Client Alert

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Hong Kong: To Vote or Not to Vote - Clarity on the Interpretation of Rule 2.10 of the Takeovers Code and the Constitution of Court Meetings for a Hong Kong Privatization Scheme of Arrangement

Re Chong Hing Bank Limited [2021] HKCFI 3091 and [2022] 1 HKC 377

In this issue

In brief

The Hong Kong court has delivered an important judgment on the interpretation of Rule 2.10 of the Takeovers Code and provided practical guidance on the types of court meeting that may be approved for privatisation of a Hong Kong incorporated company pursuant to a scheme of arrangement under the Companies Ordinance and the Takeovers Code. In view of the pandemic-related travel restrictions, the Court also directed a hybrid court meeting, allowing overseas shareholders to attend physically or online by way of electronic means. Parties which seek to use a scheme of arrangement to privatise a Hong Kong incorporated company should take heed of this decision when preparing the relevant documents.

Introduction

- On 23 September 2021, the High Court of Hong Kong ("**Court**") sanctioned the scheme of arrangement ("**Scheme**") for the privatisation of Chong Hing Bank Limited ("**Company**") by Yue Xiu Enterprises (Holdings) Limited ("**Offeror**"), by reason that the requirements under sections 673 and 674 of the Companies Ordinance (Cap. 622) (CO) and Rule 2.10 of The Code on Takeovers and Mergers ("**Takeovers Code**") were satisfied.[1]
- This case provided useful guidance and clarification on the interpretation of Rule 2.10 of the Takeovers Code in privatising a Hong Kong incorporated company by way of a scheme of arrangement and the proper constitution of a meeting of the shareholders subject to a scheme of arrangement approving the same at the direction of the Court ("**court meeting**").
- This case was also the first time in the context of a scheme of arrangement where the Court directed a **hybrid form** of a court meeting to allow overseas shareholders an option of attending and voting online through electronic means, ensure that they would not be deprived of the right to attend meetings because of the travel restrictions in Hong Kong due to the pandemic.

Background of the Scheme and Key Question

- Before the privatisation, the Offeror indirectly held about 75% of the shares of the Company. The remaining shares, which constituted the "**Scheme Shares**", were held by (a) the parties acting in concert with the Offeror (the "**Concert Parties**") and (b) other independent shareholders ("**Independent Shareholders**") (together, "**Scheme Shareholders**").

[1] The reasons for judgment was handed down on 18 October 2021. Baker & McKenzie advised Chong Hing Bank Limited in this case.

- The Company convened a meeting of the Scheme Shareholders to vote on the Scheme (the "**Court Meeting**") where the Concert Parties were excluded from **attending and voting** at such Meeting for the purpose of complying with Rule 2.10. The crux of the issue was whether the Court Meeting was regarded as duly convened under section 674(2)(a) of the CO and Rule 2.10. If so, the Court may then decide whether to sanction the Scheme.

Interpretation of Rule 2.10 and Constitution of Court Meeting

Legal Principles

- Section 674(2)(a) of CO requires the approval by a meeting of the scheme shareholders: (i) 75% or more of the voting rights of the **members present and voting at a court meeting** agree to the scheme, and (ii) the votes cast against the scheme at the court meeting do not exceed 10% of the total voting rights attached to all "disinterested shares" in the company (i.e., the Independent Shareholders in this case).
- Rule 2.10 of the Takeovers Code requires approval by a meeting of the **disinterested** scheme shareholders: (a) 75% or more of the votes attaching to **the disinterested shares cast at a duly convened meeting of the holders of the disinterested shares** agree to the scheme; and (b) the number of votes cast against the scheme at such meeting is not more than 10% of the votes attaching to all disinterested shares.

Interpretation of Rule 2.10

Position in *Re Cosmos Machinery Enterprises Ltd [2021] HKCFI 2088* ("Re Cosmos")

- In the recent judgment of *Re Cosmos*, the learned judge (in *obiter*) considered there are 2 alternative views on the meaning of Rule 2.10: (a) Rule 2.10 prohibits the offeror concert parties from **voting** entirely ("**Prohibition View**"); and (b) Rule 2.10 does not prohibit the offeror concert parties from voting as such, but **their votes cannot be counted** for the purposes of complying with the Takeovers Code ("**Non-Prohibition View**")
- The learned judge considered the Non-Prohibition View is correct: as a matter of scheme law, there must be a meeting of the scheme shareholders; if the concert parties are part of the scheme, they must be allowed to vote at such meeting. However, to comply with Rule 2.10, the concert parties' votes should not be counted.
- In light of the general and public importance of the issue, the Court invited the opinion of the Securities and Futures Commission (SFC) and appointed two *amici curiae* (Friends of the Court) to assist the Court on the interpretation of Rule 2.10.

Position of *amici curiae*

- By submission in Court, the *amici curiae* viewed that the Prohibition View is the correct position for reasons including the following:
    - The wording of Rule 2.10 clearly mandates a meeting (a) constituted only by holders of disinterested shares, and (b) at which only holders of disinterested shares are entitled **to attend and vote**; and
    - The Takeovers Code makes clear distinction between a meeting of holders of disinterested shares and general meeting of shareholders. Hence, the express reference to the "**holders of disinterested shares**" in Rule 2.10 suggests only the disinterested shareholders can **attend and vote**.

Position of the Company

- The Company also took the position that the Prohibition View is correct for reasons including the following:
    - The language of Rule 2.10 plainly envisages the court meeting shall only be a meeting of holders of disinterested share. The Concert Parties should **not attend and vote** at the Court Meeting;
    - The current Rule 2.10 was last amended in 2002 to include an explicit reference to the meeting of "**holders of disinterested shareholder**", showing Rule 2.10 was intended to be prohibitory in nature.
    - The Prohibition View would result in more coherence with the related rules in the Takeovers Code: Rule 2.2 which shares the same policy concern of Rule 2.10 (i.e., protection of minorities) prohibits voting by concert parties.

- In agreement with the Company and the *amici curiae*, the Court held the Prohibition View is correct for the interpretation of Rule 2.10. In other words, concert parties are not entitled to **attend and vote** at a meeting of **holders of disinterested shares**.

Proper Constitution of Court Meeting

- It is accepted that where the concert parties are part of the scheme, they should nonetheless be entitled to **attend and vote** at a court meeting as a matter of scheme law, although they cannot attend and vote in a court meeting comprising the disinterested scheme shareholders only due to Rule 2.10. This goes to the issue of what constitutes a duly convened court meeting.
- In this case, as the Concert Parties gave an undertaking not to vote at the Court Meeting, and they in fact did not attend or vote at the Court Meeting *qua* Scheme Shareholders, the Court was satisfied that section 674(2)(a) of the CO and Rule 2.10 of the Takeovers Code were complied with and the Court Meeting was duly convened.
- For guidance, the Court elaborated that there are 3 possible types of court meeting that may be ordered for approval of privatisation or takeover schemes involving parties acting in concert with the offeror:
    - One court meeting for all shareholders to be bound by the scheme with the concert parties undertaking to the Court not to attend and vote at the meeting, which effectively becomes a "**meeting of the holders of the disinterested shares**" (as is this case);
    - Second, two court meetings for the disinterested shareholders and the concert parties respectively. The second meeting may be dispensed with if the concert parties have agreed with the company or given an undertaking to the Court **at the time when the company sought an order to convene meetings** that they will be bound by the terms of the scheme; and
    - Third, if the concert parties have agreed with the company or the offeror to be bound by the terms of the scheme or the offer, then the scheme may simply be entered into between the company and the disinterested shareholders, in which case there is only one court meeting for these shareholders.

Key Takeaways

- The Court has helpfully clarified the position in relation to the privatisation of a Hong Kong company by way of a scheme of arrangement that, for the purpose of Rule 2.10 of the Takeovers Code, the Prohibition View prevails, in that offeror concert parties are not entitled to **attend and vote** at a meeting of the **holders of disinterested shares**.
- The Court provided practical guidance by setting out the types of court meeting that may be approved for privatisation or takeover schemes involving offeror concert parties.
- Due to the prevailing travel restrictions in Hong Kong, clients should expect that hybrid shareholders meeting will become more prevalent. Clients should be mindful of the logistical issues that may arise in respect of online meetings, including the process of verification of identity and the procedures for voting.

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