

Hong Kong Securities and Futures Commission Proposes Raising Whitewash Approval Threshold



IN SHORT

The Situation: The high level of certainty of obtaining shareholders' approval for whitewash waivers could lead to potential abuse by parties looking to obtain or consolidate control through whitewash transactions in Hong Kong.

The Development: The Securities and Futures Commission in Hong Kong proposes an increase in the voting approval threshold for whitewash waivers and the underlying transactions from simple majority to 75 percent of votes from independent shareholders.

Looking Ahead: The proposals, if adopted, would act as an additional safeguard for dissenting minority shareholders.

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On January 19, 2018, the Hong Kong Securities and Futures Commission ("SFC") published a Consultation Paper to invite comments from the public on proposed amendments to the Codes on Takeovers and Mergers and Share Buy-Backs ("Codes"). The consultation will last for three months, until April 19, 2018.

Hong Kong Securities and Futures Commission

Proposed Amendments to Codes on Takeovers, Mergers and Share Buy-Backs

The proposals put forward by the Consultation Paper include, among other matters:

Voting Approval Threshold for Whitewash Waivers	Raising the voting approval threshold for whitewash waivers and the underlying transactions from a simple majority of independent votes to 75 percent and introducing an explicit requirement to require separate resolutions to be put to independent shareholders for the whitewash waiver and the underlying transaction(s).
Dealings with the Executive, Panel, and Takeovers Appeal Committee	Clarifying the obligations of parties when dealing with the Executive, Panel, and Takeovers Appeal Committee.
Compliance Rulings	Clarifying the Executive's and the Panel's existing power to make compliance rulings as preemptive measures to prevent breaches of the Codes.
Compensation Rulings	Providing the Panel with the power to require a person found to be in breach of certain obligations related to making an offer on terms prescribed by the Codes to pay compensation and provide financial redress to shareholders.
Approval by Delistings by Independent Shareholders	Introducing measures to protect minority shareholders of companies incorporated in jurisdictions with no compulsory acquisition rights to be delisted in Hong Kong through a general offer.
Definition and Use of the Term "Associate"	Amending the definition of "associate" to eliminate overlap and potential inconsistencies that arise out of the similarities between the definition of "associate" and the definition of "acting in concert".
Disclosure of Number of, Holdings of, and Dealings in Relevant Securities	Clarifying the scope of disclosure of holdings and dealings in relevant securities, in particular where the offeror is offering securities of another company as consideration in an offer, and relaxing the timing of dealing disclosures.
Miscellaneous Amendments	Codifying existing practice and effecting a number of "housekeeping" amendments.



The rationale behind the whitewash waiver dispensation is that independent shareholders can act as a "gatekeeper" because they are given an opportunity to approve or reject a change or consolidation of control of the company.



Whitewash Waivers

Background. Rule 26.1 of the Takeovers Code prescribes that in the event of a change of control of a company to which the Codes apply, an obligation to a mandatory general offer arises.

Note 1 on dispensations from Rule 26 of the Takeovers Code provides that the Executive may waive an obligation to make a general offer ("whitewash waiver") in a comparatively narrow set of circumstances: the issue of new securities as consideration for an acquisition, or a cash subscription, or the taking of a scrip dividend, or in cases involving the underwriting of an issue of shares, provided that there is an independent vote at a shareholders' meeting. "Independent vote" means a vote by shareholders who are not involved or interested in the transaction in question.

Increasing the Voting Approval Threshold. The rationale behind the whitewash waiver dispensation is that independent shareholders can act as a "gatekeeper" because they are given an opportunity to approve or reject a change or consolidation of control of the company. However, the SFC notes that whitewash waivers have been viewed as "inevitable": between 2015 and 2017, all of the whitewash transactions (more than 90 cases) voted on by shareholders were approved. This might be due to a lack of awareness or incentive for the shareholders to vote, and the problem may be exacerbated by "warehousing" of shares with friendly parties. In addition, the high level of certainty of obtaining the requisite shareholders' approval for whitewash waivers could lead to abuse by persons looking to consolidate or obtain control in a company.

Accordingly, the SFC is seeking the market's views on whether the approval voting threshold for a whitewash waiver proposal should be increased from a simple majority to 75 percent of the independent shareholders.

Separate Resolutions for Whitewash Waiver and the Underlying Transaction. Although the Executive has the power not to grant a whitewash waiver under the Takeovers Code, the SFC is concerned that the high level of certainty of obtaining sufficient votes from shareholders could lead to abuse. In cases where securities are issued at a substantial discount, even if the whitewash waiver applicant fails to obtain a whitewash waiver, provided that the whitewash waiver condition is waivable, it can still proceed with the underlying transaction with a general offer at a heavily discounted offer price, which would be unlikely to attract acceptances from existing shareholders.

As such, the SFC proposes that in a whitewash transaction, separate resolutions should be put to the shareholders to approve the whitewash waiver and the underlying transaction—each subject to a 75 percent voting approval threshold.

Other Key Proposals

Dealings with the Executive, Panel, and Takeovers Appeal Committee. The Consultation Paper notes that in a number of recent cases, parties dealing with the Executive have not conducted themselves in an open and cooperative manner. The SFC has therefore proposed amendments to the Codes requiring prompt cooperation and assistance from persons dealing with the Executive and those to whom enquiries and other requests are directed, and they must provide true, accurate, and complete information (including subsequent corrective or new information) to the Executive.

Compensation Rulings. Currently, the Codes do not provide explicit power to the Panel to require persons who have not complied with the Codes to pay compensation to shareholders.

The Consultation Paper proposes the Panel be afforded with the power to make compensation rulings, requiring parties who are in breach of obligations to make an offer on terms prescribed by the Codes to pay compensation (as the Panel considers just and reasonable, together with interest where applicable) to shareholders who should have received an offer at the time the obligation was triggered.

Tightened Regulatory Approach

The Consultation Paper demonstrates the SFC's response to recent market concerns over whitewash transactions that have steep discounts and substantial dilutive effects on the shareholding of listed companies, and the problem of "warehousing" of shares by parties who seek to obtain or consolidate control in listed issuers. This echoes the consultation paper on "Capital Raisings by Listed Issuers" issued by The Stock Exchange of Hong Kong Limited on September 22, 2017, in which the SFC was invited to look into similar matters.

THREE KEY TAKEAWAYS

1. Voting approval threshold for whitewash waivers and the underlying transactions are proposed to be raised from a simple majority of independent votes to 75 percent.
2. It is proposed that separate resolutions be put to

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independent shareholders for the whitewash waiver and the underlying transaction in question.

3. Hong Kong regulatory authorities are taking steps to address market concerns over whitewash transactions, change of control, and fund-raising activities of listed companies.



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