codes to a Grandfathered Greater China Issuer
- New Practice Note 23
- Quarterly update on the activities of the Takeovers Team

Season's Greetings

We wish all readers a healthy and happy 2022!

Schemes of arrangement and Rule 2.10 of the Takeovers Code

Rule 2.10 of the Takeovers Code provides that:

"Except with the consent of the Executive, where any person seeks to use a scheme of arrangement or capital reorganisation to acquire or privatise a company, the scheme or capital reorganisation may only be implemented if, in addition to satisfying any voting requirements imposed by law:—

(a) the scheme or the capital reorganisation is approved by at least 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy at a duly convened meeting of the holders of the disinterested shares; and

(b) the number of votes cast against the resolution to approve the scheme or the capital reorganisation at such meeting is not more than 10% of the votes attaching to all disinterested shares."

"Disinterested shares" means shares in the company other than those which are owned by the offeror or persons acting in concert with it. See Note 6 to Rule 2.

The higher voting threshold set out under Rule 2.10 was implemented in 2002 to ensure that minority shareholders were sufficiently protected in any proposed privatisation. In particular, the approval of a privatisation should be decided by truly "independent" shareholders and the offeror and parties acting in concert with it should not be in a position to unilaterally determine or have substantial influence over the outcome of the privatisation by way of a scheme of arrangement. This is because concert parties, by definition, actively cooperate with the offeror to obtain or consolidate control of a company and if their votes were counted, this would undermine the policy underlying Rule 2.10.

The Executive notes two recent Hong Kong Court decisions on the interpretation of Rule 2.10:

(a) Re Cosmos Machinery Enterprises Limited (HCMP 601/2021, [2021] HKCFI 2088) (19 July 2021)

In this decision, The Honourable Mr Justice Jonathan Harris set out two common schools of thought on the meaning of Rule 2.10:

- Prohibition view – the offeror and his concert parties are prohibited from voting on the relevant resolution.

- Non-prohibition view – the offeror and his concert parties are not prohibited from voting, but their votes cannot be counted for the purposes of complying with the Takeovers Code.

In His Lordship's view, the Non-prohibition view is the correct position as it is more consistent with the natural and ordinary meaning of Rule 2.10 and section 674(2) of the Companies Ordinance (Cap 622) and the offeror's concert parties who are part of the scheme must be allowed to vote as a matter of scheme law.

(b) Re Chong Hing Bank Limited (HCMP 968/2021, [2021] HKCFI 3091) (18 October 2021)

In this decision, The Honourable Madam Justice Linda Chan considered Mr Justice Harris' views in Re Cosmos Machinery, which she considered to be *obiter dicta*[1] as the scheme in the case was not approved by the shareholders, and concluded that the Prohibition view is the correct interpretation of Rule 2.10.

Importantly, Her Ladyship set out three types of meetings which may be ordered by the Court for approval of privatisations or takeover schemes involving parties acting in concert with the offeror:

- one Court meeting for all the shareholders to be bound by the scheme, with the concert parties undertaking to the Court not to attend and vote at the meeting;

- two Court meetings, one for the disinterested shareholders and another for the concert parties. The Court, however, may dispense with ordering the second meeting if the concert parties have agreed with the company or given an undertaking to the Court at the time when the company sought an order to convene meetings that they will be bound by the terms of the scheme; and

- if the concert parties have agreed with the company or the offeror to be bound by the terms of the scheme or offer, the scheme may simply be entered into between the company and the disinterested shareholders, in which case there is only one Court meeting for these shareholders.

In the absence of any further clarification from a court of a higher level, and given that Madam Justice Chan's views on the interpretation of Rule 2.10 may be said to form part of the *ratio decidendi*[2] of the judgment, parties which seek to use a scheme of arrangement to privatise a Hong Kong incorporated company under the Codes should be aware of the interpretation adopted in Re Chong Hing Bank Limited.

As the Codes (including Rule 2.10) also apply to Hong Kong listed companies incorporated in other jurisdictions (for example, mainland China, Bermuda, the British Virgin Islands, the Cayman Islands or England and Wales), parties should seek legal advice and, where applicable, guidance from the relevant courts in respect of privatisation schemes of non-Hong Kong incorporated companies. The Executive will take a flexible approach to the application of Rule 2.10 to align with the company law regime of each jurisdiction.

[1] This refers to a judge's comments or observations, in passing, on a matter arising in a case before him which does not require a decision. *Obiter* remarks do not create binding precedent.
[2] This refers to the "rationale for the decision". Unlike *obiter dicta*, *ratio decidendi* possesses binding authority.

Application of the Codes to a Grandfathered Greater China Issuer

On 19 November 2021, The Stock Exchange of Hong Kong Limited (SEHK) announced a number of amendments to the Listing Rules to enhance and streamline the listing regime for overseas issuers, which will become effective from 1 January 2022.

One amendment extends the definition of "Grandfathered Greater China Issuer" to include a Greater China Issuer[3] which was both (a) controlled by a single corporate weighted voting rights (WVR) beneficiary (or a group of corporate beneficiaries acting in concert) as at 30 October 2020, and (b) primary listed on a Qualifying Exchange[4] after 15 December 2017 but on or before 30 October 2020. The addition of corporate WVR issuers codifies the special concession announced by SEHK on 30 October 2020 in its Consultation Conclusions on Corporate WVR Beneficiaries to extend the grandfathering arrangements to a larger pool of qualifying issuers.

Note to section 4.2 of the Introduction to the Codes on Takeovers and Mergers and Share Buy-backs (Codes) was introduced in April 2018. The note states: "*[a] Grandfathered Greater China Issuer within the meaning of Rule 19C.01 of the Listing Rules with a secondary listing on the Stock Exchange will not normally be regarded as a public company in Hong Kong under this section 4.2. Where the bulk of trading in the shares of a Grandfathered Greater China Issuer migrates to Hong Kong such that it would be treated as having a dual-primary listing in Hong Kong pursuant to Rule 19C.13 of the Listing Rules, the Codes will apply to it*". In other words, the Codes will not apply to these secondary listed companies before they are treated by SEHK as having a dual-primary listing in Hong Kong under the Listing Rules as a result of migration of the bulk of trading.

We note that SEHK has also provided guidance for secondary listed issuers on its approach to: (i) the migration of the majority of trading in an issuer's securities from an overseas exchange to Hong Kong; (ii) the voluntary conversion to a dual-primary listing on SEHK; and (iii) the voluntary or involuntary de-listing of a primary listing from an overseas exchange. SEHK will regard an overseas issuer as having either a dual primary listing or a primary listing in Hong Kong following each of these instances.

Section 4.1 of the Introduction clearly sets out that the Codes apply to, among others, companies with a primary listing of their equity securities in Hong Kong. As such, once an overseas issuer is subsequently regarded as having either a dual-primary listing or a primary listing in Hong Kong, the Codes will automatically apply to it.

Notwithstanding the above amendments to the Listing Rules, the application procedure for a confirmation under Note to section 4.2 of the Introduction to the Codes for overseas issuers remains unchanged.

3 An issuer with its centre of gravity in Greater China as defined under Rule 1.01 and Rule 19C.01 of the Main Board Listing Rules.

4 Qualifying Exchanges are defined under Rule 1.01 of the Main Board Listing Rules and include The New York Stock Exchange LLC, Nasdaq Stock Market and the Main Market of the London Stock Exchange plc (and belonging to the UK Financial Conduct Authority's "Premium Listing" segment).

New Practice Note 23 – Waivers from the application of Rule 26.1 of the Takeovers Code for De-SPAC Transactions

On 17 December 2021, we published a new Practice Note 23 (PN 23) providing guidance to market practitioners on the formal application process for a waiver of the application of Rule 26.1 of the Takeovers Code for De-SPAC (special purpose acquisition companies) transactions.

PN 23 can be found in the "Regulatory functions – Corporates – Takeovers and mergers – Practice Notes" section of the SFC website. [link to be inserted]

Quarterly update on the activities of the Takeovers Team

In the three months ended 30 September 2021, we received 17 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer share buy-backs), three whitewashes and 72 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.

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