# The "General Mandate" for the Issuance of New Shares Non Pre-emptively in Hong Kong:

## Recent Developments 2004-5

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## Background Note on UK Guidelines and Recent Developments

**Hong Kong 2005 AGM season**
This year's AGM season recently got underway and has produced some significant developments:

- The Bank of East Asia became the first HK-listed company to have its mandate rejected by shareholders at its AGM on April 8, 2005. The vote was 54.48% to 45.52%.

- Hong Kong Exchanges and Clearing Ltd decided not to seek a general mandate for the issuance of new shares from its shareholders at its AGM on April 12, 2005. It stated that it had sufficient cash reserves and no need for the mandate, and if it did need to raise capital it would seek the approval of shareholders at the appropriate time.

- CLP Holdings has further reduced its mandate—from 10% in 2004 to 5% at its recent AGM on April 28, 2005.

- ASM Pacific Technology (522) sought no mandate from its shareholders at its AGM on April 25 this year. Last year it sought the full 20%.

**Hong Kong 2004 AGM season**
According to the records of the annual meetings of the 33 Hang Seng Index (HSI) companies last year, minority shareholders have been voting against these mandates in large numbers. The mean-average vote against has been almost 15%, with a range of between 3.5% and 33% (of total votes cast)[1]. At four HSI companies the vote against has been between 28-33%, while at another nine it has been between 14-21%. These numbers are significant for several reasons:

1. Resolutions at AGMs in Hong Kong are routinely passed with only a very small vote against (less than 1% in most cases). The resolution on the general mandate to issue new shares, however, has emerged as a clear exception.

2. At several HSI companies, the vote against the general mandate represents a significant percentage of their total free float (in a few cases, a majority).

[1] Based on an analysis of 26 HSI companies for which voting results were available. Companies that have already reduced their cash mandate to 5% were also excluded (ie, HSBC, Hang Seng & Johnson Electric).

3. When the actual number of votes against the mandate is analysed as a percentage of all votes cast by the public shareholders on this resolution (excluding the controlling shareholder and connected directors), it becomes clear that an overwhelming majority of public shareholders are opposing the mandate. Thus for the company above where the vote against was only 3.5% of the total, it is worth noting that these votes accounted for 77% of the public-shareholder vote on this resolution.

It is also significant that several major listed companies in Hong Kong are taking the initiative to voluntarily lower the mandates they request from shareholders. Both Hang Seng Bank and Johnson Electric have reduced their cash mandate to 5%[2], while CLP Holdings has reduced its to 10% and the Bank of China (Hong Kong) gave an undertaking at its AGM this year not to exceed 10%. A number of smaller listed companies in Hong Kong have also made a voluntary reduction to 5%, with some also limiting their discount to 5%.

## Background Note on UK Guidelines and Recent Developments

In the UK, pre-emption rights for shareholders are enshrined in law (Sections 89-96 of the 1985 Companies Act). This follows the requirements of the European Union's 2nd Company Law Directive, which was adopted in 1976 and states that if a public company is intending to issue new shares for cash, it must first offer those shares to its existing shareholders unless they have previously agreed to waive their rights. Public companies in the UK wishing to seek such a waiver from their shareholders must put forward a resolution at their AGM to "disapply pre-emption rights". This is a special resolution requiring a vote in favour of 75%.

Once pre-emption rights have been disapplied, companies are subject to the following guidelines: a maximum 5% mandate in any one year, no more than a cumulative 7.5% over any rolling three-year period and a maximum discount of 5% to the market price.

These guidelines were drawn up in 1987 by the Pre-Emption Group, a diverse body of listed issuers, institutional investors and corporate finance practitioners. The Group was instigated by the Association of British Insurers and the National Association of Pension Funds, and officially formed under the auspices of the London Stock Exchange. (For more background information, go to the website of the Institutional Voting Information Service—www.ivis.co.uk—and click on "Guidelines". IVIS is a service operated by the Association of British Insurers: www.abi.org.uk).

While the guidelines are not rules, they have enjoyed broad market support and been closely followed by issuers and investors. However, in a November 2003 report, the Bioscience Innovation and Growth Team (BIGT), an advisory group set up by the UK Government to formulate a "strategic approach to the future of the bioscience industry"[3], argued that the pre-

[2] Note: Hang Seng Bank follows HSBC practice, which is to ask shareholders for a 20% mandate but to limit the issuance of new shares for cash to no more than 5% of issued share capital (ie, the balance could include new shares issued in an acquisition).
[3] UK Government, Department of Trade and Industry press release, October 8, 2004.

emption guidelines were constraining the capital-raising abilities of the biotech industry in the UK and recommended that bioscience companies with a market cap of less than £1 billion be allowed to issue new shares up to 20% of issued share capital in any three-year period without pre-emption rights applying. BIGT believes this would help address an apparent funding crisis in the industry.

The UK Government responded by saying (in May 2004):

> The issue of possible changes to the pre-emption guidelines is primarily one for companies and their shareholders. There is only limited backing for change from other sectors (mainly electronics). To secure the support of shareholders for any changes to the pre-emption guidelines—either generally or for specific industry sectors—would require more evidence of the benefits to shareholders of allowing greater financial flexibility.
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> The Government will continue to look for ways forward with the BioIndustry Association and representatives of institutional investors.[4]

In September 2004, the UK Department of Trade and Industry (DTI) announced a study into the issue and appointed as chair Paul Myners, Chairman of Marks & Spencer Group plc. The following month DTI announced the membership of an advisory group to work with Mr Myners. It comprised a diverse range of members from the biotech, listed issuer, institutional investment, corporate finance, legal and academic fields. The group consulted the market in late 2004 and released its final report in early February 2005. The thrust of the report is that pre-emption rights are a fundamental and valuable part of UK company law, but that there is scope for some flexibility in the way the current guidelines are implemented. The report also emphasises the importance of dialogue between a company and its shareholders on the merits of particular fund-raising cases.

It is worth noting as well that BIGT's recommendation was a response to a specific problem in the biotech industry in the UK in recent years (ie, the difficulty of raising new funds). Its suggestion for the limit on non pre-emptive equity issues to be raised to a cumulative 20% in any three-year period, while comparatively generous by UK standards, remains considerably tighter than the norm in Hong Kong. Aggregating the general mandates that most Hong Kong companies request each year at their AGM produces a minimum of 60% over any three-year period, increasing to 90% if the additional 10% rule on repurchased shares is included.[5] In fact, the number could theoretically be higher, since companies are permitted to refresh their general mandates before their next AGM if they secure the approval of independent shareholders.

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[4] UK Government Response to "Bioscience 2015" (the report of BIGT), page 10.

[5] The total number of securities issued under a general mandate can be extended by the inclusion of shares repurchased by an issuer—"up to a maximum number equivalent to 10% of the existing issued share capital of the issuer" and "provided that the existing shareholders of the issuer have by a separate ordinary resolution in general meeting given a general mandate to the directors of the issuer to add such repurchased securities to the 20% general mandate". Rule 13.36 (2) (b), Listing Rules (Main Board), The Stock Exchange of Hong Kong.