Hogan Lovells

Privatization of companies listed in Hong Kong

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This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

Introduction

Recently, there has been an increasing trend of Hong Kong public companies choosing to privatize. Some of these companies were trading at a substantial discount to net asset value with low liquidity, making it difficult for them to raise new equity capital. In this context, they may find that the administrative costs and management resources associated with maintaining the listing status are no longer warranted, leading to the decision to return the company into private hands with the belief that it would better ensure its future growth.

This note examines, in outline, certain of the principal commercial and legal issues relating to privatization of companies listed in Hong Kong.

What is privatization

In this context, the term "privatization" refers to a party (the offeror) buying the shares held by the shareholders of a listed company and cancelling the listing status of the company. It is also known as a public to private transaction (PTP).

How to privatize a company listed on the Hong Kong Stock Exchange and what are the applicable laws and regulations

Methods of privatizations

Privatizations can be effected by either of the following methods:

- A voluntary general offer.
- A scheme of arrangement proposed by the listed company.

Applicable laws and regulations

Both privatization methods are subject to:

- The Hong Kong code on takeovers and mergers (the Takeovers Code).
- The rules governing listing of securities on The Stock Exchange of Hong Kong Limited (the Listing Rules)[i].

- The laws of the relevant listed company's place of incorporation.

The making of an offer to shareholders may also be subject to the local securities laws in the jurisdictions in which they are based, which can add additional complexities.

Privatization by way of a voluntary general offer

Announcement[ii]

It would be normal for a joint announcement to be made by the offeror and the listed company of the offeror's firm intention to make the voluntary offer to buy all the issued shares of the listed company (other than those shares held by the offeror and possibly persons acting in concert with it) under the Takeovers Code.

Prior to the announcement, a financial adviser needs to be appointed to confirm that the offeror has sufficient financial resources to complete the purchase of shares which give rise to the offer obligation.

Independent board committee and adviser

The directors of the listed company will establish a committee of disinterested directors to advise shareholders on the merits of the offer, and the independent committee will appoint an independent financial adviser to assess the merits of the offer.

Composite document

An offer document containing the terms of the offer and the other information required by the Takeovers Code[iii], accompanied by forms of acceptance, must be posted to the shareholders within 21 days (or, in the case of a securities exchange offer, 35 days) of the date of the announcement of the firm intention.[iv]

The response document from the listed company containing the views of the disinterested board members and the financial adviser to the board as to whether or not the offer is fair and reasonable and other information required by the Takeovers Code[v] must be posted within 14 days of the posting of the offer document.[vi]

In an agreed offer, it is common and encouraged to combine the offer document and response document in a composite document to be posted within the time limit for posting the offer document.[vii]

Consideration

The consideration can take any form, such as cash or other assets (e.g., shares in the offeror).

Except with the consent of the Securities and Futures Commission (SFC), if the offeror or any person acting in concert with it has purchased 10 percent or more of the listed company's shares for cash during the offer period and in the preceding six months, the offer must be in cash or have a cash alternative, and the offer price must not be less than the highest price paid for such shares during such period.[viii]

In general, the offer price may not be made at a price being more than a 50 percent discount to the lesser of (1) the closing price of the shares of the listed company on the day before the Rule 3.5 announcement and (2) the five-day average closing price before such day.[ix]

If the offeror or any person acting in concert with it has purchased 10 percent or more of the listed company's shares in exchange for securities during the offer period and in the preceding three months, such securities will normally be required to be offered to all other shareholders of the listed company.[x]

Conditions

The offer can be made subject to any conditions the offeror stipulates (unless it is a mandatory offer under Rule 26) provided that the conditions are not dependent on judgments by the offeror or the listed company whose fulfilment is at their respective discretions.[xi]

Unless the SFC agrees otherwise, a voluntary offer must be conditional on reaching at least 50 percent control of the listed company, and may be made conditional on acceptance level of shares carrying a higher percentage of voting rights.[xii] In the context of a privatization, the offer may be conditional on the offeror receiving valid acceptances for not less than 90 percent of the shares of the listed company to which the offer relates, but allowing the offeror to waive this requirement to a lower level during the course of the offer. This is the threshold percentage which must be reached before the procedure on compulsory acquisition of the remaining shares can be implemented under the companies ordinance (Cap. 622 of the Laws of Hong Kong, "Companies Ordinance") or the equivalent provisions of the laws of the listed company's place of incorporation.

Offer opens

When the shareholders of the listed company receive the offer document and the form of acceptance, they may decide whether or not to accept the offer.

The offer must remain open for a minimum of 21 days following the date of posting of the offer document.[xiii] Where a conditional offer becomes or is declared unconditional, the offer should remain open for acceptance for not less than 14 days.[xiv] This means that if the acceptance condition is satisfied at the end of the 21 day period, the first day for the offer to close is on the thirty-fifth day after the posting of the offer document.

Except with the consent of the SFC, an offer may not become or be declared unconditional, as to acceptances after 7.00 p.m., on the sixtieth day, after the day of posting of the offer document.[xv] It is important to note that if the threshold percentage for the exercise of the compulsory acquisition right cannot be reached on this sixtieth day, this means that the privatization effectively fails unless the offeror is prepared to accept minority shareholders.

During the course of an offer, the offeror may revise the terms of the offer to attract minority shareholders. A revised offer must be kept open for at least 14 days.[xvi] As the final day for an offer to become or be declared unconditional as to acceptances is on the sixtieth day, the last day for any revision of the offer would be on day 46.

Compulsory acquisition procedure

If the offeror acquires not less than 90 percent in value of the shares in the listed company "to which the offer relates" (i.e., the shares held by the shareholders other than the offeror or persons acting in concert with it) within four months of the commencement of the offer, the remaining shares may be acquired compulsorily by the offeror under section 695 of, and division four of part 13 of, the Companies Ordinance.[xvii]

Once the offeror has the right to compulsorily acquire the remaining shares, it may, within the earlier of the end of the period of (1) three months beginning on the day after the end of the offer period; and (2) six months beginning on the date of the offer, serve an acquisition notice on the remaining shareholders in a form prescribed by the Companies Ordinance.[xviii]

When the acquisition notice has been given, a dissenting shareholder has the right to apply to court, within two months from the date of the notice, for an order that the offeror shall not be entitled and bound to acquire the shares or specify terms of acquisition different from those of

the offer.[xix] The burden is on the dissenting shareholder to prove that the offer was not fair and should not be upheld.[xx]

After the expiry of this two-month period and assuming that the application (if any) is not upheld or no application to court has been made, instruments of transfer of the shares should be executed, on behalf of the minority shareholders who have received the acquisition notices, by a person appointed by the offeror, and the offeror should send a copy of all acquisition notices to the listed company and pay to the listed company the consideration for the acquisition of the remaining shares.[xxi] The consideration for the shares subject to the compulsory acquisition must be paid into a separate bank account and held by the listed company (usually through a registrar as agent of the listed company) on trust for the relevant minority shareholders.[xxii] The trust must continue for at least 12 years or until the listed company is wound up (whichever is earlier), during which reasonable enquiry must be made from time to time to locate the shareholders who are entitled to the consideration. If the shareholders cannot be located at the end of the period, the consideration must be paid to the court.

Privatization by way of a scheme of arrangement

What is a scheme of arrangement?

A scheme is a statutory procedure under section 673 of the Companies Ordinance (or the equivalent provisions of the laws of the listed company's place of incorporation) which allows the court to sanction a scheme of arrangement proposal put forward by a company to its shareholders. It usually involves the cancellation of all the issued shares (other than those shares held by the offeror) and the issue of new shares to the offeror. In return, the offeror will pay the consideration to the listed company's former shareholders.

Announcement and preparation of court documents[xxiii]

A joint announcement is made by the offeror and the listed company of the scheme.

To apply, the listed company must submit an originating summons[xxiv] to the court (with the scheme document and a supporting statement (affidavit) from a director of the listed company setting out the background) for directions to convene a meeting of the shareholders for approval of the scheme and to seek the sanction of the court to the scheme once it is approved by the shareholders. The court hearing should be scheduled to be held before the deadline for posting the scheme document (i.e., within 21 days from the date of the announcement or such longer period as approved by the SFC). The main purpose of this court hearing is to satisfy the court that all necessary or appropriate classes of holders of securities in the listed company have been recognized.

After the hearing, the court issues an order which usually appoints the chairman of the shareholders meeting and directs him to report the result of the vote to the court and to advertise the notice of the meeting. This shareholders meeting convened at the direction of the court is often called a "court meeting". Note that this is a shareholders meeting and is not a meeting among the judges or held before the court.

Scheme document

The time limit for the issue of an offer document applies to the issue of a scheme document. The SFC should be consulted if the time limit for posting of a scheme document needs to be extended to accommodate the court timetable.[xxv]

In addition to the information required for offer documents under the Takeovers Code, the scheme document has to contain an explanatory statement on the effect of the scheme.

Notice of the court meeting is advertised and contained in the scheme document.

Consideration

The consideration can take any form, such as cash or other assets (i.e., shares in the offeror).

Except with the consent of the SFC, if the offeror or any person acting in concert with it has purchased 10 percent or more of the listed company's shares for cash during the offer period and in the preceding six months, the offer must be in cash or have a cash alternative, and the offer price must not be less than the highest price paid for such shares during such period.[xxvi]

Court meeting

The approval threshold required for the court meeting is governed by section 674 of the Companies Ordinance (or the equivalent provisions of the laws of the relevant listed company's place of incorporation) and the Takeovers Code.[xxvii] In substance, at the court meeting of the shareholders of the listed company to approve the scheme, the scheme requires the approval by not less than 75 percent of the voting rights of the shareholders present and voting either in person or by proxy, provided that:

- The scheme is approved by disinterested shareholders holding at least 75 percent of the voting rights of the shares that are voted in person or by proxy on a poll.
- The scheme is not disapproved by disinterested shareholders at the meeting by way of poll holding more than 10 percent of the voting rights of all the shares held by the disinterested shareholders.

The offeror is, therefore, not entitled to vote on the resolution approving the scheme.

Reduction meeting

In a reduction scheme, all the shares in the listed company not already owned by the offeror are cancelled by a reduction of capital of the listed company. The offeror pays the consideration to the other shareholders in consideration for the cancellation of their shares, and the reserve created by the cancellation is capitalized and applied in paying up new shares which are issued by the listed company to the offeror. Unlike a transfer scheme under which the shares in the listed company are transferred to the offeror, a reduction scheme does not involve the transfer of shares in the listed company and, therefore, it is the more commonly used scheme since it avoids stamp duty.

As a reduction of capital is involved, it is necessary for a general meeting to be held to approve the reduction by a special resolution and to apply to court to confirm the reduction.[xxviii] This shareholders meeting to approve the capital reduction is often called a "reduction meeting".

If a reduction scheme is used, notice of the reduction meeting is often incorporated into the scheme document.

The court meeting and the reduction meeting are usually held on the same day, with the court meeting being held first.

Unlike the court meeting, the offeror can vote at the reduction meeting.

Court hearing to sanction the scheme

After the scheme has been approved by the disinterested shareholders at the court meeting, it must then be presented for sanction by the court.

The chairman of the court meeting reports to the court on the results of the meeting. The report includes the number of shareholders present in person or by proxy and the results of the voting. The report and a statement (affidavit) from the chairman as to services of notices of the court meeting are lodged with the court.

At the court hearing to sanction the scheme, the court needs to be satisfied that:

- The statutory provisions on the scheme have been complied with (e.g., proper notice of the court meeting and the explanatory statement have been given and the scheme has been approved by the relevant majority in voting rights).
- The class of shareholders was fairly represented by those attending the meeting and that the statutory majority acted bona fide.
- The approval of the scheme is reasonable, which means that an intelligent and honest man, a member of the class concerned and acting in respect of his interests, might reasonably approve it. The question is not whether the scheme is reasonable but whether a shareholder could have reasonably approved it.[xxix]

Once the court sanctions the scheme, a copy of the court order must be filed with the Registar of Companies and must be annexed to every copy of the company's memorandum and articles of association issued after the order has been made.[xxx] The scheme becomes effective and binding on all the shareholders only when the court order is registered with the Registrar of Companies.[xxxi]

Court hearing to confirm the capital reduction

The court hearing on the capital reduction is usually held together with the scheme hearing.

The court will not confirm a proposed capital reduction if:

- The interests of the company's creditors are adversely affected by the proposal.
- The necessary formalities have not been complied with or the reasons and implications of the proposed capital reduction have not been fully explained to the shareholders.

If the proposed capital reduction does not involve a repayment of capital or a reduction of liability in respect of unpaid capital, the court usually dispenses with an enquiry as to creditors on the basis that the creditors' position is protected.[xxxii]

Once the court confirms the capital reduction, a copy of the court order and the minutes approved by the court showing the share capital of the company as altered should be registered with the Registrar of Companies.[xxxiii] Upon registration of the court order and minute, the special resolution for reducing the share capital then takes effect.

What are the timetables

The timetables involved for privatizations by way of a voluntary general offer and a scheme are set out in Table 1 below.

Should a voluntary general offer or scheme be used to effect a privatization

The principal factors which should be considered in choosing a privatization option are outlined below.

Control of the process

In a voluntary general offer, the offeror controls the process and the offer does not require the support of the board of the listed company. In a scheme, the process is controlled by the listed company and its board. Therefore, a scheme cannot be used in a contested bid.

Acquisition of 100 percent of the listed company

Unless the offer is conditional upon acceptance of at least 90 percent of the shares to which the offer relates, it will not be certain that 100 percent ownership of the listed company can be achieved in a voluntary general offer. In a scheme, 100 percent ownership is an all-or-none guarantee.

Profile of shareholders

In order to acquire 100 percent ownership of the listed company, the offeror has to gauge acceptances of not less than 90 percent of the voting rights of the "shares to which the offer relates" in the offer. A scheme is subject to approval by (1) 75 percent of the voting rights of shares voted and (2) with no more than 10 percent of the voting rights of all the disinterested shares (not just those voted at the meeting) being voted against.

Accordingly, if the listed company has a number of shareholders who cannot be expected to take any action, shareholder inertia may be detrimental to the offeror to achieving the 90 percent threshold. On the other hand, shareholder inertia has a less detrimental effect on a scheme as only those disinterested shareholders who actually voted are taken into account in the above test, but not those entitled to vote.[xxxiv]

Timetable

In a voluntary general offer, the first closing date would be 21 days from the posting of the offer document. This is the earliest time that the offeror can obtain control over the listed company. However, it may take a maximum of four months from the commencement of the offer for the offeror to achieve the 90 percent threshold in order to trigger the compulsory acquisition procedure. Then, the offeror must wait at least two months from service of a notice to compulsorily acquire the minority's shares, as dissident minority shareholders in the listed company have the right, during such period, to apply to the court to object to their shares in the listed company being compulsorily acquired.

In a scheme, it takes a longer time to acquire control of the listed company, but when the scheme becomes effective the offeror has acquired 100 percent of the listed company. The time required for the offeror to acquire 100 percent control of the listed company in a scheme may likely be shorter than that required in an offer.

Stamp duty and legal fees

A scheme coupled with capital reduction does not involve transfers of shares. As such, no stamp duty is payable in such a scheme. Stamp duty at the rate of 0.2 percent is payable on the transfer of shares under a voluntary general offer. Legal fees are higher in a scheme than in a voluntary general offer because a scheme involves various court hearings and shareholders meetings. However, the stamp duty saving in a scheme may outweigh the disadvantage on the increase in legal fees.

Flexibilities

In a voluntary general offer, once an offer has been made, it is comparatively easy for the offeror to revise the terms of the offer and for a revised offer document to be despatched to the shareholders of the listed company.

In a scheme, if the scheme document containing the terms of the scheme has been posted and it then becomes necessary to revise the scheme, it would be necessary to re-start the timetable from posting, obtain court's permission to post new documents to shareholders and hold a fresh shareholders meeting of the listed company.

Financing

If financing is required, financing a scheme is relatively more straightforward than financing a voluntary general offer. Multiple drawings may be required to finance acceptances at different stages of the voluntary general offer while a term loan is drawn down in one lump sum after the scheme becomes effective.

Further information

If you would like further information on any aspect of privatization of companies listed in Hong Kong please contact a person mentioned below or the person with whom you usually deal.

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[i] A listed company may voluntarily withdraw its listing on the Hong Kong Stock Exchange, irrespective of whether it has an alternative listing or not, if: (1) after a general offer a right to compulsory acquisition is exercised pursuant to applicable laws and regulations (the requirements of which are, where the listed company is not a company incorporated in Hong Kong, at least as onerous as those applicable if it were) resulting in the acquisition of all the listed securities of the listed company; or (2) the listed company is privatized by way of a scheme of arrangement or capital reorganization which is governed by the Takeovers Code and all the relevant requirements, including the shareholders' approval requirements, under the Takeovers Code have been complied with, and, in either case, it has given its shareholders notice of the proposed withdrawal of the listing by way of an announcement published in accordance with Rule 2.07C of the Listing Rules and the intention not to retain the company's listing on the Hong Kong Stock Exchange has been stated in a circular to shareholders. (Rule 6.15 of the Listing Rules)
[ii] Rule 3.5 of the Takeovers Code
[iii] Rule 8.3 of the Takeovers Code
[iv] Rule 8.2 of the Takeovers Code
[v] Rule 8.4 of the Takeovers Code
[vi] Rule 8.4 of the Takeovers Code
[vii] Rule 8.2 of the Takeovers Code
[viii] Rule 23.1 of the Takeovers Code
[ix] Note to the definition of "Offer " in the Takeovers Code
[x] Rule 23.2 of the Takeovers Code
[xi] Rule 30.1 of the Takeovers Code
[xii] Rule 30.2 of the Takeovers Code
[xiii] Rule 15.1 of the Takeovers Code
[xiv] Rule 15.3 of the Takeovers Code
[xv] Rule 15.5 of the Takeovers Code
[xvi] Rule 16.1 of the Takeovers Code
[xvii] The procedures and requirements on compulsory acquisition depend on the laws of the relevant listed company's place of incorporation. There are differences between them. Overseas legal advice should be sought if the listed company was not incorporated in Hong Kong. See also Rule 2.11 of the Takeovers Code
[xviii] Section 694(1) of the Companies Ordinance
[xix] Section 695(3) of the Companies Ordinance
[xx] Re Chez Nico (Restaurantes) Ltd [1991] BCC 736
[xxi] Section 696(3) of the Companies Ordinance
[xxii] Section 698 of the Companies Ordinance
[xxiii] Rule 3.5 of the Takeovers Code
[xxiv] Section 670 of the Companies Ordinance and O102 r5(1)(h) of the Rules of the High Court
[xxv] Note 1 to Rule 8.2 of the Takeovers Code
[xxvi] Rule 23.1 of the Takeovers Code
[xxvii] Rule 2.10 of the Takeovers Code
[xxviii] Section 226 of the Companies Ordinance
[xxix] Re Anglo-Continental Supply Co Ltd [1922] 2 Ch 723; Re Dorman Long & Co. Limited [1934] 1 Ch 635
[xxx] Sections 673 and 677 of the Companies Ordinance
[xxxi] Sections 230 and 673 of the Companies Ordinance
[xxxii] Re Shaw Brothers (Hong Kong) [2009] HKEC 448; Re Cheung Kong (Holdings) Ltd [2015] 2 HKLRD 512
[xxxiii] Section 230 of the Companies Ordinance
[xxxiv]

Date	Voluntary general offer	Scheme
D - 21	Announce offer	Announce scheme
Between D – 21 and D	-	Hearing of originating summons seeking directions for convening court meeting

D	Post offer document	Post scheme document
D + 21	First closing date	-
D + 22	If offeror has satisfied the 90 percent threshold on D + 21, it can start the compulsory acquisition procedure and the earliest time for completion is on Day + 82	-
D + 24	-	Court and reduction meetings
D + 25	-	File petition with court on capital reduction
D + 35	First day for offer to close if offer is unconditional on D + 21	-
Between D + 25 and D + 39	-	Hearing of petition
D + 40	-	Court sanctions scheme and confirms capital reduction
D + 41	-	Filing of court orders, acquisition of 100 percent control
D + 60	Last day for fulfilment of acceptance condition	-
D + 81	Last day for fulfilment of conditions (other than the acceptance condition)	
D + 120	Compulsory acquisition completed if the 90 percent threshold is satisfied on D + 60	-

Table 1: Indicative timetables involved for privatizations by way of a voluntary general offer and a scheme.