Global Public M&A Guide - Hong Kong

Before a Public Takeover Bid

| Contents |
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| To generate table of contents, right-click here and select **Update Field.** |

# 3. Before a Public Takeover Bid

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**3.1 Shareholding rights and powers**

The table below provides an overview of some of the different rights and powers that are attached to different levels of shareholding in a Hong Kong incorporated listed company:

|  |  |
| --- | --- |
| **Shareholding** | **Rights** |
| One share | * The right to attend and vote at general meetings. * The right to receive dividends. * The right to receive a distribution in a liquidation once the creditors have been repaid. * The right to receive a copy of the reporting documents for each financial year, such as annual audited accounts with the directors' report and auditor's report, as well as circulars providing further details on the resolutions to be proposed at the annual general meetings and notices of the meetings. * The right to inspect the company's registers such as registers of members, directors, company secretaries and debenture holders, its records of resolutions and meetings, and copies of certain management contracts. * The right to file a minority claim against the directors on behalf of the company. |
| 2.5% | * The right to apply to the court for an order allowing the shareholder to inspect the company's records or documents. * The right to propose resolutions to be moved at an annual general meeting, and to request circulation of statements concerning the business to be dealt with at a general meeting. |
| 5% | * The right to request the directors to call a general meeting, and, upon the directors' failure to do so, to call the meeting. * The right to apply to the court to cancel an alteration to the objects as stated in the articles of association. |
| 10% | * The right to call a general meeting by any two or more shareholders holding 10% of the total voting rights at general meetings if the company has no directors or an insufficient number of directors to form a quorum. * The right to apply to the court to have a variation of class rights (in the same class as the shareholder) set aside. |
| More than 25% (at a general meeting) | The ability at a general meeting to block resolutions which require a 75% special majority. |
| More than 50% (at a general meeting) | The ability at a general meeting:   * to appoint and remove directors; * to appoint and remove auditors and to approve their remuneration; * to approve the annual financial statements (including the directors' report and auditor's report); * to alter the articles of association in relation to the maximum number of shares the company can issue; * to approve capital increases; * to authorize the provision of financial assistance for the acquisition of the company's own shares; * to approve certain transactions which require shareholders' approval under the Takeovers Code, e.g., special deals and frustrating actions, and under the Listing Rules, e.g., certain notifiable transactions and connected transactions, a rights issue that would increase the number of issued shares or the market capitalization of the company by more than 50% and an open offer where the securities are not issued under the authority of a general mandate, provided that the shareholder is entitled to vote according to the Takeovers Code and the Listing Rules (as the case may be) (this is applicable to listed companies generally, whether they are incorporated in Hong Kong or not); and * to take decisions for which no special majority of 75% is required. |
| 75% (at a general meeting) | The ability at a general meeting:   * to change or alter the company’s name, objects and articles of association; * to authorize an off-market share buyback or a capital reduction; * to sanction a variation of class rights; * to approve takeover and privatization schemes (subject to the votes cast against them not exceeding 10% of the total voting rights attached to all disinterested shares) (see 8.1 below) and delisting; * to approve a whitewash waiver under the Takeovers Code (see 3.5 below); * to approve an amalgamation; and * to wind up the company. |
| 90% | The possibility of forcing all other shareholders to sell their shares through a public bid (a "**squeeze-out**") (see 7.1 below). |

**3.2 Restrictions and careful planning**

The key issues and restrictions associated with the acquisition of a controlling stake in a listed company in Hong Kong are summarized below. Some careful planning is therefore necessary if a bidder or a target company intends to start a process that may lead to a public takeover bid.

Hong Kong laws and regulations contain a number of rules that already apply before a public takeover bid is announced. These rules impose restrictions and hurdles in relation to prior stake building by a bidder, prior due diligence by a bidder and announcements of a potential takeover bid by a bidder or a target company.

**3.3 Due diligence and non-disclosure undertaking**

The Takeovers Code does not contain specific rules on whether or not prior due diligence can be organized or how such due diligence is to be organized. Nevertheless, the concept of prior due diligence or pre- acquisition review by a bidder is generally accepted by the market (and by the SFC and the Stock Exchange as well), and appropriate mechanisms have been developed in practice to organize a due diligence or pre-acquisition review and to cope with potential market abuse and early disclosure concerns. These mechanisms include the use of strict confidentiality procedures and data rooms.

The due diligence review typically covers financial, business, legal and operational aspects, whether through the target company’s response to the bidder’s request for provision of information or through information in the public domain obtained by the bidder, or both. The due diligence review should seek to enable the bidder to understand and assess the obligations it will assume, the nature and extent of the target company’s contingent liabilities, title to the target company’s assets, third party consents and regulatory or industry approvals required, the potential growth of the target company and litigations risks.

It is common for the target company, and important from the legal compliance perspective of the target company, to secure, at an early stage, a non-disclosure undertaking from the bidder before providing any non-public information relating to the target company for pre-acquisition review or conducting any further discussions or negotiations of the terms of the public takeover bid. The target company must, however, be mindful not to selectively disclose its inside information to the bidder. For the definition of inside information, please see 3.9 below.

**3.4 Investor rights and restrictions**

Before building a stake in a listed company in Hong Kong, the bidder should, as part of its pre-acquisition due diligence, ascertain if there is any merger control, foreign ownership control or restrictions, or industry specific approval applicable to the industry in which the listed company operates.

Foreign ownership restrictions – There are generally no restrictions on foreign ownership of shares in Hong Kong, except for companies in specific industries, such as broadcasting licensees.

Merger control regime – Mergers involving one or more parties that directly or indirectly own or control a Hong Kong telecommunication carrier licensee are subject to Hong Kong's merger control regime.

Industry specific restrictions – Specific regulated industries, such as banking, insurance, securities, telecommunications and broadcasting industries, are subject to certain ownership and control restrictions and approvals by the regulator of the relevant industry.

**3.5 Methods of acquisition**

The bidder can acquire a controlling stake in a listed company in Hong Kong by:

purchasing existing shares from a shareholder of the listed company (a "**Share Purchase**"); or

subscribing for new shares to be issued by the listed company (a "**Share Subscription**").

In a Share Purchase, the total number of shares of the listed company will remain unchanged after the bidder's acquisition and the consideration will go directly to the selling shareholder. If, as a result of the Share Purchase, the bidder (either alone or in concert with others) holds 30% or more of voting shares in the listed company, the bidder is required to make a general offer to all other shareholders in the listed company.

In a Share Subscription, the total number of shares of the listed company will increase and the shareholdings of all existing shareholders in the listed company will be diluted as a result of the bidder's acquisition. The subscription money will go directly to the listed company. If, as a result of the Share Subscription, the bidder (either alone or in concert with others) holds 30% or more of voting shares ("**30% threshold**") in the listed company, the bidder is required to make a general offer to all other shareholders in the listed company unless the SFC waives the general offer obligation (commonly referred to as the "**whitewash waiver**"). The bidder can make an application to the SFC for a whitewash waiver, which will be subject to independent shareholders' approval and compliance with certain regulatory requirements.

**3.6 General considerations**

Funding

If the bidder will be acquiring a stake which, as a result of the acquisition, will take it (either alone or in concert with others) to the 30% threshold, or which will trigger the creeper rule (as discussed in 4.1 below), the bidder must have committed funding to satisfy its acquisition of the target company shares, as well as all the remaining shares in the offer, at the time of the announcement of its firm intention to make an offer.

Bidder is a listed company

If the bidder is a listed company, it should comply with any requirement under the listing rules that may be applicable to it, such as reporting, disclosure and/or shareholders' approval. In the context of the Listing Rules, the application of such requirements will depend on the value of the stake to be acquired and the size of the target company relative to that of the bidder.

Treasury shares

Under the Takeovers Code, treasury shares are not considered as voting shares. They are excluded from the calculation of various thresholds, including the 30% threshold, the 2% threshold under the creeper rule, the acceptance condition (see 4.1 and 4.2 below), and disinterested shares (see 8.1 below).

**3.7 Insider dealing and market abuse**

Before, during and after a takeover bid, the normal rules regarding insider dealing and market manipulation remain applicable. The rules provide, among other things, that manipulation of the target company's stock and futures price, e.g., by creating misleading rumors, is prohibited. In addition, the insider dealing provisions prevent a bidder that has inside information regarding a target listed company from dealing in securities of the target listed company (other than in relation to launching the actual takeover bid). For the definition of inside information, please see 3.9 below. That being said, stake building for the sole purpose of the takeover bid is an exception to the insider dealing rule (see 6.1 below).

**3.8 Disclosure of shareholdings**

The rules regarding the disclosure of shareholdings and transparency apply before, during and after a public takeover bid.

Under the SFO, if a bidder starts building up a stake in a Hong Kong listed target company, it will be obliged to disclose its stake publicly by submitting a prescribed form electronically through the Disclosure of Interests Online System with the Stock Exchange if the bidder's interest in the voting shares has passed an applicable disclosure threshold. The key applicable disclosure thresholds for a bidder (who is not a director of the target company) include:

Initial disclosure threshold: 5% interest (including an interest in the underlying shares of equity derivatives).

Subsequent disclosure threshold:

increases or decreases in the interest across a percentage level, e.g., from 5.9% to 6.1%; or

1% short position, and subsequent increases or decreases in the short position across a percentage level.

When determining whether or not a threshold has been passed, a bidder must also take into account the interest (or short position) in voting shares held by (a) such bidder's spouse and children under the age of 18, (b) related trusts, (c) corporations in which the bidder controls one-third of voting rights or the majority of its board of directors, and (d) parties who are regarded as its "concert parties" for the purposes of the disclosure of interests regime in the SFO, e.g., other parties to an agreement to which it is also a party that contains provisions for the acquisition by any one or more of them of interests in voting shares in the target company and that imposes obligations or restrictions on any one or more of them with respect to the use, retention or disposal of their interests in voting rights in the target company acquired in pursuance of the agreement. The concept of "concert parties" for the purposes of the disclosure of interests regime in the SFO is different from the definition of parties "acting in concert" under the Takeovers Code. Please see 4.1 below for the definition of "acting in concert" under the Takeovers Code.

**3.9 Announcement by the target company**

The target company must continue to comply with the statutory provisions and general rules regarding disclosure and transparency. These include the requirement that a Hong Kong listed company must immediately announce all inside information. The term "inside information" means specific information that is about:

the listed company;

a shareholder or officer of the listed company; or

the listed securities of the listed company or their derivatives; and

is not generally known to persons who are accustomed or would be likely to deal in the listed securities of the listed company but would, if generally known to them, be likely to materially affect the price of the listed securities.

In practice, the question of whether or not a piece of information constitutes "inside information" is determined by the board of directors of the listed company.

The facts surrounding a potential public takeover bid may constitute inside information. If so, the primary obligation for making an announcement rests with the target company once its board has been approached. There are specific circumstances where the board of the target company must make an announcement, for instance, when a firm intention to make an offer is notified to the target company’s board, or when the target company is the subject of rumor or speculation about a possible offer or there is undue movement in its share price or share turnover volume.

**3.10 Launch of a public takeover bid**

No one is permitted to announce the launch of a public takeover bid until the announcement has been approved by the SFC. This prohibition not only applies to a bidder, but also to the target company (even if the target company has to announce the launch of a bid pursuant to the general disclosure obligations described in 3.9 above).

Before the board of the target company is approached, the responsibility of making an announcement normally rests with the bidder. A bidder that intends to announce a public takeover bid must first inform the SFC of its intention and obtain the SFC’s permission to make the announcement. If there are rumors or leaks that a bidder intends to launch a public takeover bid, the bidder must make an announcement.

**3.11 Acting in concert**

The majority of questions concerning interpretation of the Takeovers Code arise in relation to the concept of persons "acting in concert". For the definition of "acting in concert", please see 4.1 below.

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