

PART 13

ARRANGEMENTS, AMALGAMATION, AND COMPULSORY SHARE ACQUISITION IN TAKEOVER AND SHARE BUY-BACK

Introduction

1. Part 13 basically restates the provisions with some proposed amendments concerning schemes of arrangement with creditors or members, reorganisations of share capital of a company, and reconstructions or amalgamations of a company with other companies. The relevant provisions are currently found in sections 166, 166A, 167, 168, 168B and the Ninth and Thirteenth Schedules¹ of the CO.
2. Based on the recommendation of the SCCLR and the feedback from the public consultation conducted in June to September 2008, we will introduce a court free statutory amalgamation procedure whereby wholly-owned intra-group companies would be allowed to amalgamate and continue as one of the amalgamating companies without the need for any court sanction.
3. On the review of the “headcount” test under section 166(2) of the CO which was included in the First Phase Consultation Paper issued in December 2009, we are studying the feedback obtained during the consultation and will amend the relevant provisions in the CB, if necessary.

- The significant changes to be introduced under this Part are highlighted below:

Schemes of Arrangements, Takeovers and Share Buy-backs

- (a) **Extending the application of the provisions for facilitating reconstructions and amalgamations of companies currently under section 167 of the CO to cover companies liable to be wound up under the CO, which would include both Hong Kong and non-Hong Kong companies;**

¹ The Ninth Schedule deals with provisions relating to acquisition of minority shares after successful takeover offer. The Thirteenth Schedule covers provisions relating to acquisition of minority shares after successful buy out under a share buy-back.

- (b) Revising the definitions of “property” and “liabilities” currently under section 167(4) of the CO to include rights and duties respectively of a personal character or incapable under the general law of being assigned or performed vicariously;
- (c) Clarifying the meaning of a “takeover offer”, “shares already held by the offeror” and “shares to which the offer relates”;
- (d) Introducing new provisions to allow an offeror in a takeover offer or share buy-back offer who is unable to achieve the necessary squeeze out threshold because of untraceable shareholders related to the offer, to apply to court for an authorization to give squeeze out notices;
- (e) Introducing new provisions to allow a revised offer to be treated as the original offer so long as certain specified conditions are met;

Court-free Statutory Amalgamation Procedure

- (f) Introducing a new court-free statutory amalgamation procedure for wholly-owned intra-group companies.

Significant Changes

Schemes of Arrangements, Takeovers and Share Buy-backs

- (a) **Extending the scope of section 167 of the CO to cover companies liable to be wound up under the CO**

Background

4. Section 167 of the CO, which provides for the sanctioning of a scheme of compromise or arrangement by the court initiated under section 166, does not apply to a company other than one formed and registered under the CO or the preceding Companies Ordinances. This is contrary to the provision of section 166(5) and 166A where the expression “company” means any company liable to be wound up under the CO which in effect includes a non-Hong Kong company.

Proposal

5. **Clauses 13.3 to 13.10** restate the provisions under sections 166, 166A and 167 of the CO. **Clause 13.3(1)** defines a company for the purpose of these clauses as a company liable to be wound up under the Companies (Winding-up Provisions) Ordinance (Cap 32)² thereby removing the difference in the categories of companies currently covered under section 166, 166A and 167 of the CO.
- (b) **Revising the definition of “property” and “liabilities” currently under section 167(4) of the CO**

Background

6. The expression “property” is defined in section 167(4) of the CO as including “property, rights and powers of every description”, and the expression “liabilities” as including “duties”. Based on the court’s views in decided cases, a transfer order made under section 167 to facilitate reconstructions and amalgamations of companies is unable to operate to transfer a contract of personal service. As a result, contracts of employment are not transferable under the section.
7. We propose to follow the ACA where “property” and “liabilities” are defined to include rights and duties respectively of a personal character or incapable under the general law of being assigned or performed vicariously (i.e. in substitution for another person). This will enable personal rights and duties, which could not have been transferred or assigned unless with the consent of the parties concerned, to be transferred or assigned once a transfer order is made.

Proposal

8. **Clause 13.9** restates section 167 of the CO. **Clause 13.9(8)** redefines “property” as including:
 - (a) rights and powers of a personal character and incapable of being assigned or performed vicariously under the law; and

² Provisional title of Cap 32 after it is consequently amended by the new Companies Ordinance. It is subject to change.

(b) rights and powers of any other description.

and “liabilities” as including:

(a) duties of a personal character and incapable of being assigned or performed vicariously under the law; and

(b) duties of any other description.

(c) **Clarifying the meaning of “takeover offer”, “shares already held by the offeror” and “shares to which the offer relates” in a takeover**

Background

9. Section 168 of the CO, together with the Ninth Schedule, deal with the compulsory acquisition of shares following a takeover. Section 168 applies, inter alia, where a company makes an offer to acquire all the shares not already held by it in another company on terms which are the same in relation to all the shares to which the offer relates. There are no clear definitions of what would constitute “shares already held by an offeror” and “shares to which the offer relates”. For the sake of clarity, we consider that these terms should be clearly defined.

Proposal

10. **Clause 13.22(1)** defines what constitutes a takeover offer. First, it must be an offer to acquire all the shares (or shares of any class) in the company except those that, at the date of the offer, are held by the offeror. Secondly, in relation to all the shares to which the offer relates (or all the shares of the class to which the offer relates), the terms of the offer must be the same.

11. **Clause 13.22(3)** defines “shares that are held by an offeror” as including shares that the offeror has contracted, unconditionally or conditionally to acquire, but excluding shares that are subject to a contract which is:

(a) intended to secure that the holder of the shares will accept the offer when it is made; and

(b) entered into for no consideration by deed, for consideration of negligible value, or for consideration consisting of a promise by the offeror to make the offer.

12. **Clauses 13.22 and 13.24** clarify that shares to which a takeover offer relates may include:
- (a) shares that are allotted after the date of the offer but before a date specified in the offer (**Clause 13.22(6)**);
 - (b) shares which the offeror acquires or contracted to acquire other than by virtue of acceptances of the offer during the offer period unless the acquisition consideration exceeds the consideration specified in the terms of the offer (**Clause 13.24(2)**); and
 - (c) shares which a nominee or an associate of the offeror has contracted to acquire after a takeover offer is made but before the end of the offer period, unless the acquisition consideration exceeds the consideration specified in the offer (**Clause 13.24(4)**).
13. **Clauses 13.40(1), 13.40(3) and 13.42** contain similar provisions in relation to compulsory acquisition powers following a share buy-back offer.
- (d) **Introducing new provisions to allow an offeror in a takeover offer or share buy-back offer who was unable to achieve the necessary squeeze out threshold because of untraceable shareholders related to the offer to apply to court for an authorisation to give squeeze out notices**

Background

14. Under the CO, there is no mechanism for an offeror to apply for a court order authorising the giving of squeeze out notices for those takeover or buy-back offers which failed to achieve the applicable threshold for giving of such notices because of untraceable shareholders related to the offer. Such a mechanism has been included in the UK Companies Act since 1987 and is considered practical and useful.

Proposal

15. **Clauses 13.26(3) to (7)** introduce the mechanism mentioned in paragraph 14 above which will apply if the offeror has been unable to trace the relevant shareholders after reasonable enquiry. The consideration offered must be fair and reasonable and the court may not make an order unless it considers that it is just and equitable to do so having regard, in particular, to the

number of shareholders who have been traced but have not accepted the offer.

16. **Clauses 13.45(4) to (8)** provide a similar mechanism in the case of a share buy-back offer.
- (e) **Introducing new provisions to allow a revised offer to be treated as the original offer so long as certain specified conditions are met**

Background

17. At present, the CO does not have any provision on revised offers to provide for unexpected changes of circumstances after the making of an offer. As a result, an offeror who wishes to revise his offer will have to make a new takeover or share buy-back offer and address the acceptances received under the old offer. Both the UKCA 2006 and the SCA have provisions for a revised offer to be treated as the original offer as long as certain specified conditions are met. The ACA has specific provisions for variation of offers.

Proposal

18. **Clause 13.25** provides that a revision of the terms of a takeover offer is not regarded as the making of a fresh offer if:
 - (a) the terms of the offer provide for the revision and the acceptances on the previous terms to be regarded as acceptances on the revised terms;
and
 - (b) the revision is made in accordance with that provision.
19. **Clause 13.43** contains a similar provision in the case of a share buy-back offer.

Court-free Statutory Amalgamation Procedure

(f) **Introducing a new court-free statutory amalgamation procedure for wholly-owned companies which are within the same group**

Background

20. At present, companies intending to amalgamate have to resort to the procedures under sections 166 to 167 of the CO which require court sanction. In practice, sections 166 to 167 of the CO are rarely used. Apart from the complex procedure involved and high compliance costs, the court's restrictive approach in applying the provisions may also be a disincentive. Other comparable jurisdictions such as Singapore and New Zealand have provided a court-free regime in their company law.
21. In June 2008, we consulted the public whether a court-free amalgamation process along the lines of the Singaporean model with minor modifications should be introduced in Hong Kong³. While a majority of the respondents supported the introduction of a court-free procedure, some respondents raised a pertinent concern regarding the protection of the interests of minority shareholders and creditors. To minimise the risk that the new procedure may be abused, we consider it prudent to confine it only to amalgamations of wholly-owned intra-group companies where minority shareholders' interests would normally not be an issue⁴. The proposed procedure is modelled on the "short form amalgamation" procedure under sections 215D to 215J of the SCA and sections 222 to 226 of the NZCA.

Proposal

22. **Clauses 13.11 to 13.19** provide for a court-free statutory amalgamation procedure for wholly-owned intra-group companies limited by shares to amalgamate and continue as one of the amalgamating companies. The amalgamation may either be vertical (i.e. between the holding company and one or more of its wholly-owned subsidiaries) or horizontal (i.e. between two or more subsidiaries of the same holding company) (**Clauses 13.13(1) and 13.14(1)**).

³ See FSTB, *Consultation Paper on Share Capital, the Capital Maintenance Require, Statutory Amalgamation Procedure*, Chapter 4 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

⁴ See FSTB, *Consultation Conclusions on Share Capital, the Capital Maintenance Require, Statutory Amalgamation Procedure* (February 2009), paragraphs 55 to 56 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

23. The details of the procedure are:

- **Amalgamation Proposal**

Clauses 13.13(2) and 13.14(2) set out the terms and conditions of the amalgamation. No formal amalgamation proposal is required.

- **Directors' approval and solvency statements**

Clauses 13.13(2) and 13.14(2) provide that the board of each amalgamating company must make a statement to confirm that the assets of the amalgamating company is not subject to any charge of a floating nature⁵ and to verify the solvency of the amalgamating company as well as the amalgamated company. Details of the solvency statement are set out in **Clause 13.12**.

Clause 13.16(1) — every director who votes in favor of the making of the solvency statement must sign a certificate confirming that in his opinion, the amalgamating company and/or the amalgamated company satisfy the required solvency conditions.

- **Shareholders' approval**

Clauses 13.13(1), (3) and (4) and 13.14(1), (3) require that the amalgamation proposal be approved by the shareholders of each amalgamating company by special resolution.

- **Notice of amalgamation**

Clause 13.15(2) stipulates that the directors of each amalgamating company must give written notice of the proposed amalgamation to every secured creditor of the amalgamating company and to publish a newspaper notice of the proposal.

- **Registration of amalgamation**

Clause 13.17 requires that the amalgamation proposal, the directors' solvency statement, the certificate regarding the solvency statement, etc must be registered with the Registrar. As soon as practicable after the registration of the required documents, the Registrar shall issue a certificate of amalgamation.

⁵ Please see the last bullet point below.

- **Effect of amalgamation**

Clauses 13.18(1) and (2) state that the amalgamation shall take effect on the date shown in the certificate of amalgamation. Upon the amalgamation taking effect, each amalgamating company ceases to exist as an entity separate from the amalgamated company (**Clause 13.18(3)**). The amalgamated company succeeds to all the property rights and privileges and all the liabilities and obligations of each amalgamating company.

Clause 13.18(4) further sets out that on or after the effective date of an amalgamation, any proceedings pending by or against an amalgamating company may be continued by or against the amalgamated company. Any conviction, ruling, order or judgment in favour of or against an amalgamating company may be enforced by or against the amalgamated company.

- **Creditors' and shareholders' right to seek court relief**

Clause 13.19 provides that before the effective date of the amalgamation proposal, on application by a member or creditor of an amalgamating company, the court may disallow or modify the amalgamation proposal or give any directions, if it is satisfied that giving effect to the amalgamation proposal would unfairly prejudice a member or a creditor of an amalgamating company or a person to whom an amalgamating company is under an obligation. This is to protect the interests of the minority shareholders and creditors in the course of the amalgamation process.

- **Exclusion of companies with floating charges**

As the effect of amalgamation is that the amalgamated company takes the benefits and is subject to the liabilities of the amalgamating companies, this poses a problem when 2 or more of the amalgamating companies have floating charges subsisting over their respective assets in favour of different security holders. There will be a question of priorities between the competing security holders over the assets of the amalgamated company, which may result in unfairness between the security holders.

The problem will not be solved by providing that any floating charges will be deemed crystallized immediately before the coming into effect of the amalgamation proposal, as the question of the order of priority between crystallized former floating charges over the same assets still persists. Further, upon crystallization, the company will no longer be able to deal with the assets in the ordinary course of business without the consent of the chargee and this may have the effect of paralyzing the business of the company.

As the purpose of the proposal is to introduce a simple and less costly procedure for amalgamation, we therefore propose to exclude companies with floating charges from the proposal in order to keep the procedure simple and easy to implement.