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Mergers and acquisitions

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CHAPTER 7

MERGERS AND ACQUISITIONS

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1. Introduction

The mergers and acquisitions ('M&A') environment is a fast-paced, complex world where transactions may be arranged in a matter of days and involve large sums of money. In 2012, the value of announced M&A activities (involving Singapore companies as either acquirers or target companies) reached US$65 billion, based on data from Thompson Reuters. The list of high profile Singapore transactions in 2012 included Heineken's acquisition of Asia Pacific Breweries and the battle for control of Fraser and Neave.

This chapter gives an overview of the process of regulating an M&A transaction involving a publicly listed target company, with emphasis to the laws and regulatory framework. By the time you embark on a course on the law of M&A, you would have read foundational courses in contract law, tort law and company law and would be familiar with concepts such as using contracts to allocate risks between parties, civil liabilities in tort law, corporate governance, directors' duties and rights of shareholders. The law of M&A also deals with securities regulation, including the regulation of the transferability of blocks of shares and controlling interests in companies. The law of M&A provides excellent opportunities for you to apply the concepts that you would have learnt in the foundational courses.

2. Types of M&A Transactions

If the acquirer chooses to acquire the shares of a target company, there are two principal options. One is a general offer for the shares of the target company where its accepting shareholders will tender their shares to the acquirer in return for the consideration paid by the acquirer which may be cash, securities or a mix of both; the second is a scheme of arrangement pursuant to which the target company proposes a scheme to its shareholders for the shares to be transferred to the acquirer and in return the acquirer will pay the shareholders cash, securities or a mix of both. In either option, the end result is that the target company becomes a subsidiary of the acquirer. This enables the acquirer to consolidate the financial results of the target company with its own. In addition to the above methods, other ways to achieve the merger or acquisition in Singapore may include setting up a new holding company to acquire both the acquirer and the target company or amalgamating the target company into the acquirer so that it ceases to exist as a legal entity.

It is also possible for the M&A transaction to take the form of an acquisition of the businesses of the company (rather than shares of the company). An acquisition

of business allows the acquirer to pick and choose the businesses, assets or liabilities that it wishes to acquire, leaving the balance behind with the target company. However, in an acquisition of business, in order to properly transfer the benefits and obligations of the contracts with third parties to the acquirer, the process is more difficult. Under contract law, the benefits of the contractual arrangements may be assigned by the target company to the acquirer, unless there are express prohibitions or restrictions within the terms of the contract. Obligations under contracts cannot be assigned unless the third parties consent so the acquirer will need to approach the third parties for their consent. In contrast, an acquisition of shares of the target company does not require the consent of the third parties who have contracted with the target company, in the absence of contrary provisions in the contracts.

Each method of an M&A transaction (whether by the acquisition of shares or businesses) will generally require the approval of target shareholders but the threshold of the approval differs. A sale of substantially of all of the assets of the target company to the acquirer will require the approval of the majority of the shareholders voting at the shareholders' meeting. A general offer for the shares of the company must be conditional, at the minimum, upon more than 50% of the acceptances by the shareholders. If the acquirer manages to secure 90% acceptances of the shares under the offer, the acquirer may exercise its rights of compulsory acquisition of the remaining shares from the dissenting shareholders. A scheme of arrangement must be conditional upon a majority in number, representing 75% in value present and voting, voting for the scheme. A successful scheme, however, will mean that the acquirer acquires 100% of the target company.

3. Regulatory framework

Singapore Code on Takeovers and Mergers

The regulation of M&A activity of publicly listed companies in Singapore is a combination of statutory rules, stock exchange rules and common law. Takeover regulation is primarily found in the Singapore Code on Takeovers and Mergers (the 'Takeover Code'). The Takeover Code regulates the acquisition of, among other things, ordinary shares of public companies. (The Takeover Code is normally not concerned with the acquisition of business since it does not amount to obtaining control of the company).

The Takeover Code is enforced by the Securities Industry Council ('SIC'), which is made up of representatives of the government, the Monetary Authority of Singapore, and the industry. The day-to-day business of the SIC is conducted by a professionally staffed full-time Secretariat.

The Takeover Code contains General Principles, Rules, and detailed notes. Nonetheless, the Takeover Code notes that it is impracticable to devise rules in sufficient detail to cover all circumstances that can arise in takeover and merger transactions. Accordingly, both the letter and spirit of the Takeover Code must be observed, especially in circumstances not explicitly covered by any Rules.

The parties to a takeover and their advisers are primarily responsible for ensuring observance of its provisions. If there appears to be a breach of the Takeover

Code, the SIC may summon the suspected offenders to appear before the SIC for a hearing, in which every alleged offender will have the opportunity to answer allegations and to call witnesses. The Securities and Futures Act provides the SIC with powers to investigate any acts of misconduct in relation to or connected with a transaction involving a takeover or merger transaction when it has reason to believe that any party or any financial adviser is in breach of the Takeover Code. In this respect, the SIC is empowered to make inquiries, summon persons to give evidence on oath or affirmation, or to produce any document or material necessary for the purpose of the inquiry.

Although the Takeover Code does not have the force of law and does not give rise to criminal proceedings, its breach may result in the imposition of sanctions by the SIC. Sanctions that the SIC may impose include private reprimands, public censure, and, when the breach is flagrant, further action designed to deprive the offender temporarily or permanently of its ability to enjoy the facilities of the securities market. SIC may also order compensation to be paid to shareholders or former shareholders by persons who have contravened certain provisions of the Takeover Code.

One of most important aspects of the Takeover Code relates to the mandatory bid rule. The mandatory bid rule is triggered in either of the two situations: (1) If any acquirer, either on its own or together with parties acting in concert with it, acquires an interest in 30 percent or more of the voting shares of the target company, or (2) if such an acquirer holds, either on its own or together with parties acting in concert with it, between 30 and 50 percent (both inclusive) of voting shares of the target company, and acquires additional voting shares representing more than one percent of the voting shares in the target company in any six-month period.

In a case falling within (1) or (2), the acquirer must extend a takeover offer for the remaining voting shares of the target company in accordance with the provisions of the Takeover Code. An offer for consideration other than cash must, subject to certain exceptions, be accompanied by a cash alternative at not less than the highest price paid by the acquirer or parties acting in concert with it within the preceding six months. The mandatory bid rule allows the remaining shareholders to exit the target company at a fair price upon a change of control of the company.

'Parties acting in concert' comprise individuals or companies who, pursuant to an arrangement or understanding (whether formal or informal), cooperate, through the acquisition by any of them of shares in a company, to obtain or consolidate effective control of that company. Certain persons are presumed (unless the presumption is rebutted) to be acting in concert with each other. They include a company and its related and associated companies and companies whose associated companies include any of these companies.

Under the Takeover Code, there are two fundamental principles: (i) target shareholders should have the freedom to decide whether the offer succeeds; and (ii) all target shareholders of the same class must be treated equally. For this reason, the target board is prohibited from engaging in any action that frustrates a bona fide offer (except with the approval of shareholders), even if the target board believes that the offer under-values the company or that such offer is not in the interests of the company. The target company is also prohibited from giving a preferred potential acquirer an unfair advantage by furnishing it with information, thereby

making it more difficult for a less favoured suitor to compete, with the result that target shareholders may be deprived of a better offer. No inducement may be given to a shareholder, which is not offered equally to other shareholders.

Statutory Shareholding Restrictions in Specific Industries

Other statutes relating to particular industries also govern takeover activity in Singapore, insofar as they limit or require prior regulatory approval for share ownership in companies engaged in those industries. Those industries are generally industries perceived to be critical to national interests—for instance, banking, finance, insurance, and media. These are found in the specific legislation, such as the Banking Act, Finance Companies Act, Insurance Act and Newspaper and Printing Presses Act.

4. Key Process of a Negotiated M&A transaction

Initial Stages of Negotiation

At the transaction planning stage, the acquirer has to assemble its team of key executives, legal advisers, financial advisers and reporting accountants. The acquirer and its advisers have to determine the appropriate method of M&A transaction based on the considerations discussed above. The acquirer also has to determine the price and the mode of financing for the bid if there is a cash component, and whether to make purchases of shares in advance of the bid.

Similar to the acquirer, the target company will also assemble its own team of key executives, financial advisers, legal advisers and reporting accountants. The target company may also commence an auction process in order to obtain the best price for its shares or assets.

Due Diligence

As a matter of business strategy, before an offer for a takeover or acquisition is formally made, due diligence must be conducted to assist the party contemplating the takeover or acquisition in deciding whether or not to make an offer and how to structure it. There is no standard method for carrying out due diligence. However, the due diligence process is often limited by various legal and regulatory restrictions. While potential acquirers seek to find out all they can about the target company, there is no obligation imposed on a target company to assist an acquirer with its inquiries. If a target company provides information to a potential acquirer, the Takeover Code provides that the same information must be provided to any other bona fide acquirer that emerges. The directors of the target company must authorise the disclosure and bear in mind that their fiduciary duty is to act in the best interests of the target company.

Notably, any disclosure of information in the due diligence process by the target company is hampered by the restrictions on disclosure set out in the Singapore Exchange listing rules as well as the insider dealing laws and regulations. A listed company is subject to continuing disclosure requirements, which require that the company must keep the Singapore Exchange, its shareholders, and other holders of its listed securities informed of all material information relating to it, and, as a

corollary, a listed company cannot provide any information to a person that would put this person in a privileged dealing position. Any such disclosure by the target company may also give rise to insider dealing concerns under the Securities and Futures Act.

Therefore, in a takeover scenario, usually only limited due diligence conducted by an acquirer before making a takeover bid for a target company. The acquirer will have to rely on information that is publicly available. This may be found in the target company's memorandum and articles of association and other documents and filings with Singapore Exchange. The listed company will also have to publish quarterly financial information and other routine information such as results of meetings and dividend details.

Announcement of the Bid

In a negotiated transaction, the parties will begin their negotiations on the agreement implementing the M&A transaction. This agreement, sometimes known as an implementation agreement, sets out the structure, terms and conditions of the acquisition and the respective obligations of the acquirer and the target directors and management during the acquisition process (that is, from the date of signing until the date of completion). The terms and conditions vary according to the structure, depending on the relevant issues and each party's negotiating power.

If the offer effected is a voluntary offer (as opposed to a mandatory offer), the price of the shares must not be less than the price of the shares paid by the acquirer and its concert parties for the three-month period preceding the offer.

The implementation agreement is an important means to allocate risks between the parties, particularly between signing and closing (which may occur several months later). These risks relate not only to risks of the transaction not completing but also include risks relating to the loss of value of the target company during this period. Between the time of signing of the implementation agreement and the time of completion, the acquirer may find out a number of unpleasant surprises about the target such as where the target has to restate its earlier (inaccurate) financial statements and it is not as valuable as the acquirer thought it was. There may be also events that occur beyond either party's control which cease to make strategic or business sense for the acquirer to continue with the acquisition. For example, a credit crisis may occur such that the acquirer has to incur significantly more borrowing costs than what it thought was envisaged or terrorist attacks occurred and the target company finds that its short-term earnings dip sharply. In either case, the acquirer may want to walk away from the transaction without having to pay any compensation. Even if the target company may have in breach of the agreement, if the acquirer is forced to complete and pay the acquisition price, suing the target company, which is now its subsidiary, is a pointless exercise. A well-drafted implementation agreement should make it clear as to which party bears the risks of these occurrences.

However, against the background of the implementation agreement, the SIC is also cautious in allowing the acquirer to terminate a transaction (other than the non-fulfillment of the acceptance condition or a regulatory condition) because termination can lead to grave uncertainty in the market. The Takeover Code therefore only permits the acquirer to invoke a condition so as to cause the offer to

lapse if the circumstances which give rise to the right to invoke the condition are of 'material significance' to the acquirer in the context of the offer, and information about the condition is not available from public records or is not known to the acquirer before the offer announcement.

Once the implementation agreement is entered into, the parties will publicly announce the bid.

Getting the Approvals

After announcement, the parties will obtain all the approvals necessary for the M&A transaction to close. Depending on the offer structure, the offer document, and the target circular containing a fairness opinion from the independent financial adviser and the recommendation of independent directors of the target company will be circulated to the target shareholders. The Takeover Code sets out the information that must be included in an offer document, including the acquirer's intentions relating to the target company and its employees; disclosure of interests in securities held by the acquirer, its directors, or concert parties; financial information about the acquirer; and conditions of the offer and any special arrangements. Information about any undertakings given by shareholders must be set out in the offer document.

Generally speaking, the shareholders in the target company must be put in possession of all the facts necessary for the formation of an informed judgment as to the merits or demerits of the offer. The obligation of the acquirer in these respects toward the shareholders of the target company is the same as the acquirer's obligation toward its own shareholders.

The Takeover Code also sets out the information that must be contained in the target document to the shareholders. The target document must contain the advice of the independent financial adviser of the target company and the recommendation of the target company's directors on the offer. Usually, the recommendation will contain advice as to whether the terms of the offer are fair and reasonable and whether the shareholders should accept or reject the offer. It must also include information on the shareholdings of the target company in the acquirer, the shareholdings in the target company and in the acquirer in which the directors of the target company are interested, the shareholdings in the target company controlled by its independent financial adviser, and whether the target company's directors intend to accept or reject the offer with respect to their own beneficial shareholdings. Information as to certain arrangements affecting directors must also be provided in the target document—for instance, details of any agreement or arrangement made between any director of the target company and any other person in connection with or conditional upon the outcome of the offer.

Completion

If all the requisite approvals are obtained (including the requisite shareholder acceptance or approval) in an offer for the target shares, the acquirer will proceed to complete the M&A transaction and pay the consideration to the target shareholders.

Directors' Duties in the Course of Takeover

In addition to the duties under the Takeover Code, directors of acquirers and target companies have to be mindful of their duties under the Companies Act and at common law to act in the interests of the companies of which they are directors. Directors may sometimes use their powers, ostensibly for the purpose which is within their legitimate management powers, but in effect to resist a takeover which they believe would be damaging to the company. For example, directors may issue shares, ostensibly to raise capital of the company, but the real purpose is to resist a takeover which they believe would be damaging of the company. It is often difficult to determine whether such conduct is legitimate or not by reference only to the directors' professed purpose.

In many instances, the Takeover Code reinforces the position that exists at common law. For example, the Takeover Code provides that the directors of an acquirer or target should, in advising their shareholders, have regard to the interests of shareholders as a whole, and not to their own interests or those derived from personal or family relationships. In other instances, the Takeover Code goes further than the common law position by preventing the target board from frustrating a bona fide offer in the absence of shareholder approval. When a target company's board of directors has been notified of a bona fide offer, or after the target's board has reason to believe that a bona fide offer is imminent, the board cannot, without shareholders' approval, take any steps which could effectively result in either the offer being frustrated, or denial of the target shareholders' opportunity to decide on the merits of the offer. The board can only rely on its persuasive power in persuading the shareholders as to its recommendations on the offer.

5. Conclusion

Law of Mergers and Acquisitions is an upper-year elective subject in law schools and it assumes that you have a foundational knowledge of contract law, tort law and company law. The subject requires you to think critically across these subject areas and also securities regulation. Since issues in M&A do not come neatly compartmentalised into each area of law, it hones your problem-solving skills. The course has an immediate practical value if you do transactional work when you qualify as a lawyer. As M&A raise legal issues that will affect strategy, deal structure, legal responsibilities and liabilities, an understanding and sensitivity to such issues will be valuable even if you choose to become a business leader, investment banker, business consultant or entrepreneur and will enhance your effectiveness.