Hong Kong Institute of
Certified Public Accountants
香港會計師公會

BY EMAIL & BY HAND

Our Ref: C/EPL

7 February 2005

Mr. Peter Au-Yang,
Executive Director of Corporate Finance,
Corporate Finance Division,
The Securities and Futures Commission,
8/F Chater House,
8 Connaught Road Central,
Hong Kong.

Dear Peter,

Consultation Paper on a review of the Codes on Takeovers and Mergers and Share Repurchases

The Institute's Expert Panel of Listing has considered the captioned Consultation Paper and its comments on the 34 Questions of the Consultation Paper are set out in the attached **Annex**.

We are fully supportive of any plans by the SFC to ensure continued fair treatment for shareholders who are affected by takeovers and mergers by keeping the Codes up-to-date with market developments and international practice.

We trust that you will find our comments helpful. If you have any questions on any of our comments, please do not hesitate to contact me at 2287 7026 or schan@hkicpa.org.hk.

Yours sincerely,

STEPHEN CHAN
TECHNICAL DIRECTOR (ETHICS & ASSURANCE)

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Annex

HKICPA'S COMMENTS
ON THE CONSULTATION PAPER ON A REVIEW OF THE CODES ON TAKEOVERS AND MERGERS AND SHARE REPURCHASES

Question 1

Class 2 of the definition of "*acting in concert*"

Class (2) of the definition of "*acting in concert*" provides that a company is presumed to be acting in concert with *"any directors (together with their close relatives, related trusts and companies controlled by any of the directors, their close relatives or related trusts) of it or of its parent, subsidiaries or fellow subsidiaries".*

The class 2 presumption was expanded in the 2002 Code review to include directors of a company's parent, its subsidiaries and fellow subsidiaries. This presumption previously applied only to a company and its directors. This is still the position in the London Takeover Code. In the light of experience and market feedback since 2002 the Executive believes that the wording of the class 2 presumption is unnecessarily wide.

In a number of recent transactions involving offerors that are part of large corporate groups, the Executive accepted representations that directors were not involved in the offer and were not acting in concert with the offeror. In these cases the Executive granted one-off waivers from a strict application of class 2 on the basis that it would not have been practical or possible for such sizeable groups to monitor share dealings of a very large number of **individuals** worldwide regarding those individuals' **personal** investments.

There is however a concern that the granting of such waivers may cause an unacceptable degree of uncertainty.

The Executive therefore recommends that the class 2 presumption be amended to apply only to a company, its directors and the directors of its parent companies. The amended presumption will continue to apply to directors of parent companies and will therefore be wider than the pre-2002 version. The question of whether any directors of subsidiaries or fellow subsidiaries are acting in concert would revert to being a question of fact rather than a presumption.

Question 1 *Do you think that the class (2) presumption should remain unchanged or should it be amended, as set out in Appendix 1 to this paper, to apply only to a company and its directors and the directors of its parent company or parent companies?*

HKICPA's Comments

We agree that class (2) presumption should be amended to apply only to a company and its directors and the directors of its parent company or parent companies.

Question 2

Stock borrowing and lending

The Executive proposes to add the following new Note 11 to the Notes to the definition of acting in concert to clarify that a stock borrowing and lending transaction carried out in the ordinary course of the lender's business would not normally create a concert party relationship.

" Stock borrowing and lending

A stock lending institution would not normally be regarded as acting in concert with a borrower of the lender's stock if the stock lending transaction is carried out in the lender's ordinary course of business and the stock lending agreement is substantially similar to ***a standard form of agreement that is recognized by the International Securities Lending Association****.*

Transfers of voting rights involved in stock lending transactions conducted in such manner would not normally be regarded as acquisitions of voting rights under Rule 26.1. The Executive should be consulted if a stock lending transaction is conducted in any other manner." Emphasis added.

Question 2 Does the reference to a standard form agreement that is recognized by the International Securities Lending Association (marked in bold above) encompass the standard agreement(s) used by stock borrowers and lenders in the normal course of business in Hong Kong?

HKICPA's Comments

None.

Questions 3 and 4

General Principle 9, Rule 4 (no frustrating action) and definition of *"offer"*

The Executive has recently issued a number of rulings concerning "one cent" or "low-ball" offers, the meaning of a "*bona fide offer"* under the Codes and the application of Rule 4 to such offers. The Panel has also considered the application of the Takeovers Code to a "low-ball" offer (see the Takeover Panel's decision in relation to International Capital Network Holdings Limited dated 8 November 2002). The Codes do not provide any guidance on "low-ball" offers. However section 1.8 of the Introduction to the Codes provides that the Codes are not concerned with the financial or commercial advantages or disadvantages of a takeover transaction. This leaves little room for the Executive or the Panel to decide what may or may not constitute a "low-ball" offer, and as a result conclude that an offer is not bona fide for the purposes of the Codes. Nevertheless the Executive remains concerned that "low-ball" offers might be used as a tactic to frustrate the target's business where there is no genuine intention to seek control – for example a "one cent offer" for a Hang Seng Index stock. The Executive notes that all "low-ball" hostile offers made in Hong Kong in recent years failed; none had any meaningful levels of acceptance.

Some financial advisers have suggested that the Codes should be amended to prohibit an offeror from making a voluntary offer at below a set price (e.g. a price at a substantial discount to the market price) without the Executive's consent. On balance the Executive prefers a more flexible approach which would allow the Executive to take into account all relevant circumstances in determining whether or not an offer is "*bona fide*". The Executive therefore proposes to add the following new note to the definition of *"offer":*

"Note to definition of offer:

If a voluntary offer is made or is to be made at a price that is substantially below the market price of the offeree company shares, the Executive may rule that the offer must not proceed unless the offeror can demonstrate to the satisfaction of the Executive that there is a reasonable prospect of the offer or potential offer succeeding. If in doubt the Executive must be consulted at the earliest opportunity."

Question 3 *Do you agree that a new note to the definition of "offer" should be added to the Codes as proposed?*

Question 4 *Do you think the new Note should contain specific guidance as to the meaning of "substantially below the market price of the offeree company shares" and if so, what is the appropriate threshold to impose (e.g. below 50% of the lesser of the closing price of the relevant shares on the day before the Rule 3.5 announcement and the 5 day average closing price)?*

HKICPA's Comments

We agree that a new note to the definition of "offer" should be added to the Codes as proposed. However, we do not think that the new note should contain specific guidance as to the meaning of "substantially below the market price of the offeree company shares". This should be left to the judgment of the Executive given that market price may not be the only factor in determining whether or not an offer is "*bona fide*".

Question 5

Rule 7 (resignation of directors of offeree company)

The main purpose of Rule 7 is to prevent directors of the offeree company from resigning from the board prior to the first closing date or the offer becoming unconditional, whichever is later. This provides stability, and ensures that offeree directors remain in place to advise shareholders and to respond to the offer. The Executive proposes to delete the restriction in Rule 7 relating to directors of an offeree company's subsidiaries which appears overly restrictive. The Executive also proposes the following amendments to Rule 7 to clarify when a director may resign and also the application of the Rule to whitewashes:

"Once a bona fide offer has been communicated to the board of the offeree company or the board of the offeree company has reason to believe that a bona fide offer is imminent, except with the consent of the Executive, the directors of an offeree company should not resign until the first closing date of the offer, or the date when the offer becomes or is declared unconditional, or shareholders have voted on the waiver of a general offer obligation under Note 1 on dispensations from Rule 26, whichever is the later."

Question 5 *Do you agree that Rule 7 should not apply to directors of subsidiaries of the offeree company?*

HKICPA's Comments

We agree that Rule 7 should not apply to directors of subsidiaries of the offeree company.

Questions 6 and 7

Note 1 to Rule 8 (documents to be on display)

It has been proposed that Note 1 to Rule 8 be amended to require documents on display to be posted on an appropriate website and that these documents should include the certificates of incorporation of the offeror or the offeree company. It has also been suggested that the Note be amended to clarify that audited consolidated accounts of the offeror should be required to be posted on the appropriate website only in securities exchange offers. The Executive agrees and proposes to amend Notes 1 and 2 to Rule 8 as set out in **Appendix 1** to provide for disclosure of the relevant documents on the website of the company issuing the offer document, offeree board circular or other relevant document or its financial adviser.

Question 6 *Do you agree that documents on display should be made available for inspection on the website of the issuer of the document or its financial adviser?*

Question 7 *Do you think that documents on display should be made available on the SFC or Stock Exchange's website rather than or in addition to the website of the issuer of the relevant document?*

HKICPA's Comments

We agree that documents on display should be made available for inspection on the website of the issuer of the document and/or its financial adviser. The documents should also be on the SFC's and Stock Exchange's websites.

Questions 8 and 9

Rule 10.6 (statements which will be treated as profit forecasts)

It is often difficult to determine whether a working capital statement (which is frequently put into a document as a requirement of the Listing Rules) is a profit forecast under the Codes. A simple statement to the effect that a company has sufficient working capital will not be deemed a profit forecast under Rule 10 unless it places a floor under, or a ceiling on, the profits of the company. However, whilst a working capital statement is not a profit forecast under Rule 10, it comprises important material information, and there should be confirmation that it has been compiled with due care and consideration. The Executive therefore proposes to add the following new paragraph (f) to Rule 10.6 to clarify (i) when a statement regarding working capital will be regarded as a profit forecast and (ii) that such statements should be reported on by a financial adviser under Rule 10.

"(f) Working capital statements

A working capital statement will not normally be treated as a profit forecast unless it puts a floor under, or a ceiling on, the likely profits for a particular period or contains data necessary to calculate an approximate figure for future profits within the meaning of this Rule 10.6(a). However, where a document includes a working capital statement which is not a profit forecast under this Rule 10, such statement must be compiled with due care and consideration by the directors. The financial advisers must also satisfy themselves that the statement has been compiled properly by the directors. An independent financial adviser to the offeree company may perform a financial adviser's role under this Note."

Question 8 *Do you agree with the proposed clarifications regarding working capital statements in proposed new paragraph (f) to Rule 10.6?* *Question 9* *Do you agree with the proposed obligations of financial advisers in respect of working capital statements?*

HKICPA's Comments

We agree with the proposed clarifications regarding working capital statements in proposed new paragraph (f) to Rule 10.6 and the proposed obligations of financial advisers in respect of working capital statements.

Question 10

Rules 11.1 (disclosure of valuations) and 11.5(d) (valuation certificate to be on display)

Rule 11.1 of the Takeovers Code provides that "*When valuations of assets are given in connection with an offer details of the valuations or an appropriate summary thereof must be included in the offer document, offeree board circular or other documents.*" Note 1(c) to Rule 8 provides that the full valuation report must be made available as a document on display.

It has been suggested that the full valuation report should be made available either by incorporating it in full in the offer document, offeree board circular or other relevant document or by making it available as a document on display on a central website (as proposed in paragraph Question 6 of this paper). Others consider that the full valuation report would be of limited use to shareholders and might impose an unnecessary burden on the issuer of the document.

Question 10 Do you think that the full valuation report, rather than just a summary, should be put into the relevant document given that a full valuation report is a document on display under Rule

HKICPA's Comments

We do not agree that the full valuation report should be put into the relevant document.

Question 11

Rule 15.5 (final day rule)

Rule 15.5 contains the "Day 60" rule for a conditional offer. The Executive proposes to amend the reference to *"midnight on the 60th day"* which is the latest time for declaring an offer unconditional as to acceptances to *"7.00 p.m. on the 60th day"* to make it consistent with the 7.00 p.m. deadline in Rule 19.1 which applies when an offer closes on an earlier date.

Question 11 Do you agree with the amendment of the latest time for declaring an offer unconditional as to acceptances from "midnight on the 60th day" to "7.00 p.m. on the 60th day"? Do you think such changes will pose any practical difficulties for the offeror?

HKICPA's Comments

We agree with the amendment and do not think that such changes will pose any practical difficulties for the offeror.

Questions 12 to 16

Note 1 to Rule 16.1 (announcements which may increase the value of an offer) and Rule 21.3 (restriction on dealings by offeror during non-cash offers)

The current Note 1 to Rule 16.1 restricts an offeror, in the case of a securities exchange offer, from making any announcement about its trading results, profit or dividend forecasts, asset valuations, merger benefit statements or proposals for dividend payments after "Day 46". Such announcements may affect the value of the offer without affording sufficient time to the offeree board to respond to the revision and to the offeree shareholders to consider the revision before "Day 60". Competing bidders are not allowed to revise their offers after "Day 46".

The Executive recommends that these restrictions be extended as follows:

- to include announcements of any material new information (as discussed in paragraphs 65 and 66 of this paper); and
- to include announcement of any *"capital reorganisation"* that may have the effect of increasing the value of the offer.

It is therefore proposed that Note 1 to Rule 16.1 is amended as follows:

"1. Announcements which may increase the value of an offer

Where an offer involves an exchange of equity or potential equity, the announcement by an offeror of any material new information (including trading results, profit or dividend forecasts, asset valuations, merger benefits statements, proposals for dividend payments, proposals for a capital reorganisation or proposals for any material acquisition or disposal) may have the effect of increasing the value of the offer. An offeror will not, therefore, normally be permitted to make such announcements after it is precluded from revising its offer. If an announcement of the kind referred to in this Note 1 might fall to be made during the offer period, the Executive must be consulted at the earliest opportunity and an offeror will not be permitted to make a no increase statement as defined in Rule 18.3 prior to the release of the announcement."

The Executive believes that *"capital reorganisation"* in this context should include rights issues, capital distributions or special dividends, dividends in specie other than scrip dividends of the same class (this would cover demergers if scrip in a subsidiary were to be distributed to shareholders of its parent). It would follow that stock splits, stock consolidations, bonus issues of the same class, ordinary dividends not exceeding the earnings per share for the period in respect of which the dividend is declared, nominal share capital and share premium reductions not involving any distribution to shareholders would not be included.

Similar issues arise in relation to Rule 21.3 which sets out the following dealing restrictions on offerors during non-cash offers:

"Where the consideration under an offer includes securities of the offeror or a person acting in concert with it, neither the offeror nor any person acting in concert with it may deal in such securities during the offer period."

Rule 21.3 has two main purposes:

- to prevent an offeror from supporting or otherwise manipulating its share price during a securities exchange offer; and

- to restrict activities that might affect the nature or value of the consideration being offered.

The Executive believes that Rule 21.3 should be amended to restrict an offeror from proposing and/or completing the following activities (which are normally subject to approval by an offeror's shareholders) during an offer period:

- On-market share repurchases
- Off-market share repurchases
- Share repurchases by general offer

The Executive believes that these activities should be restricted throughout the offer period under Rule 21.3 rather than just after "Day 46" (as would be the case if they were to be included in Note 1 to Rule 16.1).

- If these activities are carried out during an offer they may lead to uncertainty about the terms of the offer.
- If the restrictions applied only to the announcement of such transactions after "Day 46" (the deadline for all bidders to revise their offers) it would be unfair to competing bidders and shareholders of the offeree company who may not have sufficient time to consider and react to such transactions.
- The restrictions for on-market share repurchases should apply throughout the offer period (rather than only after the announcement of a firm intention to make an offer under Rule 3.5) to reduce the possibility of manipulation of the share price before the terms of the offer are announced.

There is also a concern whether Rule 21.3, in its current form, is wide enough in that the dealing restriction extends only to an offeror and its securities and not to dealings by offerors in the securities of competing offerors.

Finally, the Executive proposes to amend the title of Rule 21.3 to clarify that it applies to all securities exchange offers irrespective of whether there is a cash alternative. The Executive therefore recommends the following changes to Rule 21.3:

"Restrictions on share dealings and transactions by offeror during securities exchange offers

Except with the consent of the Executive, where the consideration under an offer includes securities of an offeror or a person acting in concert with it, neither the offeror nor any person acting in concert with it may deal in such securities or conduct any on-market repurchase of such securities during the offer period.

Where the consideration under an offer includes securities of an offeror or a person acting in concert with it, and after the announcement of a firm intention to make an offer under Rule 3.5, such offeror or the issuer of the securities may not propose or conduct

any off-market share repurchase, or share repurchase by general offer, until the end of the offer period. This restriction does not apply to repurchases announced before the offeror's Rule 3.5 announcement."

Question 12 *Should the activities listed in paragraphs 70 and 75 above be restricted throughout the offer period under Rule 21.3 or only after "Day 46" under Note 1 to Rule 16.1?*

Question 13 *Do you agree that the restrictions in Note 1 to Rule 16.1 should be extended to "any material new information" including any "capital reorganisation" that may have the effect of increasing the value of the offer?*

Question 14 *If capital reorganisations are to be restricted under Note 1 to Rule 16.1 as proposed, what should be the scope of restricted activities (see paragraph 72 for further discussion)?*

Question 15 *If the activities referred to in paragraphs 70 and 75 above should be restricted as proposed, should there be a materiality test: if the size of an offer is less than a small percentage of the offeror's total issued share capital, the Executive may grant a waiver from the restrictions imposed on such transactions?*

Question 16 *Do you think that Rule 21.3, in its current form is wide enough to deal properly with competing offerors? If so, should there be a more general restriction on all offerors from dealing in each other's relevant securities (as defined in Rule 22) during an offer period?*

HKICPA's Comments

None.

Questions 17

Rules 28.4 and 28.5 – Rule 28.4 provides that the Executive will not normally consent to partial offers that may result in an offeror holding between 30% and 50%. Rule 28.5 provides that the Executive may consent to a partial offer for 30% or more so long as over 50% of all independent shareholders approve the offer (not by voting but by means of a separate indication on the form of acceptance). The combined effect of these two Rules is that the Executive will normally only consent to a partial offer that involves a change of control if the offer may result in the offeror holding 50% or more.

The rationale for the difference in treatment of these two types of partial offer, both of which involve a change of control (within the meaning of the Codes), is not entirely clear. A possible explanation is that successful partial offers for 50% or more result in statutory control and therefore greater certainty for management of the company. This is also consistent with the spirit of the 50% acceptance condition under Rule 30.2 which is a fundamental principle in the Takeovers Code. The London Takeover Code expressly allows partial offers for between 30% and 50%.

The Executive proposes the following options:

- **Option 1** –the current position under the Codes in terms of the different treatment of partial offers for between 30% and 50% and those for 50% or more would remain unchanged.
- **Option 2** – this option proposes amending the Codes to provide that all partial offers that may result in a change of control (as in Class B above) should be permitted under the Codes subject to the approval procedure contained in Rule 28.5 i.e. delete Rule 28.4. Please note the changes proposed in Option 2 are not set out in **Appendix 1** to this paper.

Question 17 Do you agree with Option 1 or Option 2? Please give reasons for your response.

HKICPA's Comments

We agree with Option 2, which is in line with international practice.

Question 18

Rule 32.1 of the Takeovers Code and Rule 6 of the Share Repurchase Code (Takeovers Code implications of share repurchases)

Rule 32 provides a mechanism for whitewash waivers of general offer obligations triggered as a result of off-market share repurchases or share repurchases by general offer. Effectively the Rule 32 whitewash mechanism applies only to a shareholder who is a director or a person who is acting in concert with a director of the company. An unconnected shareholder would not normally be regarded as having triggered a mandatory bid obligation under Rule 26 if the increase in his shareholding is solely due to share repurchases by the company (Note 2 to Rule 32).

The Executive has received a proposal that Rule 32 should be extended to allow a shareholder to seek a whitewash of a general offer obligation triggered by on-market share repurchases. The suggestion is that Hong Kong should be brought into line with international practice which allows such waivers (in particular the UK). It has also been suggested that any corporate governance concerns could be addressed by introducing sufficiently stringent requirements into the Codes.

The Executive has some reservations about extending Rule 32 in this way. A whitewash waiver is a dispensation from one of the most fundamental obligations under the Takeovers Code: that if a shareholder or concert group acquires 30% or more of the voting rights a general offer must be extended to all other shareholders. This is why whitewash waivers are only available in a limited number of circumstances (see Note 1 on dispensations from Rule 26 and Rule 32). The Executive believes that, in view of the prevalence of controlling shareholders in Hong Kong (which clearly distinguishes it from London), it may not be appropriate to follow international practice as proposed. There are already a number of differences between the London Takeover Code and the Codes that reflect differing market conditions and practices, for example, the provisions relating to privatisations.

The Executive also has concerns about investor protection and the equality of treatment of shareholders that result from fundamental differences between on-market and off-market share repurchases. Off-market share repurchases are single transactions; disclosure is made in a shareholders' circular of **all** relevant circumstances on the basis of which disinterested shareholders will vote on the proposal. A whitewash waiver relating to on market share repurchases would necessarily relate to a period during which circumstances could change fundamentally.

Question 18 Should the Codes be amended to provide for whitewash waivers of general offer obligations triggered as a result of on-market share repurchases and if so, do the provisions set out below provide sufficient safeguards for shareholders?

HKICPA'S COMMENTS

We are of the opinion that the Codes should not be amended to provide for whitewash waivers of general offer obligations triggered as a result of on-market share repurchases.

Questions 19 to 31

If Rule 32 were to be extended to cover on-market repurchases the Executive would recommend the safeguards set out below.

Application of Rule 3.5 - Rule 3.5 of the Takeovers Code, which sets out the disclosure requirements for an announcement of a firm intention to make an offer, also applies to whitewash waivers. The Executive recommends that Rule 3.5 should be amended to require disclosure of the following:

- reasons for the share repurchase mandate;
- benefits to the company;
- maximum number of shares to be repurchased;
- conditions of the mandate;
- details of how the repurchase will be financed;
- based on latest published financial information, impact on the company's
- financial position: earnings per share, net assets per share, working
- capital and liabilities if the mandate is fully utilised and a statement by the directors that the company's financial position and operations will not be adversely affected;
- impact on shareholders' percentage shareholdings;
- details of dealings in securities of the company by the person seeking the whitewash waiver and parties acting in concert with him during the 6 months prior to the date on which the board resolves to put the mandate to shareholders for approval, or a negative statement.

Question 19 *Do you agree that Rule 3.5 should be amended as proposed? Is there any additional information that should be included in the Rule 3.5 announcement?*

Conditions of the proposal – The whitewash should be conditional on approval by independent shareholders and on prior consent by the Executive. Independent shareholders would be those shareholders who are not involved in, or interested in, the repurchase mandate. The following persons would not be considered as independent:

- the person seeking the whitewash waiver and parties acting in concert with him;
- directors of the company (other than independent non-executive directors who would still need to satisfy the independence test under Rule 2) and their associates; and
- associates of the company.

Question 20 *Do you agree that the relevant whitewash should be subject to independent shareholders' approval and the Executive's consent as described above?*

Whitewash circular – As in the case of all whitewash waivers under the Codes, the circular to shareholders must comply with the disclosure requirements under Schedule VI of the Codes. In addition the Executive recommends that the Codes be amended to require disclosure of the following information:

- Confirmation by the directors that the repurchase mandate, if fully utilised, will not result in the failure of the company to meet the public float requirement under the

Listing Rules if the company is listed in Hong Kong.

- Paragraph 7 of Schedule III – the effect on percentage shareholdings of shareholders if the mandate is fully utilised.
- Paragraph 11 of Schedule III – consideration – price range restrictions (see paragraph 131 below).
- Paragraph 20 of Schedule III – the effect of the mandate on the company's earnings per share, net assets per share, liabilities and working capital, and a statement that the financial position and operations of the company will not be adversely affected.
- Paragraph 24 of Schedule III – details of any capital re-organisation of the offeree during the 2 financial years preceding the announcement of the proposal.
- Paragraph 25 of Schedule III (and Explanatory Statement) – details of repurchases by the company in the 12 months preceding the date of the document.
- Paragraph 26 of Schedule III – details of shares issued in the 2 years preceding the date of the document.
- Paragraph 27 of Schedule III – details of dividends or other distributions in the past 2 years and any plans or intentions to declare a dividend or alter a dividend policy.

Question 21 *Do you agree with the additional disclosure requirements set out above? Is there any additional information that should be included in the circular?*

Shareholders meeting, voting and maximum period during which the company can carry out on-market repurchases - The Executive believes that any general meeting convened to obtain shareholders' approval should be separated (by at least one day) from the annual general meeting of the company. The purpose of this is to segregate this special business from the more routine matters normally considered at annual general meetings. The vote at any such meeting should be conducted by poll and the results of the poll announced in accordance with Rule 2.9 of the Takeovers Code.

Question 22 *Do you agree with the above proposals concerning shareholders meetings and announcement of the results?*

Question 23 *What is the appropriate threshold for shareholder approval? (i) 50% (ii) 75% or (iii) 75% but not voted against by more than 10% of all independent shareholders?*

It has been proposed that on-market share repurchase whitewash waivers should be valid for 12 months, renewable each year. The Executive believes that a validity of 3 months would be more appropriate to increase certainty for shareholders. The Executive also recommends that a company should not propose another on-market share repurchase whitewash waiver within 6 months of the end of the last whitewash period.

Question 24 *What should be the appropriate maximum period for a waiver of the obligation triggered by on-market share repurchases? 1 month? 3 months? or 6 months?*

Restrictions on repurchases by the company – The Executive believes that the total number of shares that can be repurchased in any whitewash period should be restricted. Rule 10.06(1)(c) of the Listing Rules already prohibits a company from repurchasing more than 10% of its shares under a shareholders' repurchase mandate.

Question 25 *What do you consider to be an appropriate level of restriction? 3%? 5%? or 10%?*

Price – The Executive recommends a price limit at which share repurchases under a whitewash waiver could be made. The Executive believes that an appropriate level would be not higher than 5% or more than the average closing market price for the 5 trading days on which the shares were traded on the Stock Exchange preceding the date of the Rule 3.5 announcement (this is consistent with the price restrictions in Rule 10.06(2)(a) of the Listing Rules).

The Executive also proposes that the consideration should only be in cash.

Question 26 *What do you consider to be the appropriate price restrictions for repurchases under a whitewash waiver?*

Question 27 *Do you agree that the consideration should only be in cash?*

Disqualifying transactions – The Executive would like to consult the public about the extent to which the company should be restricted from carrying out any repurchases during the period between the announcement of the proposals and the shareholders' meeting. There are a number of options:

- **Option 1** - Any repurchase by the company during the period between the announcement of the proposals and the shareholders' meeting would be deemed a disqualifying transaction for the whitewash waiver.
- **Option 2** – The company would be free to repurchase shares during the period between the announcement of the proposals and the posting of the whitewash circular subject to full disclosure of any repurchases being made in the circular. Thereafter further repurchases would not be allowed in the period between the posting of the whitewash circular and the shareholders' meeting.
- **Option 3** – There should be no restrictions on the company repurchasing its shares during the period between the announcement of the proposals and the shareholders' meeting subject to the restrictions in paragraphs 3(a) and 3(b) of Schedule VI of the Codes.

Question 28 *Do you agree with any of the options set out above? Please give reasons for your response.*

Restrictions on dealings by the person seeking whitewash waiver and parties acting in concert with him – The disqualifying transaction provisions in paragraphs 3(a) and 3(b) of the Whitewash Guidance Note in Schedule VI would apply.

Restrictions on dealings by directors and persons acting in concert with them – Rule 10.06(2)(c) of the Listing Rules provides that a company shall not knowingly purchase its shares from a connected person and a connected person shall not knowingly sell shares to the company. The Executive believes that this restriction should be extended to directors and persons acting in concert with them (as defined in the Codes) during the period from the date of the Rule 3.5 announcement to the end of the whitewash period.

Question 29 *Do you agree with extending the restrictions on dealings to directors and persons acting in concert with them?*

Subsequent issue of new shares following announcement of the whitewash period – The Executive recommends extending the restriction from the date of the Rule 3.5 announcement to the end of the mandate period – in our recommendation, 3 months. There is a similar restriction in Rule 10.06(3) of the Listing Rules. This prohibits without Exchange approval the issue of new shares, or the announcement of a proposal to issue new shares, for a period of 30 days after any repurchase other than pursuant to the exercise of warrants, share options or similar instruments, which were outstanding prior to that repurchase.

Question 30 *Do you agree that the restriction on new share issues should apply from the date of the Rule 3.5 announcement to the end of the mandate period?*

Announcement at the end of the whitewash period or when the maximum number of shares have been repurchased – The Executive recommends that the company should publish an announcement with the following information on the next business day after the whitewash period, or if earlier when the maximum number of shares under the whitewash have been repurchased:

- Aggregate number of shares repurchased.
- Highest and lowest price paid.
- Weighted average price paid.
- Total consideration paid (excluding commissions, levy and charges).
- Issued share capital as at the date of the announcement and any changes since the date of the whitewash circular.
- Shareholdings of the directors and the person who obtained the whitewash waiver, as well as parties acting in concert with him.

Question 31 *Do you agree with the proposed contents of an announcement at the end of the whitewash period or when the maximum number of shares have been repurchased?*

HKICPA'S COMMENTS

As we do not agree with the proposal in Question 18 that the Codes should be amended to provide for whitewash waivers of general offer obligations triggered as a result of on-market share repurchases, we do not comment on the proposals in Questions 19 to 31.

Questions 32 and 33

The Telecommunications Authority ("TA")

Proposals for changes to the Takeovers Code - In view of the possible impact of the new law on a number of Hong Kong companies the Executive recommends amending the Takeovers Code to provide a framework for dealing with TA reviews. The Executive proposes two options for change (see below) on which it would like to consult.

Option 1 proposes that the Takeovers Code is amended to provide for the extension of "Day 39" (the latest date for announcement of new information by the offeree company) following any final decision of the TA. Option 1 includes a provision that if any such extension were to exceed 3 months after posting of the offer document, the Executive should be consulted to determine whether the offer should lapse and if so, which provisions of the Takeovers Code would continue to apply.

The Executive favours Option 1 given that Stage 2 investigations by the TA are likely to be significantly shorter than Phase 2 investigations in Europe. In reaching this view the Executive has taken into account the TA's indications of the one month (Stage 1) plus two months (Stage 2) timeframe for its reviews. It appears from the Guidelines that TA reviews lasting 3 months or more will be rare.

One consequence of Option 1 is that, in the case of a hostile bid, a significant delay of "Day 39" (and hence "Day 46" and "Day 60") may give rise to disputes between the offeree board and offeror. Option 1 gives the Executive flexibility in dealing with any dispute.

Option 2 closely follows the rules in the London Takeover Code relating to a "*competition reference period*". These rules have been drafted in the context of the UK market where hostile bids are relatively common.

Option 2 proposes that Rule 12 of the London Takeover Code be adopted so that an offer would lapse on the commencement of a Stage 2 review by the TA. Thereafter the offeror would be under no obligation to reinstate the offer after the TA issues his final decision (even if that decision were favourable to the offeror). The Executive is however doubtful whether Option 2 is necessary in Hong Kong given the relatively short expected duration of Stage 2 investigations by the TA in comparison to Phase 2 investigations in the UK and Europe. Option 2 also raises concerns under Rule 30. This provides that there should not be any subjective conditions to an offer and that an offeror should not invoke a condition unless it is of material significance to the offeror.

Rule 26.2 does not allow a mandatory offer to be subject to any conditions other than the 50% acceptance condition. It should therefore be made clear in Rule 26.2(b) that no acquisition of voting rights which triggers a mandatory offer can be completed before obtaining any necessary consent from the TA, if the acquisition or mandatory offer will result in a "*change*" within the meaning of section 7P(16) of the TO. Effectively this means that issues under this section of the TO would need to be resolved with the TA before a mandatory bid is triggered through the acquisition of voting rights – possibly during a pre-conditional or possible offer stage.

The Executive would like to consult the public on Option 1 and Option 2 as set out below.

Option 1 – This option recommends adopting an equivalent provision to Note 3 on Rule 31.6 of the London Takeover Code by extending "Day 39" following any final decision of the TA. The Takeovers Code would also be amended to provide that if an extension is likely to exceed more than 3 months after posting of the offer document, the Executive should be consulted to determine whether the offer should lapse and if so, which provisions of the Takeovers Code will continue to apply after the lapsing of the offer. In considering such issues the Executive would normally apply the relevant principles of the London Takeover Code. This option would not involve a concept similar to the "*competition reference period*" in the London Takeover Code. The proposed amendments under Option 1 are set out below and in **Appendix 1** to this paper.

Question 32 *Should the Takeovers Code be amended as proposed in Option 1?*

Add definition of "**TA**":

*"**TA**: means the Telecommunications Authority appointed under section 5 of the Telecommunications Ordinance (Cap. 106)."*

Add a new Note 3 to Rule 15.5 to reflect Note 3 on Rule 31.6 of the London Takeover Code:

"3. TA decisions

If there is a delay in a decision of the TA under section 7P of the Telecommunications Ordinance (Cap. 106) after posting of the offer document, the Executive will normally extend "Day 39" (see Rule 15.4) to the second day following the announcement of such decision with consequent changes to "Day 46" (see Rule 16.1) and "Day 60". If there is a significant delay or there is an appeal against the TA's decision whereby the extended "Day 39" under this Note 3 is likely to be more than 3 months from the posting of the offer document, the Executive should be consulted to determine whether the offer should lapse and to what extent the relevant provisions of the Takeovers Code will continue to apply after lapsing of the offer."

Further, add a new Note 4 to Rule 26.2:

"4. TA consent

No acquisition of voting rights which would give rise to a requirement for an offer under this Rule 26 may be made if such acquisition or offer may result in a "change" in relation to a carrier licence within the meaning of section 7P(16) of the Telecommunications Ordinance (Cap. 106). The restrictions in Rule 26.2 mean that the offeror cannot make the offer conditional upon any TA decision. A potential offeror under this Rule 26 must seek consent of the TA under section 7P(6) of the Telecommunications Ordinance before he triggers an obligation to make a general offer under Rule 26.1.

If an offeror triggers a mandatory offer without obtaining the TA's consent he will be in breach of this Note 4 and subject to possible disciplinary action."

Option 2 - With regard to a one month Stage 1 investigation by the TA, this option proposes that any timetable issues would be addressed under a new Note 3 to Rule 15.5. This would follow Note 3 on Rule 31.6 of the London Takeover Code (by extending "Day 39" to the second day following the TA's announcement that he will not commence a detailed investigation).

For Stage 2 investigations, this option proposes introducing a "TA review period" which would be similar to a "*competition reference period*" under the London Takeover Code. A "TA review period" would commence after an announcement of a detailed Stage 2 investigation by the TA (the TA has stated that he will issue his final decision in such investigations within 3 months of receiving the application for consent). If a Stage 2 investigation were to commence the offer would lapse in accordance with a new Rule 37 (as is the position under Rule 12 of the London Takeover Code). Rules that would continue to apply during a TA review period are set out in detail below together with the proposed amendments under Option 2. Please note the changes proposed in Option 2 are not set out in **Appendix 1** to this paper.

Question 33 *Should the Takeovers Code be amended as proposed in Option 2?*

HKICPA'S COMMENTS

None.

Question 34

Requisitioning shareholders meetings after an offer

In a recent hostile takeover difficulties arose when the incumbent offeree board took deliberate action to delay convening a general meeting to reconstitute the board after receipt of a valid requisition by the successful offeror (following the offeror's acquisition of 50% of voting rights in the offeree and the offer being declared unconditional). Whilst the board's action did not breach the laws of the country of incorporation (in this case Bermuda) it effectively prevented the incoming controlling shareholder from exercising its rights of control.

Under Bermuda and Hong Kong law shareholders holding not less than 10% of the voting rights of a company may requisition a general meeting of shareholders. However the timing requirements differ.

Under both Hong Kong and Bermuda law directors must convene a meeting within 21 days of the deposit of a shareholders' requisition. Under Hong Kong law the directors must hold the meeting within 28 days of the convening notice. If the directors fail to hold a meeting within 28 days, the requisitionists may exercise a right themselves to hold a meeting. UK law contains similar provisions.

However under Bermuda law there appears to be no similar time limit for directors to hold the meeting after they have issued the convening notice.

The Codes do not regulate how and when a successful offeror takes control of the board following the acquisition of statutory control. Generally any issues that arise concerning the bona fides of the incumbent board are principally a matter between the directors and the successful offeror (and ultimately the courts). However the Executive is also mindful of the risks to shareholders arising from an incumbent board taking deliberate lawful action (e.g. issuing new shares or taking other action to reduce the overall value of the company) to frustrate the exercise of board control by a successful offeror. In a recent case the hostile bidder had to keep its unconditional offer open until it gained board control (so that the restrictions under Rule 4 would continue to apply to the offeree company). This was clearly unsatisfactory.

The Executive would like to consult the public on the following options:

- **Option 1** – the Codes would be amended to provide that after the offer has become or is declared unconditional in all respects the offeree board must extend the fullest cooperation to the successful offeror.
- **Option 2** – the Codes would be amended to provide that the offeree company board must not, without shareholder approval or the offeror's consent, take or agree to take any action listed in paragraphs (a) to (e) of Rule 4 during the period after the offer has become or is declared unconditional in all respects up to the day of any general meeting at which the shareholders' vote on resolution(s) proposed by the offeror for the purpose of securing control of the board of the offeree company.

Question 34 Do you agree with Option 1 or Option 2? Please give reasons for your response.

HKICPA'S COMMENTS

We support Option 2 as it is more specific.

PARAGRAPH 20 OF THE CONSULTATION PAPER (NOT RELATED TO ANY SPECIFIC QUESTIONS)

Rule 1 (approach) and Rule 1.1 (offer to the board)

Rule 1.1 provides that any offer should be put forward to the board of the offeree company before it is announced to the public. It has been suggested that this requirement should also apply to a revision and withdrawal of an offer. The Executive supports this proposal as it encourages transparency and may assist in preventing a false market. It is therefore proposed that Rule 1.1 be amended as follows:

"1.1 Offer to the board

Any offer, revision or withdrawal of an offer, should be put forward in the first instance to the board of the offeree company or its advisers, before it is announced to the public."

HKICPA'S COMMENTS

We support the proposed changes but question why the proposal will encourage transparency.