



**CONSULTATION PAPER
ON PROPOSED AMENDMENTS TO THE
CODES ON TAKEOVERS AND MERGERS AND
SHARE BUY-BACKS**

The Law Society's Submissions

The Securities and Futures Commission ("SFC") issued a consultation paper on 19 January 2018 on proposed amendments to the Codes on Takeovers and Mergers and Share Buy-backs (together the "Codes"). In response thereto, the Law Society provides the following submission on the consultation questions posed.

***Question 1:** Do you agree with the proposals regarding parties' dealings with the Executive, Panel and Takeovers Appeal Committee? If not, please give reasons.*

Law Society's response:

Agree, however whilst the proposed language is broadly consistent with that of the Introduction to The City Code on Takeovers and Mergers (the "**London Code**"), it does omit certain language which we believe would be appropriate to replicate in the Codes. In particular, section 9(a) of the London Code requires that a person dealing with the Panel "must take all reasonable care not to provide incorrect, incomplete or misleading information to the Panel" whilst the draft proposed language at the last sentence of section 5.2 contains what appears to be a stricter, more absolute standard. We believe that the concept of reasonable care strikes the right balance between the need to keep the Executive fully informed in an open and co-operative manner, whilst also recognising that there is an on-going obligation to update the Executive if any information is found to be incomplete or inaccurate and the risk that the information provided by parties to the Executive may be judged with the benefit of hindsight to be inaccurate notwithstanding that the parties did take all reasonable steps to ensure the Executive was fully informed at the time of their dealing. As a result, we would support the introduction of a reasonable care standard concept.

The London Code also utilises the formulation that information provided to the Panel must not be "incorrect, incomplete or misleading" – we would support the inclusion of the words "not misleading" into the proposed draft section 5.2 as information can be "true, accurate and complete" but may still be "misleading".

In addition, the London Code codifies an explicit exception to the obligation to provide

information to the Panel in the form of legal professional privilege (as extracted below), which we would support including in the Codes to ensure that there is no conflict between the Codes and a party's rights at law:

“A person is entitled to resist providing information or documents on the grounds of legal professional privilege.”

Given the formal nature of a ruling (as compared to a consultation), we would propose that a higher and more onerous standard of ensuring truthfulness, accuracy and completeness of information supplied to the Executive should apply to the former (as compared to the latter) cases of dealings with the Executive.

There is also the question of who is “dealing with” the Executive, the Panel and the Takeovers Appeal Committee and so is subject to this obligation? We note that during the consultation process for the revisions to the London Code which were introduced in 2005 to implement similar changes, the question of who was “dealing with” the Executive was addressed and the Panel stated that: *“Thus, once a dialogue has been commenced between a person and the Panel about a certain matter, that person will have to disclose to the Panel any information relevant to that matter of which they are aware and correct or update the information if it changes”*. We would ask that the Executive confirms this view that only those parties who have commenced or engaged in a dialogue between the Executive are subject to these obligations.

To the extent there are good and valid reasons for detracting in substantive aspects from the position under the London Code (which this amendment is intended to mirror), they have not been articulated in the Consultation Paper.

Question 2: *Do you agree with the proposal to add new sections 7.2 and 13.12 to the Introduction to the Codes and to amend section 13.10 to the Introduction to the Codes? If not, please give reasons.*

Law Society's response:

The issue here is where there is a genuine disagreement about how the Code applies, can the Executive of the SFC issue a compliance ruling that obliges a party to follow his views including not taking certain actions, failing which such party will be regarded to be in breach of the proposed section 7.2 to the Introduction to the Codes notwithstanding that the SFC turns out to be incorrect in its interpretation or implementation of the relevant Code provision in question. In short, is it proposed that the SFC can, in effect, issue an injunction that turns out to be wrong, but a party will still be penalised if it acts in breach of the injunction in the meantime?

We support the change but a balance needs to be struck here so that in such situations, a panel hearing must be held expeditiously.

In addition, it also appears that the Executive may issue a compliance ruling even if he has not heard the views of all parties which are involved in a particular transaction.

In this context, we note that the London Code includes the following provisions, which we would support mirroring in the Codes:

“(b) Interpreting the Code — rulings of the Executive and the requirement for consultation

...

The nature of the Executive’s rulings will depend on whether or not the Executive is able to hear the views of other parties involved. If the Executive is not able to hear the views of other parties involved, it may give a conditional ruling (on an ex parte basis), which may be varied or set aside when any views of the other parties have been heard; if the Executive is able to hear the views of other parties involved, it may give an unconditional ruling. Save where the Executive varies or sets aside a ruling, a ruling is binding on those who are made aware of it unless and until overturned by the Hearings Committee or the Board, or unless the Hearings Committee or the Board otherwise directs. In addition, such persons must comply with any ruling given by the Executive for the purpose of preserving the status quo pending the unconditional ruling.”

We believe that introducing a distinction between conditional and unconditional compliance rulings would mitigate some of the risks indicated above.

We would also note that under the proposed wording for section 7.2 the Executive can give any direction that “appears necessary”. We believe that a compliance ruling should be “appropriate” as well as necessary to ensure that any ruling also has to meet some standard of reasonableness to achieve the objectives of the Codes. The wording would therefore read “...the Executive may give any direction that appears necessary **and appropriate** in order to...”

Question 3: *Do you agree with the new proposal regarding compensation rulings? If not, please give reasons.*

Law Society’s response:

Agree, but the compensation should be “such amount as is just and reasonable” as if the offer were made, and not “such amount **as the Panel thinks** just and reasonable”. In addition, the interest should also be “just and reasonable” and the reference to “simple or compound interest” should be deleted.

In addition, we would also question whether it is appropriate that a breach of Rule 30 of the Codes should trigger a potential compensation ruling, given the Executive will have an opportunity to prevent an offer being made which has subjective conditions. Is the only scenario where this is envisaged one where a subjective condition is included in an offer and then invoked against the views of the Executive? Presumably this is a remote possibility.

Question 4: *Do you agree with the proposed amendments to section 12.2 to the Introduction to the Codes? If not, please give reasons.*

Law Society's response:

Agree.

Question 5: *Do you agree with the proposal to amend the definition of associate and the consequential amendments? If not, please give reasons.*

Law Society's response:

Agree. It does help to address some difficult and onerous compliance issues where inadvertent breaches may occur.

However, we would also like to understand the Executive's logic for not deleting the definition of "associate" further, given the objective here is to address the overlap between the definition of "acting in concert". In principle, we would request that SFC informs the market the reason for not taking a position which is consistent with that adopted by the UK Panel following their consultation on similar proposals in 2010 where the Code Committee concluded that:

"In the light of the above, the Code Committee has reached the following conclusions:

(a) that the definition of "associate" should be conformed with the definition of "acting in concert" and, as a result, that the persons who should be treated as associates of an offeror or the offeree company should be the same as the persons who should be treated as persons acting in concert with an offeror or the offeree company;

(b) that, in view of the conclusion in paragraph (a) above:

(i) there would be no reason for retaining the definition of "associate" in the Code; and

(ii) that the definition of "associate" should therefore be deleted and the provisions of the Code which refer to the term "associate" should be amended so as to refer instead to any person acting in concert with an offeror or the offeree company (or equivalent wording);"

Question 6: *In respect of the proposed amendments to class (3) of associate, do you agree with Option 1 or Option 2? Please give reasons.*

Law Society's response:

Regarding the two options, the issue with Option 2 is that extending "associates" to directors of controlled companies of the offeror or the offeree and their parents is that such "controlled" companies may in fact be majority controlled by third parties.

Question 7: *Do you agree that the voting threshold for whitewash waivers should be increased from 50% to 75%? If not, please give reasons.*

Law Society's response:

Disagree. The abuse originates from an alleged ability to somehow solicit more than 50% disinterested members to vote and pass the whitewash waiver resolution. This may be on account of either shareholders' inaction, or more likely, warehousing of shares.

Shareholders' inaction could be on account of diverse factors and will not be resolved by increasing the approval threshold. Warehousing of shares is an abuse that should be tackled by enforcement, rather than increasing the threshold to 50% and thus making it more difficult for law abiding companies to make legitimate use of the waiver.

We wish to point out that the proposed approach is not adopted in the London and Singapore Codes. In addition, such an approach would be a significant deviation from established practice such as the approval requirements for significant transactions under the Listing Rules or matters otherwise requiring a special resolution under the Companies Ordinance. We do not think that there is a necessary linkage between this and the approval thresholds for an off-market buy-back or a privatisation given the different nature of these transactions and the fact that any whitewash transaction would necessarily already have been approved through a ruling by the Executive.

We see that the other source of abuse originates from steep discount offers. Specific rules should be designed to deal with them, rather than introducing a change that cuts across the board.

If the Executive believes that a rule along these lines must be introduced notwithstanding our comments above, then we would propose that the Executive or the Panel be given the discretion to require a 75% approval threshold on a case-by-case basis. This would enable a more targeted "enforcement-like" approach to address concerns rather than a sweeping change.

Question 8: *Do you agree that separate resolutions should be required for each of the underlying whitewash transaction(s) and the whitewash waiver? If not, please give reasons.*

Law Society's response:

Agree, although we would expect that the whitewash waiver resolution would be conditional on the passing of the whitewash transaction resolution.

Question 9: *Do you agree that the 75% voting threshold should apply to each resolution for the underlying whitewash transaction(s) and the whitewash waiver? If not, please give reasons.*

Law Society's response:

Disagree. Please refer to our response to Question 7 and we would also urge the Executive to make a distinction between the approval threshold of the whitewash transaction resolution and the whitewash waiver resolution – the transaction approval resolution should be seen separately and the relevant rules which apply to the approval of significant transactions as applied to the relevant company should be applicable to such resolutions. This could have significant unintended consequences if the proposed position is changed.

***Question 10:** Do you agree with the proposed amendment to Note 1 on dispensations from Rule 26 to include the word “normally”? If not, please give reasons.*

Law Society's response:

Agree.

***Question 11:** Do you agree with the proposal to add a Note to Rule 2.2 to clarify the matters above? If not, please give reasons.*

Law Society's response:

Agree.

***Question 12:** Do you agree with the proposed amendments to Rules 3.8 and 22 and the consequential changes to Note 1 to paragraph 4 of Schedule I and paragraph 12 of Schedule I? If not, please give reasons.*

Law Society's response:

Agree.

***Question 13:** Do you agree with the proposed new paragraph 3(p) in Schedule IX? If not, please give reasons.*

Law Society's response:

Agree.

***Question 14:** Do you agree with the proposal to amend Note 5 to Rule 22? If not, please give reasons.*

Law Society's response:

Agree.

***Question 15:** Do you agree with the proposal to amend Note 6 to Rule 22? If not, please give reasons.*

Law Society's response:

Agree.

***Question 16:** Do you agree with the amendment to class (5) of the presumption of acting in concert? If not, please give reasons.*

Law Society's response:

Agree.

***Question 17:** Do you agree with the proposal to amend section 8.3 of the Introduction to the Codes? If not, please give reasons.*

Law Society's response:

Agree.

***Question 18:** Do you agree with the proposed amendments to Notes 2 and 3 to Rule 8.1? If not, please give reasons.*

Law Society's response:

Agree.

However, the new wording in Note 3 requires a financial adviser to confirm to the Executive that printed materials, such as press releases or printouts of slides which highlight the salient facts of an offer, distributed in a meeting must be "fairly presented". Notes 2 and 3 to Rule 8.1 are aimed at addressing the specific aspect of not adducing new information and that is in the context of Rule 8.1 which requires equal dissemination of information about an offer. Rule 8 is not aimed at assuring the fairness or accuracy of the information and that aspect is regulated by Rule 9. We therefore suggest that the reference to "and the information therein is fairly presented" at the end of the second paragraph to Note 3 be deleted.

***Question 19:** Do you agree with the proposed new Notes 4 and 5 to Rule 12 and the consequential changes relating to the new Note to Rule 8.6 and the new Note 6 to Rules*

9.3 and 9.4? If not, please give reasons.

Law Society's response:

Agree.

Question 20: Do you agree with the proposed deletion of the definition of "CA" and the proposed amendments to Note 3 to Rule 15.5 and Note 4 to Rule 26.2? If not, please give reasons.

Law Society's response:

Agree.

Question 21: Do you agree with the proposed clarification to Note 2 to Rule 18? If not, please give reasons.

Law Society's response:

Agree.

Question 22: Do you agree with the proposal to amend Note 4 to Rule 18? If not, please give reasons.

Law Society's response:

Agree.

Question 23: Do you agree with the proposed amendments to Rule 2.9 and the proposed new Note to Rule 19.1? If not, please give reasons.

Law Society's response:

Agree.

Question 24: Do you agree with the proposed amendments to Rule 30.1? If not, please give reasons.

Law Society's response:

Agree, although we would note that there are some inconsistencies with the version in the London Code, which is replicated below. On balance we prefer the formulation under the London Code, including the additional guidance provided by the final sentence:

13.1 SUBJECTIVITY

An offer must not normally be subject to conditions or pre-conditions which depend solely on subjective judgments by the offeror or the offeree company (as the case may be) or, in either case, its directors or the fulfilment of which is in their hands. The Panel may be prepared to accept an element of subjectivity in certain circumstances where it is not practicable to specify all the factors on which satisfaction of a particular condition or pre-condition may depend, especially in cases involving official authorisations or regulatory clearances, the granting of which may be subject to additional material obligations for the offeror or the offeree company (as the case may be).

Question 25: *Do you agree with the proposed amendments to Rule 31.3? If not, please give reasons.*

Law Society's response:

Agree.

Question 26: *Do you agree with the proposal to amend paragraph 1 of Schedule II and the related Note 4? If not, please give reasons.*

Law Society's response:

Agree.

Question 27: *Do you agree with the proposal to add a new Note 5 to paragraph 12 of Schedule I and a new note to paragraph 16 of Schedule III? If not, please give reasons.*

Law Society's response:

Agree.

Question 28: *Do you agree with the proposal amendments as set out in Appendix 3? If not, please give reasons.*

Law Society's response:

Agree.

**The Law Society of Hong Kong
24 April 2018**