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Our Ref: SN/4

19 April 2018

Mr Ashley Ian Alder  
Chief Executive Officer  
The Securities and Futures Commission  
35/F, Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

Dear Mr Alder,

**Consultation Paper on proposed amendments to  
the Codes on Takeovers and Mergers and Share Buy-backs**

The Hong Kong General Chamber of Commerce welcomes the opportunity of commenting on the Consultation on the Securities and Futures Commission's proposed amendments to the codes on takeovers and mergers and share buy-backs ("the CP"). We are pleased to attach for your consideration our comments in response to the CP's proposals.

In general, we welcome proposals that enhance investor protection, provided that they are shown to be necessary to achieve this objective, and that the benefits exceed the costs. Given Hong Kong's existing international success as a financial centre, it is vitally important that such a detailed assessment is conducted before any decision is made to implement the proposals. Our comments and suggestions are made with these principles in mind.

In particular, we believe that a second round of public consultation, providing further details of the perceived benefits and costs of the proposals would (as with the consultation papers on the proposed introduction of weighted voting rights, for example) prove to be beneficial for all concerned.

We hope you will find our comments useful to your deliberations.

Yours sincerely

Shirley Yuen  
CEO

*Encl.*

cc: Corporate Finance Division, The Securities and Futures Commission

**Hong Kong General Chamber of Commerce (“HKGCC”)  
Response to Securities and Futures Commission’s Consultation Paper of 19 January 2018  
on proposed amendments to the Codes on Takeovers and Mergers and Share Buy-backs  
 (“the CP”)**

*Introduction*

HKGCC welcomes this opportunity to respond to the CP. We have comments on four sections of the CP, namely (using the headings in the CP):

- Dealings with the Executive
- Compliance rulings
- Compensation rulings
- Voting threshold for Whitewash Waivers.

We deal with each of these in turn.

*Dealings with Executive*

We are not aware of the details of the cases that the CP refers to in which parties have not conducted themselves in an “open and cooperative manner”. However, we are concerned about using the term “open and cooperative” in a Code requirement, since this is a very subjective term, and reasonable people may differ in their views on whether a party has been sufficiently open and cooperative in a given case. This is a particular concern since, under the proposal on Compliance rulings (discussed below) a party which is deemed not to have been sufficiently open and cooperative could be subject to a direction.

We therefore recommend the deletion of the first sentence of the proposed new section 5.2. We believe that the objective of the new section is any event achieved by the remainder of the proposed section, in combination with General Principle 10.

*Compliance Rulings*

HKGCC believes that any proposed new requirement imposed on businesses (and indeed individuals) should be accompanied by a clear, evidence-based explanation of the need for the new requirement. Given that the Executive already has the power to make pre-emptive rulings (as the CP itself notes), and no evidence has been produced that these do not work, we would appreciate a fuller justification for this proposal before we can support it.

If the proposal does go ahead, we would recommend the following change in the wording of the proposed new section 7.2:

*“...the Executive may give any direction that **is reasonably** necessary in order to...” etc.*

We recommend the words “is reasonably necessary” in place of the current suggestion of “appears to it [the Executive] to be necessary”, because the test for issuing a ruling should be objective, not subjective.

### *Compensation rulings*

As with Compliance rulings, the need for this proposal has not been clearly demonstrated in the CP. Have there been cases where shareholders or former shareholders have suffered financial loss as a result of breaches of Code provisions, and where they have not been compensated? A full justification for this proposal would again be appreciated. We have the following further questions and comments on this proposal:

- It is relatively unusual for a Panel such as this one to be given the role of assessing the amount of loss which a person has suffered and the power to award compensation in respect of such loss. This is a role normally given to courts and other adjudicating bodies, after examining detailed evidence, including from expert witness. Is the SFC satisfied that this is consistent with Article 80 of the Basic Law, as interpreted by the High Court in *Luk Ka Cheung v Market Misconduct Tribunal and Financial Secretary*?<sup>1</sup>
- Assuming this is the case, how would the Panel go about quantifying the loss, given that this is a very complex, and to a large extent subjective process? For example, would the Panel outsource the work to experts in this area, or call upon the evidence of expert witnesses? One such firm of experts comments that: “Many disputes involve monetary compensation, and if this is significant it is likely to be difficult and subjective to quantify...Quantification of losses needs to be based on factual evidence, documents and witness statements, as well as expert reports”.<sup>2</sup>
- Under the proposed new section 13.13 the Panel must take the view that the amount of compensation is “just and reasonable”. This is a subjective term. If this criterion is to remain (as opposed to say, compensation for the actual estimated loss), we would appreciate an explanation of what factors the Panel would take into account in assessing whether a compensation amount is “just and reasonable”.

### *Voting Threshold for Whitewash Waivers*

The proposed increase in the voting threshold for whitewash waivers from 50 per cent to 75 per cent would constitute a very major change in the *status quo*. As such, as with the proposals on Compliance Rulings and Compensation Rulings, the need for this new provision must be clearly demonstrated, and assessed against potential downsides. However, the purported justification for the amendment in the CP is somewhat tentative and hypothetical. For example:

- The CP mentions a concern that the independent shareholders voting requirement in whitewash transactions “is not acting as the ‘gatekeeper’ it was intended to be”. It cites in support the fact that all whitewash transactions that were voted on by shareholders between 2015 and 2017 were approved, but goes on to recognize that “This is possibly attributable to a number of factors (such as lack of awareness and incentive to vote) and may be exacerbated by the problem of warehousing of shares with friendly parties who vote in favour of the relevant transaction”.<sup>3</sup> We would have appreciated a fuller enquiry into the actual reasons before concluding that the proposal is the best solution.

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<sup>1</sup> HCAL 49/2008.

<sup>2</sup> <https://www.intangiblebusiness.com/legal/loss-or-damage-quantification>

<sup>3</sup> CP para 40.

- The CP states that “[t]he high level of certainty of obtaining approval from shareholders of a whitewash favour can lead to abuse”.<sup>4</sup> But have there been actual cases of abuse, and are other Code provisions and General Principles not sufficient to deal with them?
- The CP states that the Executive’s power to withhold the issue of a whitewash waiver “may not adequately concern of abuse”. But is there any evidence to support this, or is the risk theoretical?

### *Conclusion*

The proposals in the CP discussed above would constitute significant changes to the *status quo*, and as such would benefit from a fuller costs v benefits analysis to justify the rationale for them, in the areas highlighted in this submission. As such, we would welcome a further consultation containing more detailed justifications for the proposals, and answering the issues we have identified above.

However, if the proposals are to be implemented without such further consultation, we hope that you will find our suggested drafting changes helpful, and give them serious consideration.

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<sup>4</sup> CP para 42.