

Company Law Guidance Note (Sixth Issue) — Share repurchase by a Hong Kong Company

Share Repurchase by a Hong Kong Company

1. Introduction

The governance professional will know that the ability for a Hong Kong company to be able to repurchase its own shares is not a straightforward matter due to the traditional concept of capital maintenance under companies law. The manner in which share repurchases of a Hong Kong incorporated company has been enhanced in the changes introduced under the new Companies Ordinance (Cap 622 of the Laws of Hong Kong) (the “Companies Ordinance”) that came into effect in 2014. The focus on capital maintenance has been relaxed as Hong Kong joins other jurisdictions in moving towards solvency and financial health of the company instead. The Companies Ordinance

introduced a statutory regime whereby a company may purchase its own shares with funds out of its share capital regardless of whether there are sufficient distributable profits or proceeds of a fresh issue of shares.

This paper (1) provides a brief summary of the requirements to carry out a share repurchase (also known as a “share buy-back”) under the Companies Ordinance; and (2) highlights some issues to consider from a practical point of view when implementing a share repurchase including for Hong Kong incorporated listed issuers, from a Companies Ordinance perspective, which are intended to serve as a practical governance related regulatory reference to the governance professional, directors and senior management.

Gratitude is expressed to Benita Yu FCG HKFCG, Partner, Slaughter and May, as author of this paper. The members of the Company Law Interest Group are Benita Yu FCG HKFCG (Chairman), Angela Mak FCG HKFCG, Cathy Yu FCG HKFCG(PE), Loretta Chan FCG HKFCG, Caron Lee FCG HKFCG and Wendy Yung FCG HKFCG. April Chan FCG HKFCG, Past President and Chairman, Institute Technical Consultation Panel, and Mohan Datwani FCG HKFCG(PE), Institute Deputy Chief Executive, contributed to finalising this paper. Mohan Datwani serves as Secretary to the Institute’s Interest Groups. If you have any comments and/or suggestions relating to the Institute’s thought leadership please contact: mohan.datwani@hkcg.org.hk.

2. Reasons for share repurchase

Returning surplus cash to shareholders

A buy-back is one method of returning cash to shareholders and this is one of the principal reason for a listed company to purchase its shares.

Increase earnings per share/increase net assets per share

A buy-back enhances earnings per share and improves the company's price / earnings ratio.

Exit route/restricted share transfer

A buy-back can be used to facilitate the exit of a shareholder from a company without the need to apply for a court order. (See Note 1)

Employee incentive schemes

Companies may purchase shares issued to an employee under an employee incentive scheme when the employee ceases to be employed by the company.(See note 2)

Adjusting gearing

A buy-back can be used to adjust the level of debt to equity, and should increase the company's gearing (the ratio of debt to assets).

De-listing

A buy-back can be used to give shareholders an exit route where a company is intending to cancel the listing of its shares. (See note 3)

Notes:

1. The off market buy-back of shares by a Hong Kong listed company is subject to the Code on Share Buy-backs ("**Share Buy-backs Code**") and require shareholders' approval.
2. The shares of a Hong Kong listed company so repurchased have to be cancelled under the Companies Ordinance and the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "**Listing Rules**").
3. Subject to the delisting-related requirements under the Listing Rules, the Code on Takeovers and Mergers (the "**Takeovers Code**") and the Share Buy-backs Code.

3. Key conditions/principles of share buy-backs under the Companies Ordinance

- Share buy-backs are subject to restrictions in the company's articles.
- Share buy-backs must not result in there being no shareholder of the company holding shares other than redeemable shares.
- Shares to be bought back must be fully paid shares.

- Shares must be paid for on buy-back.
- Shares bought back are to be cancelled.

4. Key features and requirements of share buy-backs by listed companies and unlisted companies as set out in the Companies Ordinance

4.1 Listed companies:

Under the Companies Ordinance, a listed Hong Kong incorporated company may buy back its own shares pursuant to a general offer or on recognised stock market or approved stock exchange with the prior approval of the shareholders by way of an ordinary resolution (except when (i) the general offer involves a compulsory acquisition, or (ii) payment is made out of capital, in which case a special resolution is required). The following sets out requirements under the Companies Ordinance. Share repurchases by a Hong Kong listed company are also subject to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”), the Takeovers Code and the Share Buy-Back Code.

(A) by way of a general offer

Repurchase by way of general offer is the most complex and regulated method. The general offer needs to be pre-approved by a shareholders’ ordinary resolution. If the general offer may result in a shareholder being compelled to dispose of his or her shares because 90 per cent of the shareholders have accepted the offer, such offer must be authorised by a special resolution on which no non-tendering shareholder votes. In addition, an independent investment adviser must be appointed to advise shareholders who may be affected by the compulsory disposal on the merits of the offer. The notice of the proposed resolution must include (a) a copy of the document containing the proposed general offer, and (b) a statement, signed by the directors of the company, containing information that would enable a reasonable person to form a valid and justifiable opinion as to the merits of the offer.

(B) on recognised stock market or approved stock exchange

An on-market repurchase is the most common form of share repurchase and also the most straightforward. However, a listed company is not allowed to make a payment out of capital in this scenario under the Companies Ordinance. The notice of the proposed resolution should include a memorandum of the terms of the proposed repurchase. Most listed companies will ask shareholders for a general mandate by way of ordinary resolution at each annual general meeting to enable the directors to repurchase shares that are no more than 10 per cent of the existing issued share capital of the company

(C) under contract authorised in advance (off-market buy-back)

An off-market repurchase is a private contract between the company and one or more specific shareholders. The contract sets out the terms of the transaction, including the price, and the transaction is not conducted on a stock market. The contract should be authorised in advance by special resolution and it may take the form of a contingent buy-back contract (i.e. conditional on shareholders’ approval). The notice of the proposed special resolution must include (a) a copy of the proposed contract or, if it is not in writing, a memorandum of its terms, and (b) a statement, signed by the directors of the company, after having made due and diligent inquiry of the shareholders holding the shares to which the proposed contract relates, containing information that would enable a reasonable person to form a valid and justifiable opinion as to the merits of the contract. The resolution will not be effective if an interested shareholder votes, whether on a poll or by proxy, such that the resolution would not have passed without his or her votes.

4.2 Unlisted companies:

(A) under contract authorised by special resolution

An unlisted company may buy back its own shares under a contract that is authorised in advance by special resolution. The Companies Ordinance sets out detailed provisions regulating the disclosures of the proposed contract. If the special resolution is proposed at a general meeting, a copy of the contract (if it is in writing), or memorandum of its terms (if it is not in writing) must be available for inspection by shareholders both at the company's registered office for at least 15 days prior to the meeting and at the meeting itself. The resolution will not be effective if an interested shareholder votes, such that the resolution would not have passed without his or her votes.

5. Ways to pay for share repurchases under the Companies Ordinance

5.1 Out of distributable profits or proceeds from fresh issue of shares

One of the key principles of share repurchase under the old Companies Ordinance (Cap. 32) was that share buy-backs must generally be financed out of distributable profits or the proceeds of a new issue of shares. This traditional position is retained in the new Companies Ordinance.

5.2 Out of share capital (not allowed for listed companies repurchasing on a recognised or approved stock exchange)

This is a key change introduced by the new Companies Ordinance, which allows all companies (whether listed or not) to fund buy-backs out of capital subject to a solvency test, regardless of whether there are sufficient distributable profits or proceeds of a fresh issue. The only exception is that a listed company is not allowed to make a payment out of capital in respect of a purchase of its own shares on the stock exchange because it would be impractical for the listed company to follow all the procedures for payment out of capital each time before it purchases its own share in the market.

If a company wishes to make a payment out of capital in respect of the buy-back of its own shares, in addition to the requirements mentioned above, the following requirements / procedures must be observed.

(A) solvency statement

All directors of the company must make a solvency statement in a specified form, stating that after inquiring into the company's state of affairs and prospects and taking into account all the liabilities of the company, each director has formed the opinion that (a) immediately after the share buy-back, there will be no ground on which the company could be found to be unable to pay its debts; and (b) the company will be able to pay its debts as they become due during the period of 12 months immediately following the date of the share buy-back.

(B) special resolution

Approval for payment out of capital must be by way of shareholders' special resolution, which shall be passed within 15 days after the date of the solvency statement.

(C) notice of payment out of capital and inspection of documents

The company must also publish a notice about the payment out of capital in the Hong Kong Government Gazette no later than the last working day of the week after the week in which the special resolution is passed, and publish a notice in a Chinese and English newspapers or give written notice to all creditors of the company before the end of the week after the week in which the special resolution is passed. The company must ensure the relevant special resolution and the solvency statement are kept at its registered office or a prescribed place for a period from the day of the publication of the notice and ending 5 weeks after the date of the special resolution for inspection by shareholders and creditors of the Company during business hours in that period.

(D) application to court by shareholders or creditors

Within 5 weeks of the date on which the special resolution is passed, any creditor or non-approving shareholder of the company may apply to the court for cancellation of the resolution. The company must give the Companies Registry notice in the specified form of the application within 7 days after the day on which the application is served on it. On an application, the court must make an order confirming or cancelling the special resolution for payment out of capital and may do so on any terms and conditions it thinks fit.

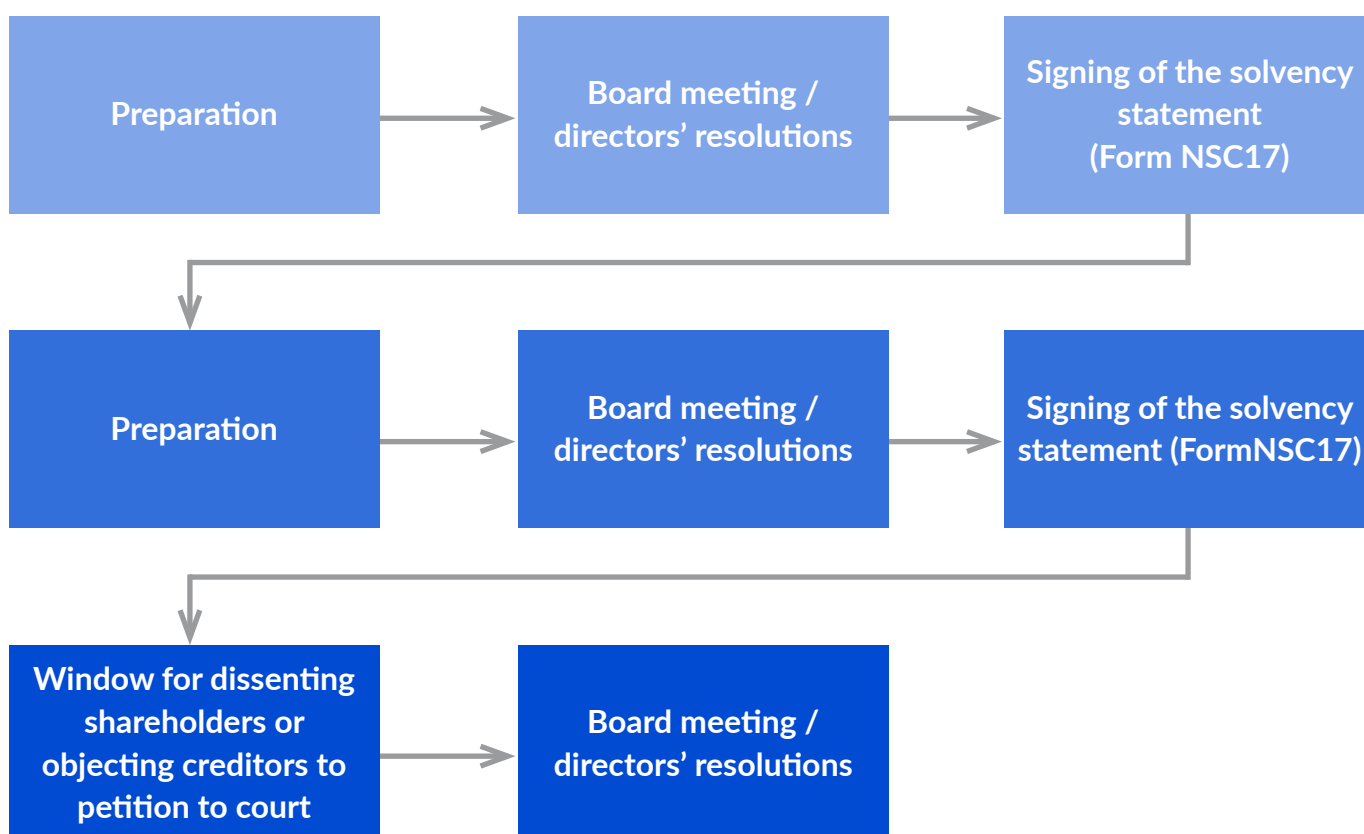
(E) registration of court order

The company must deliver an office copy of the court order to the Companies Registry for registration within 15 days (or such longer period as ordered by the court) after the court has made the order.

(F) timing for payment out of capital

Subject to any application the court by shareholders or creditors of the company, the payment out of capital and the buy-back must be made no earlier than 5 weeks and no later than 7 weeks after the date of the special resolution.

6. Procedures to implement a share buy-back out of capital by a private company



Major Steps	Main Issues to Note	
Preparation	<ol style="list-style-type: none"> Prepare relevant documents, including: <ul style="list-style-type: none"> interim or management accounts to ascertain assets, current liabilities (from the date of the solvency statement) and distributable profits accounts need not be audited but must enable each of the directors to form a reasonable judgement as to whether he or she can express the opinions required by the Companies Ordinance solvency statement form (Form NSC17) share buy-back contract 	
Board meeting / directors' resolutions	<ol style="list-style-type: none"> The board of directors resolve to: <ul style="list-style-type: none"> approve the proposed share buy-back contract approve the solvency statement form (Form NSC17) If the board resolves to convene a general meeting for shareholders to consider and vote on the share buy-back and payment out of capital: <ul style="list-style-type: none"> dispatch a notice of the general meeting to each shareholder together with a circular setting out the reasons for the proposed share buy-back not less than 14 days before the date of the general meeting make available for inspection by shareholders at the company's registered office a copy of the proposed share buy-back contract or a memorandum setting out its terms not less than 15 days ending on the date of the general meeting 	
Signing of the solvency statement	Each director signs the solvency statement (Form NSC17) not more than 15 days before the date on which the shareholders' special resolution is passed	
Shareholders' approval by special resolution	<ol style="list-style-type: none"> If the special resolution is passed by written resolution, on the circulation date of the written resolution, deliver to each shareholder a copy of: <ul style="list-style-type: none"> the form of the written resolution the solvency statement the share buy-back contract or a memorandum setting out its terms A copy of the written resolution needs to be sent to auditors on or before the circulation date of the written resolution Within 15 days after the written resolution is passed, the company needs to notify all shareholders and auditors that the written resolution has been passed 	If the special resolution is passed by shareholders at a general meeting, a copy of the solvency statement, the share buy-back contract or a memorandum setting out its terms must be available throughout the general meeting

Major Steps	Main Issues to Note
Registration of the special resolution and solvency statement	<ol style="list-style-type: none"> 1. A copy of the special resolution should be delivered to the Company Registry for registration within 15 days after the passing of the resolutions 2. A copy of the solvency statement should be delivered to the Company Registry for registration no later than the date of publication of the Gazette notice or notice in newspaper
Publication of notice	<ol style="list-style-type: none"> 1. Gazette notice should be published no later than the last working day of the week after the week in which the special resolution is passed 2. Newspaper notice should be published or written notice to creditors should be sent before the end of the week after the week in which the special resolution is passed
Window for dissenting shareholders or objecting creditors to petition to court	<ol style="list-style-type: none"> 1. Any dissenting shareholder or creditor may apply to the court for cancellation of the special resolution within 5 weeks after the date of the special resolution 2. If a court application is made, the company should give Companies Registry a notice in specified form (Form NSC3) of the court application within 7 days after the day on which the application is served on the company 3. If a court application is made, the company should deliver the court order to the Companies Registry for registration within 15 days after the making of the court order
Signing, registration and completion (subject to any application to court)	<ol style="list-style-type: none"> 1. If no court application has been made, no earlier than 5 weeks after the date of the special resolution, the company and the relevant shareholder(s) can execute the share buy-back contract, instrument of transfer, bought and sold notes and arrange for stamping 2. Payment out of capital for the share buy-back should be made no later than 7 weeks after the date of the special resolution 3. Relevant share certificates must be returned and the register of shareholders should be updated 4. Within 15 days after the date on which the shares are delivered to the company, deliver a return in specified form (Form NSC2) to the Companies Registry for registration

7. Practical tips

Hong Kong Government Gazette is published every Friday. The relevant notice should be sent to the Government Logistics Department with a signed application form (GLD 18 Application Form) at least a week prior to publication. Upon receiving these documents, a copy of the “printing proof” of the notice will be faxed to the applicant with a request for sign-off and payment. Only minor alterations are allowed afterwards. Payment (by cash or cheque) is to be delivered by hand to the Collection Office at the Accounts Section of the Government Logistics Department by 4 pm on the Monday of the week of publication. The notice will be published in a subsequent issue if the deadline is missed.