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Client Alert
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Transforming the Malaysian Code on Take-Overs and Mergers - Key Changes Under the Rules on Take-overs, Mergers and Compulsory Acquisitions

On 15 August 2016, the Malaysian Minister of Finance ("**MOF**") revoked the Malaysian Code on Take-Overs and Mergers 2010 ("**Old Code**"). In its place is the Malaysian Code on Take-Overs and Mergers 2016 ("**New Code**"). Contemporaneous with this replacement, the Securities Commission Malaysia ("**SC**") has also issued the Rules on Take-Overs, Mergers and Compulsory Acquisition 2016 ("**Rules**").

The changes introduced by the Rules reflect the SC's desire to move towards a proportionate regulatory regime. On the one hand, changes have been made to facilitate take-overs, such as the abolishment of the requirement for an offeror and persons acting in concert ("**PACs**") to hold more than 50% of the voting shares of the offeree before undertaking a take-over by way of a scheme. However, the changes also provide a higher degree of protection to offeree shareholders in the form of enhanced disclosure requirements and the enhanced role and obligation of independent advisers.

The Rules also provide guidance in areas that were previously subject to scrutiny and led to confusion amongst the offeror, offeree and their respective advisers. These changes are welcomed and has brought Malaysia's take-over regime closer to other mature jurisdictions such as the United Kingdom and Hong Kong.

This Alert highlights the key changes under the New Code and Rules as well as the way take-overs, mergers and compulsory acquisitions (referred to generally as "take-overs" unless specifically stated), will now be regulated.

New Code vs Old Code

As with the Old Code, the New Code is a legislative supplement issued under the Malaysian Capital Markets and Services Act ("**CMSA**"). Under the CMSA, the MOF is empowered to issue the New Code (on the recommendation of the SC) as subsidiary legislation.

The Old Code was a comprehensive piece of legislation that laid down detailed requirements for take-overs. This was supplemented by practice notes, issued by the SC, that provided guidance on its interpretation and operation. In contrast, the New Code is a short-form document – in essence, twelve overarching general principles which serve as statements of standards of commercial behavior to be observed in any take-over. The Rules, being the equivalent of the now superseded practice notes, sets out the operative provisions for take-overs. This approach is in line with the revisions made to the CMSA in 2015.

As the New Code is subsidiary legislation, any amendment will require the approval of the MOF. Amendments to the Rules, however, will not. **This provides greater autonomy to the SC to amend the operative requirements for take-overs under the Rules, without having to seek the MOF's sanction.** The approach will broadly be in line with the take-over regimes in Singapore and the United Kingdom. Significantly, it demonstrates the need for a dynamic regulatory environment for public take-overs.

Scope of Take-Over Offer

- **Application of the Rules**: The Old Code applied to (i) any target company which is a Malaysian public company (whether or not listed on any stock exchange); or (ii) a real estate investment trust or a foreign company that is listed on Bursa Malaysia Securities Berhad. **This has now been expanded to apply to business trusts which are listed in Malaysia, but narrowed to include only unlisted public companies with more than 50 shareholders and net assets of RM15 million or more.** As such, corporate exercises involving public (non-listed) financial institutions with a handful of shareholders would no longer be subject to a take-over regime.

- **Determining whether a person is acting in concert**: The three circumstances which the SC may consider in determining whether a person is acting in concert under the Old Code, i.e., (i) shareholders voting together on a resolution in one general meeting or more, (ii) shareholders acquiring shares or rights without each other's knowledge but subsequently coming together to co-operate as a group, or (iii) shareholders making a requisition or attempting to make a requisition for a board control-seeking proposal in a general meeting, have been largely retained albeit with refinements. For instance, **the SC now recognises that the act of voting together on resolutions at one general meeting would not normally of itself be regarded as triggering a mandatory offer obligation**. This is aligned with the commercial reality where shareholders may vote together on resolutions regularly for many other justifiable and commercial reasons.

  The Rules have widened the scope in determining when a person is acting in concert with regards to a board control-seeking proposal. There is now a presumption that the supporters of the shareholders as well as the directors who come together to requisition (or threaten to requisition) for a board control-seeking proposal, are acting in concert with each other once the agreement is reached in respect of the board control-seeking proposal. That said, there needs to be a significant relationship between any of the requisitioning shareholders or their supporters, and any of the proposed directors. The presumption is rebuttable as the SC will consider other factors in determining if the persons are acting in concert.

  Where a person is regarded as acting in concert with an offeror, there are various disclosure requirements and other obligations that would be triggered under the Rules.

- **Upstream acquisitions**: Under the Old Code, a mandatory offer is triggered if a person intends to obtain or has obtained control (i.e. 33% of voting shares and voting rights) in an upstream entity which (i) holds or is entitled to control more than 33% of voting shares and voting rights of a downstream entity, and (ii) has significant degree of influence in the downstream entity. The SC also, amongst other considerations, adopts a purpose test in determining if there is significant degree of influence in the downstream entity - the main purpose of acquiring control of the upstream entity must be to control the downstream company.

The Rules now only apply to upstream acquisitions where a person or group of PACs has acquired more than 50% of a company (whether or not it is a company to which the Rules apply) and as a result, acquires control of 33% of voting shares and voting rights in a downstream company. However, once the 50% threshold is met, the **mandatory offer obligation on the downstream entity is now more likely to apply as the Rules have lowered the bar of the purpose test -** acquiring control of the downstream company only needs to be a "significant purpose" (as opposed to "main purpose").

- **Removal of the percentage range of 20% up to 33% to trigger control**: The Old Code provided that a person acquiring between 20% and up to 33% from a controlling vendor could trigger a mandatory offer.

  The Rules now give more discretion to the SC and has removed the quantitative percentage band when determining if a mandatory offer is triggered. The SC will now consider the substance of the acquisition (rather than the percentage of shares being acquired). In line with the current practice in other jurisdictions, the SC will take into account the following factors:

  a) the degree of control that a vendor has over the retained shares;

  b) the price paid for the shares by the buyer; and

  c) the proportion of the shares retained by the vendor vis-à-vis the total issued share.

- **Options and derivatives**: Under the Old Code a mandatory offer will only be triggered on the conversion of options into voting shares or voting rights. **Under the Rules, an acquisition of long options and derivatives (where the holder will benefit economically if the underlying price increases) may trigger the mandatory offer obligation.** The structuring of equity derivative transactions, and existing contracts, will need to be reviewed to determine if the mandatory offer obligation applies.

- **Minimum Offer Price**: **The Rules prescribe the minimum offer price for mandatory take-over offers, and voluntary take-over offers.**

  For a mandatory general offer, the offer price must not be less than the highest price paid or agreed to be paid by the offeror or any person acting in concert with the offeror for any voting shares or voting rights to which the take-over offer relates, within six months before the beginning of the offer period ("**MGO Minimum Offer Price**"). However, the Rules now provide for a mandatory offer arising from an arrangement, agreement or understanding to control between persons acting in concert, the offer price shall be the higher of the MGO Minimum Offer Price or the volume weighted average traded price of the offeree for the last 20 market days prior to the triggering of the mandatory offer obligation ("**VWAP**"), whichever is the higher. This may have an effect on private treaties for sale of shares of a company to which the Rules apply. A possible offeror who has entered into a private treaty with the vendor to acquire voting shares to acquire control at a price which is lower than the VWAP and who himself has not traded the shares of the target company, may still be obliged to launch the offer to the remaining shareholders of the offeree at the VWAP (if the VWAP is higher than the negotiated share sale price). For instance, a potential offeror who triggers a mandatory offer obligation by acting in concert with other shareholders of the offeree, will be obliged to launch the offer to the remaining shareholders of the offeree at the VWAP if it is higher than the MGO Minimum Offer Price. **The SC has now increased its influence by retaining a discretion to disregard any unusually high or low trading prices within the relevant period when determining the VWAP.**

In a voluntary take-over offer, **the offer price must not be less than the highest price paid or agreed to be paid by the offeror or PACs, during the offer period and within three months before the start of the offer period, for any voting shares or voting rights in the offeree.**

- **Compulsory acquisitions**: **The Rules now facilitate a squeeze-out of minority holders of convertible securities, which was previously not permitted.** For an offeror to exercise its rights to compulsorily acquire holders of convertible securities, it must secure acceptances of the take-over offer by 90% of the holders of all convertible securities in the company, in addition to securing acceptances from 90% of the holders of all ordinary shares. **This is a welcome change as offerors seeking to take a company private will be able to squeeze-out minority convertible security holders without having to undertake individualised negotiations with each such holder, or be subject to such holders converting their interest into voting shares of the company post-privatisation.**
- **Schemes**: The Rules **apply to trust schemes, schemes of arrangement, compromise and amalgamation and selective capital reductions that seek to acquire control or consolidate voting rights or voting power.** There is however, no guidance as to what constitutes a "trust scheme".

  Under the Old Code, schemes can only be used if the offeror and PACs hold 50% of the voting shares or voting rights in the offeree. This restrictive requirement has now been abolished under the Rules.
- **Independent advisers**: They **now have a more prominent role** under the Rules. If the scheme results in a reverse take-over or a "merger of equals", the requirement to appoint an independent adviser extends to the offeror (in addition to the offeree). Further, if the scheme triggers a mandatory offer obligation, the independent adviser of the offeree must (i) advise the shareholders of the offeree that they are essentially agreeing to the offeror and PACs acquiring control without having to undertake a mandatory offer; and (ii) include prescribed information relating to the details of the offeror and PACs in the independent advice letter.

Conduct prior to and during the Offer Period

- **Movements of Directors**: There have been **changes to the requirements** for the **appointment and resignation of directors** on the board of the offeree ("**Offeree Board**") if a take-over offer is imminent or during the offer period.

  Under the Rules, appointments of directors nominated by the offeror or PACs onto the board of the offeree requires the SC's consent. There were previously exemptions from this requirement under the Old Code, namely (i) in a mandatory offer, if the offeror or PACs already hold more than 50% of the voting shares or voting rights in the offeree; and (ii) in a voluntary offer, if there is no acceptance condition. These exemptions no longer apply under the Rules. That said, the SC has indicated that it may grant consent if the previous exemption in (i) is fulfilled.

  Directors on the board of the offeree cannot resign until the first closing date of the take-over offer or on the date the offer becomes unconditional. This restriction however only applies where (i) a bona fide take-over offer has been communicated to the board of the offeree; or (ii) the board of the offeree has reasons to believe that such an offer is imminent.
- **Favourable Deals**: Under the Old Code, arrangements between selected shareholders of the offeree and the offeror or PACs on terms which have more favourable conditions are restricted during the take-over offer or when such offer is reasonably contemplated. The Rules extend this

restriction to a period of six months after the post-closing of a take-over offer. The Rules also provide guidance on the considerations in determining whether this restriction applies to among others, finders' fees, repayment of shareholders' loans, top-up arrangements and management incentives, and how they are linked to the consideration paid under the offer. **This new guidance will be particularly helpful which would help to financial investors such as private equity funds or other institutional funds when they structuring e a take-over.**

Whilst there is greater clarity on the ability of an offeror to incentivise management, the SC is also keen to ensure that minority investors' interests are safeguarded. Thus if a member of management of the offeree retains a financial interest in the offeree post-closing, SC will require (i) the independent adviser to opine that the arrangement is fair and reasonable; and (ii) that shareholders' approval be obtained if the arrangement is unusual or of significant value.

Process and procedures of a Take-Over Offer

- **Approach to Board of the Offeree**: Under the Rules, there is a new requirement that an offeror is required to present the offer to the Offeree Board before triggering a take-over offer and announcing the offer to the public. This **ensures that the Offeree Board is given advance notice that a take-over is imminent and in turn enables it to comply with the requirement to announce the receipt of the take-over offer within one hour of receipt of the take-over notice**. Where the Offeree Board is unable to comply, a temporary trading halt should be requested until the announcement is made. To facilitate a speedy announcement, the requirement under the Old Code requiring the Offeree Board to confirm in the initial announcement upon receipt of an offer, as to whether it is seeking a competing offer, has been removed.
- **Board of the Offeree may make enquiries:** The Offeree Board can, under the Rules, make enquiries to satisfy itself that the offeror will be able to implement the offer, including the source and evidence that the funds are available to the offeror. The Rules are silent as to what actions the Offeree Board can take if it is not satisfied that the offeror can implement the offer and presumably it can either reject the offer or seek a competing offer.
- **Announcement of firm intention:** Under the Rules, there is a new requirement that an offeror must announce the take-over offer within one hour of incurring an obligation to do so. The offeror and PACs cannot acquire additional shares in the offeree until the take-over is announced. These new requirements, coupled with the requirement for the Offeree Board to announce the receipt of the take-over offer within one hour of receipt, **ensure that full information is disseminated to the offeree shareholders promptly**. It also reduces the risk of the offeree / minority shareholders being disadvantaged by trading on those shares without knowledge of the take-over offer.
- **Duration of Take-Over Offer**: For voluntary offers, the maximum period for offeree shareholders to accept the offer under the Rules has been extended from 74 days from the despatch of the offer document, to 95 days from the despatch of the offer document.

  Under the Old Code and Rules, the last day for fulfilling an acceptance condition is the 60th day from the despatch of the offer document. All other conditions to a voluntary offer must be fulfilled within 21 days after the acceptance condition is fulfilled.

  The change to the timeline provides a longer period for the offeree shareholders to accept the offer, and enables them to hold out until they

have visibility that all conditions to the voluntary offer have been fulfilled before they turn in their acceptance.

- **Competitive situation:** The SC has introduced an auction procedure under the Rules, as a fall-back in the event the competing offerors and the Offeree Board are unable to reach a mutual agreement on the manner to resolve competing bids. **This procedure helps to mitigate uncertainty and undue movement in the share price of the offeree, over whether either or both competing offerors would revise their bids leading up to the close of the offer period.** Where the auction procedure is triggered by the SC:

  a) any revisions to the offer must be announced in accordance with the auction procedure;

  b) the auction will be completed in five days and a revised offer can only be announced where the other competing offeror has made a revised offer;

  c) each competing offeror can only make one revised offer each day; and

  d) the consideration must not be calculated by reference to the value of a revised offer by the other competing offeror.

Take-Over documentation

- **Submission**: As with the Old Code, the Rules require the offer document to be submitted to the SC prior to the despatch of the offer document to the offeree shareholders. **The SC's role is no longer to consent to the offer document, but to comment and provide guidance in resolving any issues under the Rules.** It is the sole responsibility of the offeror and its advisors to ensure that the Rules, including the minimum content requirements, are fully complied with.

- **Minimum content requirements**: There have also been changes to the minimum content requirements for offer documents, independent advice circulars and submissions to the SC. **The changes entail a higher degree of disclosure.** This includes, for example, requiring the disclosure of all substantial shareholders of the offeror and its PACs, and tracing the ultimate controlling shareholders. The **Rules also now require disclosure of the directors of the ultimate parent companies.** This represents a shift towards transparency in the identity of not only the offeror, but also any other person who is driving the general offer process.

  Submissions to the SC now also require the **inclusion of information** pertaining to the chronology of events leading to the offer being made, the steps taken to safeguard the interest of the independent shareholders, and a description of the financing arrangements for the proposed transaction.

  The enhanced disclosure requirements will lead to a more informed market and protection of minority shareholders.

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